

*Calvin*

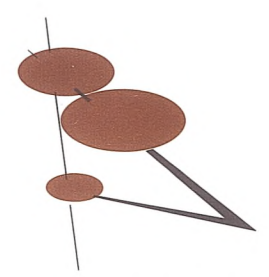
FEDERAL  
RESERVE  
BANK OF

SAN FRANCISCO

# Monthly Review

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November 1969

## **Slowing Pains**

... Recent data have not provided very clear signals of a lowered business temperature, but the signs can still be found.

## **Policy . . . Still Tight**

... Public policy: continued pressure on bank reserves, and a continued (albeit declining) surplus in the Treasury's accounts.

## **Mounting Problems**

... The West advanced at close to the national pace this summer and fall, but problem spots appeared in aerospace and elsewhere.

## **Mounting Pressures**

... The balance sheet of Western banking clearly showed the cumulative effect of '69-style restrictive monetary policy.

**Editor: William Burke**

## Slowing Pains

Prices continued their seemingly inexorable climb during the summer and early fall, but a number of major indicators pointed to a gradual slowdown in business activity, thus giving some foundation to the hope that 1970's price performance will be tamer than 1969's. The tightest policy measures of the past decade helped to rein in business activity during this period, with the Treasury's surcharge-based surplus reinforcing a tight Federal Reserve holddown on the money supply and bank reserves. (Still, the Administration warns that the surplus will quickly turn into a stimulative deficit if Congress does not repeal the investment-tax credit and retain a 5-percent income-tax surcharge through mid-1970.)

Recent GNP data have not provided very clear signals of a lowered business temperature. In current-dollar terms, total expenditures increased by \$18 billion, to a \$943-billion annual rate, during the third quarter—the largest increase since last fall. But in real terms—after adjustment for the sharp rate of price advance—GNP continued to grow at a relatively slow pace, at about 2 percent annually. The industrial-production index also rose only modestly in the third quarter, and this index actually showed a decline in late summer after reaching a peak in July.

On the other hand, September's sharp rise in new orders for durable goods pointed in the direction of continued strength in business activity, and other signs of overheating were also quite evident. The third quarter's 5½-percent annual rate of increase in the general price level was the worst since Korean War days. Moreover, September's increases in consumer prices were large, and also widespread: the usual seasonal decline

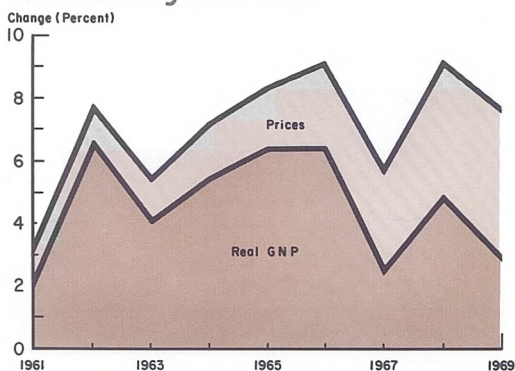
in food prices failed to materialize, while prices went up substantially on apparel, services, and housing.

Viewing this scene, Presidential adviser McCracken recently reminded business analysts that a slowdown in the price trend normally follows, instead of leading, a slowdown in the growth of output and sales. Thus, the historical pattern may once again be repeated, once the turnaround takes place.

### Defense: unambiguous

The defense spending sector has already shown evidence of reduced pressure. Again, this was not at all apparent in the third-quarter spending figures, since the Federal pay raise boosted spending \$2 billion during that quarter, to more than an \$80-billion annual rate. (More than that, factory shipments of defense goods were higher last quarter than at any other time since 1953.) But Pentagon cutbacks are now the order of the day, with Vietnam spending due to be heavily reduced by the end of fiscal '70, and budget makers are likely to keep the pressure on the Pentagon because of their knowledge

### Price increases account for most of gain in GNP



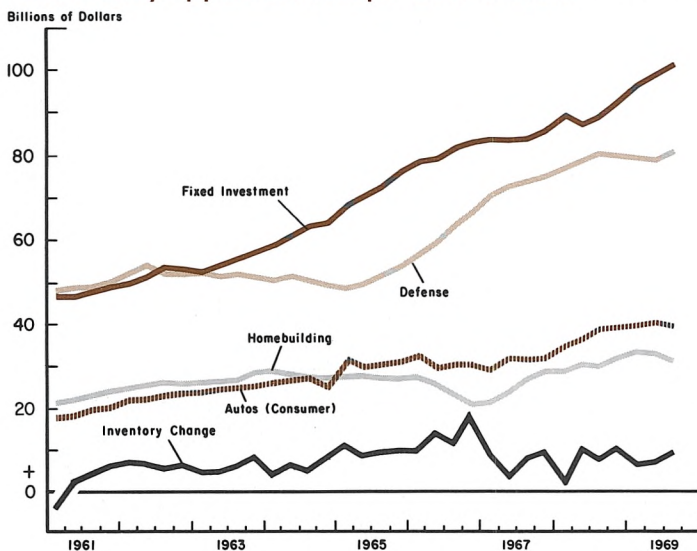
that the fiscal restrictiveness of the tax surcharge will be missing in fiscal 1971.

The Administration's long-range plan to reduce troop strength to 2.6 million men could save \$8 billion a year. Despite that factor, the post-Vietnam "peace dividend" may be relatively small. Congress is already committed to over a dozen new weapons systems whose costs could ultimately exceed \$100 billion—not surprisingly, in view of the immense amounts involved in translating new technology into production-line items. To cite one current example, the F-14 Navy fighter approved for development this year will cost two to three times as much as the plane it will replace.

**Business: ambiguous**

The business-investment sector also has shown signs, albeit ambiguous signs, of reduced spending pressure. Fixed-investment spending jumped \$3 billion in the third quarter, to more than a \$100-billion annual rate, but recent surveys suggest a significant slowdown in the expansion rate in late 1969 and 1970.

**Softening of business activity not readily apparent in major GNP sectors**



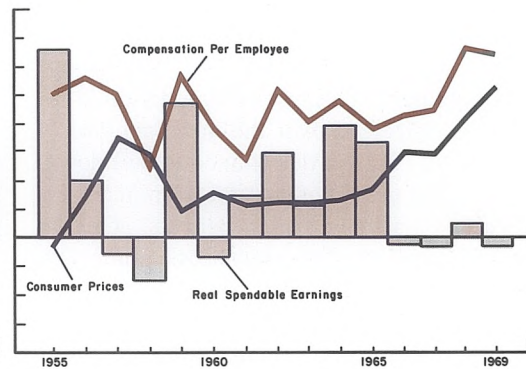
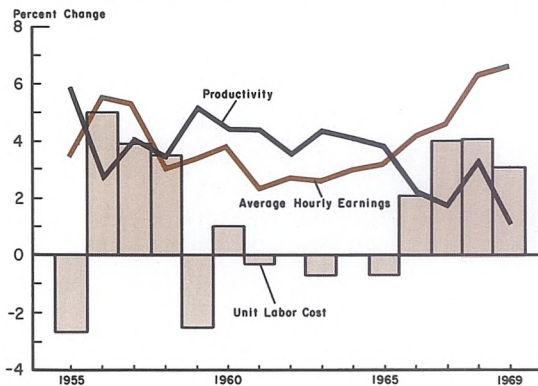
The latest Commerce Department survey indicated only a 5-percent increase in plant-equipment spending (annual rate) between the second and fourth quarters of this year—less than half the previous six-month gain. Manufacturing firms posted a record rate of new starts this summer, but these firms also adopted a more cautious stance toward future spending. Meanwhile, transportation firms (air, rail, and trucking) cut back their spending plans severely.

Business firms were pressed to rein in their spending by the reality of tight credit, the near-reality of an investment tax-credit repeal, and the prospect of short-term weakness in business activity. (Already, with recently installed capacity growing faster than output, the factory capacity-utilization ratio dropped from 84.5 percent in first-half '69 to 84.1 percent in the third quarter.) At the same time, other factors encouraged businesses to maintain a record level of expenditures; namely, longer-term optimism over business prospects, and short-term needs to offset spiralling labor costs.

Within the business sector, the inventory component also gave off ambiguous signs in recent months. During the third quarter, inventory spending increased at about an \$11-billion annual rate, or roughly \$4 billion above the previous quarter's rate. The increase suggests the continuation of inflationary spending pressures, to the extent that involuntary stockbuilding was not involved in the expansion. In those industries where involuntary stockbuilding was involved, however, later cutbacks in new orders and production may well follow.

These figures underline the dilemma faced by the nation's purchasing agents. They are anxious

## Bosses determined to halt incessant rise of labor costs ... workers determined to halt fall in real earnings



to build up their inventories, because of the pressures generated by the rapid rise of prices—and yet they are uneasy about purchasing too much, partly because of the soaring interest costs involved in carrying inventories, and partly because of the developing possibility of a downtrend in demand.

### Consumer: sluggish

The massive consumer sector exhibited less ebullience than heretofore during the third quarter. The \$8-billion spending gain, to a \$581-billion annual rate, was the smallest increase since last fall, and inflation-boosted pricetags meant that the expansion in real terms was even smaller. Spending on durables actually dropped off slightly, to a \$90-billion annual rate, as fiscal restraints ate into paychecks and as monetary restraints cut into consumer borrowing plans. Moreover, the increasingly cautious consumer boosted his savings to 6½ percent of disposable income—a full percentage point over the average of first-half '69—and meanwhile tended to reduce his spending plans for future months.

In the new-car market, the sales trend has been generally weak since last winter, with the exception of sudden spurts in June and September. Unit sales were up 20 percent over year-ago levels in September, because

of the early unveiling of 1970 models and a stronger-than-normal upsurge in orders from fleets and rental agencies, but the downtrend was resumed again in October. Not too surprisingly, new-car dealers had a record supply of '69 models on hand when the '70's made their early appearance, so in view of this overhang and the questionable sales trend, automakers may produce somewhat fewer cars in the current quarter than they did in the like period of a year ago.

In another consumer-related sector, residential construction, signs of a slowdown continued to develop. In something of a replay of the 1966 scenario, spending dropped by \$1½ billion during the third quarter, to a \$31-billion annual rate, and new starts fell almost 20 percent below the first-quarter peak rate to 1.4 million units.

Many observers see continued weakness in this sector; some even visualize a further drop in starts to a 1-million rate. But the basic situation is quite different from that prevailing in the 1966 housing crunch, when there was a heavy overhang of surplus units in most markets, in contrast to the shortage now prevailing. In any event, a 1966-style crisis is likely to be avoided this year, in view of the help the market has received from FNMA mortgage purchases and Home Loan Bank support of savings-and-loan operations.

### Bargaining crunch?

Consumer spending prospects — and the business environment generally — will be strongly influenced in 1970 by the state of the inflation-beset labor market. On the one side will stand an increasingly militant union rank-and-file, distressed over the incessant rise of household costs and determined to nail down, in this still-tight labor market, significant increases in pay and fringe benefits. On the other side will stand the business community, distressed over the incessant rise of labor costs in the face of a possible weakening of demand. This mixture could be explosive in 1970, when 60 percent more workers will be involved in major wage negotiations than this year.

Average compensation per employee may rise 6 percent this year, roughly in line with last year's gain, but this increase will be largely offset by the acceleration in consumer prices. In fact, the average worker may suffer an actual reduction in real earnings this year as rising prices and taxes cut into his weekly

paychecks. On the other hand, labor productivity may grow only about 1 percent, or one-third as fast as in 1968, but the gain in hourly earnings may exceed even 1968's 6-percent increase, and business profit margins will be squeezed in the process as unit labor costs continue rising close to 1968's rapid 4-percent rate of advance.

But policymakers seem determined to see that price increases taper off substantially in the months ahead. The slowing that is envisioned in the present economic-policy stance involves some painful adjustments, both for those who have built inflationary expectations into their operations and for those who carry such expectations to the bargaining table. The meaning is clear in Dr. McCracken's words: "Commitments about new facilities or prices or wage rates which would be comfortable only if the inflation continues will become increasingly painful. . . . They will mean sluggish markets, or diminished job opportunities, or facilities with a disappointing rate of return."

*William Burke*

## Policy . . . Still Tight

Public policy remained strongly restrictive during the third quarter of the year, but at the same time, the composition of the monetary-fiscal mix shifted somewhat. On the fiscal side, the Treasury continued to run a surplus, but the amount of the surplus was only about half as large as in the preceding quarter; on the monetary side, meanwhile, pressures continued to build up on the increasingly scanty reserve position of the banking system.

The Treasury surplus may have reached its high point in the second quarter, at a \$13½-billion annual rate (national-income basis). During the current half-year, the sur-

plus may be in the neighborhood of a \$7-billion annual rate. During the first half of calendar 1970 the surplus may be down to a \$3-billion rate if the income-tax surcharge is reduced to 5 percent from its present 10-percent level—and it may be converted into a \$5-billion deficit if Congress lets the surcharge lapse and fails to repeal the investment tax-credit. Part of the anticipated fall-off in the budget surplus reflects the fact that the Federal fiscal system, with its "automatic stabilizers," is so constructed that a slowdown in business activity automatically triggers a drop in tax receipts and a rise in unemployment-compensation payments.

### Squeeze on reserves

The Federal Reserve kept a very tight rein on bank reserves during the third quarter. Total member-bank reserves, after increasing at a 1-percent annual rate during the second quarter, declined at a 9½-percent rate in July-September, with most of the reduction being concentrated in July. Nonborrowed reserves decreased at a 5-percent rate, just about the same as in the second quarter.

During the summer period, net borrowed reserves averaged \$940 million and member-bank borrowings averaged \$1,185 million, both down somewhat from their second-quarter levels. In September, the Treasury found it necessary to restore its cash balance through short-term borrowing from the New York Federal Reserve Bank, and this, plus the marshalling of funds in the bidding for Alaska oil leases, contributed to a transitory easing in certain money-market conditions.

But these developments did not necessarily reflect any easing in the policy of restraint. In the third quarter, the Federal Reserve reduced its holdings of U. S. Government obligations by selling \$91 million of securities (net) in the open market. Through these open-market sales, and through the \$65-million decline in member-bank indebtedness, the System absorbed about \$156 million in bank reserves.

### Reg Q's contribution

The most potent of the monetary tools of control continued to be Regulation Q, which sets ceilings on the interest rates payable on time-and-savings deposits. The maximum rate now payable — 6¼ percent on large negotiable time certificates of six months maturity and longer — was more than 2¼ percent below the yield such CD's commanded in the secondary market during the third quarter. Obviously, then, banks had little success in attracting new CD's, and the funds from maturing CD's went elsewhere in search of a higher return.

Commercial banks lost slightly more than \$3 billion of CD's in the third quarter. These funds presumably remained in the banking system as demand deposits rather than time deposits, and as such required a higher reserve behind them. This does not imply that large idle balances were held in the form of demand deposits, which earn no interest. But although holders of such deposits attempted to minimize their balances, given the high opportunity cost of yields on other uses, there are limits on their ability to economize on funds for financing transactions.

In any event, a runoff of \$3 billion of CD's at banks would have required \$345 million more reserves against an equivalent amount of funds transferred from time deposits to demand deposits, given a 6-percent reserve requirement against time deposits and a 17½-percent reserve requirement against demand deposits. With the Federal Reserve meanwhile absorbing reserves, an increase in reserve needs of this type simply intensified the pressure on the banks.

### Tight money—and response

The reduction in the reserve base of the banking system during the third quarter brought about a very sharp drop in the rate of growth of the money supply. Narrowly defined (currency plus demand deposits adjusted), the money supply grew by less than a ½-percent annual rate during the third quarter, as against a 4-percent rate of gain in the preceding quarter. If time deposits are included, the total actually declined.

This decline in deposits was not confined to the runoff of large negotiable CD's, which are typically held by corporations. Time deposits of individuals and of state-and-local governments also decreased during the third quarter, since the holders of these funds were just as susceptible as the holders of CD's to the 7-percent yield available on Treasury bills and the even higher yields available elsewhere.

## FEDERAL RESERVE BANK OF SAN FRANCISCO

The third-quarter decline in the banking system's total reserves forced banks to continue their year-long restructuring of assets. Total loans and investments decreased at a ½-percent annual rate during the quarter, as banks sold off U. S. Government securities at an 11-percent rate and reduced their holdings of other securities (chiefly municipal issues) at an 8-percent rate. These reductions in investment portfolios helped banks to expand total loans at a 3½-percent annual rate during the quarter. Business loans rose at a 5½-percent rate, but this expansion was rather modest compared to the 14-percent rate of gain during the January-June period.

In adjusting to the runoff of CD's and the reduction in total reserves, commercial banks depended more heavily on other sources of funds. Over the quarter, the banks both increased their drawings upon the Eurodollar market and obtained funds through holding-company sales of commercial paper.

### Whither interest rates?

In mid-October, it appeared that interest rates had crested after a fairly consistent advance since the first of the year. The turnaround was credited, among other things, to the increasing signs of a slowdown in the

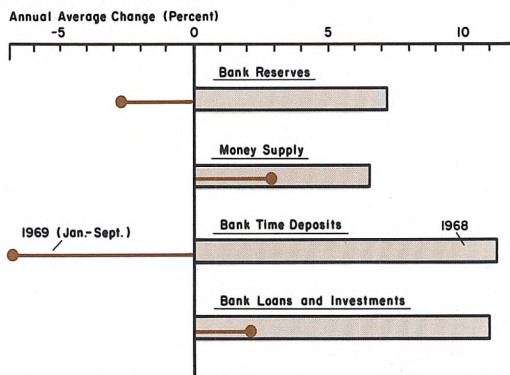
economy and the brightening prospects for a settlement in the Vietnam war. However, in spite of rather sharp declines in yields across the board, by mid-November interest rates had firmed up again and regained a large part of the declines of the preceding weeks. In the short-term market, the 91-day Treasury bill rate slipped from a peak of 7.14 percent at the beginning of October to 6.85 percent at mid-month, only to return to the 7.14 percent mark in the second week of November. Other short-term yields showed substantial decreases during October, such as the rate on commercial paper, which declined by 60 basis points to 8.17 percent in the first week of November before rising a dozen basis points in the succeeding week.

The long-term markets also registered some spectacular gains during October, only to realize a sharp reversal in the first half of November. Treasury issues led the way, as yields on long-term U.S. Government bonds dropped 37 basis points from a peak of 6.76 percent in the first week of October to 6.29 percent in the third week of the month. By the end of the second week of November, these issues rose to 6.66 percent, recovering most of the decline of the preceding three weeks.

*Herbert Runyon*

## Monetary Variables in '69

In the year to date, commercial banks have expanded their credit less than one-fourth as rapidly as they did during 1968. This reflects both a slowdown in the growth of the money supply — currency plus demand deposits—and an actual decline in time deposits as well as in the reserve base of the banking system. Altogether, these '69 indicators point to an even tighter situation than prevailed in tight-money '66.





## Mounting Problems

Some problem spots continued to develop in the Western economy during the third quarter, but generally, the Twelfth District advanced at close to the national pace. Metals, petroleum, and agriculture all made strong gains during the quarter, while weaknesses showed in the aerospace, construction, and lumber industries.

Total nonfarm employment in the District reached 10.3 million (seasonally adjusted) during the summer period. Still, the pace of growth has slackened a little since the first of the year—up 2.9 percent annually, as against a 4.0-percent annual gain in the preceding nine-month period—in part because of the developing weakness in aerospace manufacturing and in construction. Elsewhere in the nation, employment has grown recently at a faster pace than in the District, rising at a 3.6-percent annual rate during the first nine months of the year.

As expected, the unemployment rate has risen in line with the increased sluggishness in business activity. In California, the jobless rate rose from 4.2 percent in the second quarter to 4.6 percent in the third, while in the rest of the District the increase was even greater—from 4.2 percent to 4.9 percent. The jobless rate also rose elsewhere in the nation, from 3.4 to 3.6 percent, but it remained considerably below the District rate.

In midsummer, Western retail sales were less than one percent higher than a year ago, compared with a 2-percent year-to-year gain nationwide. The totals reflected a 6-percent decline in durable-good sales and a 4-percent increase in nondurables. Faltering demand sharply affected sales at lumber and hardware outlets as well as at auto showrooms. As another indicator of sluggish demand, new-car registrations in California lagged 3 per-

cent behind the year-ago pace during the third quarter.

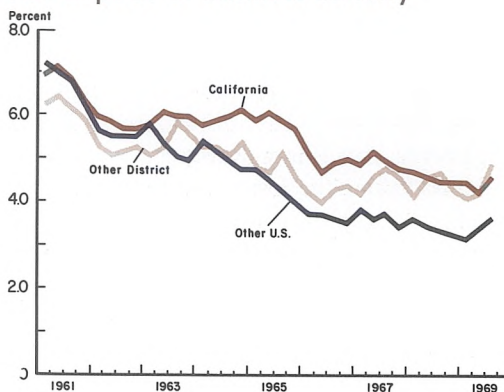
The summer months brought no break in the upward movement of prices. In most Western cities, retail prices increased at an annual rate of 5½ to 6 percent, generally matching the national increase. The higher costs affected all sectors of the household budget, with the greatest strains showing up in soaring grocery and housing costs.

### Aerospace . . . construction

The decline in aerospace employment accelerated during the third quarter. Payrolls in District plants dropped by roughly 14,000 workers during this period, as compared with declines of 12,000 in each of the first two quarters—bringing the total decline since the December 1967 peak to 74,000 (10 percent). Nationally, aerospace employment has also been easing, but not so rapidly as in the West.

Some of the weakness has resulted from cancelled military contracts, such as those for the Manned Orbiting Laboratory and the Cheyenne helicopter. In the spring quarter,

### Jobless rate rises, in line with slower pace of business activity



prime-contract awards to District firms dropped 24 percent from the year-ago level, to \$1.8 billion. As for fiscal 1970, the proposed \$2.6-billion reduction in Pentagon spending for procurement and research could have a considerable impact on the West's aircraft, communications-equipment, and scientific-equipment industries.

In the commercial market, production of current models of jet aircraft eased further during the third quarter. In addition, financial difficulties prompted major airlines to cancel some orders for both current-production models and new-generation transports. On the other hand, the Administration bolstered the outlook for the Northwest's aircraft industry by requesting funds for the construction of two supersonic transports.

Construction activity in the District moderated during the summer months, reflecting declines in all major sectors — residential, non-residential, and heavy engineering projects. On the heels of a sharp upturn in the spring period, housing starts declined about 4 percent in the third quarter to a 334,000-unit annual rate. This rate, however, was still about 15 percent above last year's third-quarter pace. Homebuilding activity continued to show considerable strength in

Phoenix, Los Angeles, and Orange County, but it tended to level off or decline in other areas.

New construction awards also declined for both non-residential and heavy engineering projects, in dollar terms, although spending still ran comfortably above the 1968 pace. Activity varied considerably among District states, with some states (California, Arizona, Idaho, and Washington) posting significant gains over a year ago.

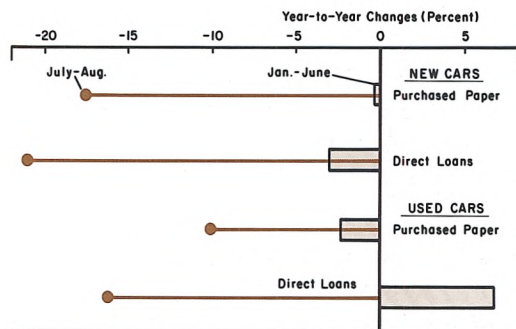
### Lumber . . . metals

Gloom pervaded the forest-products industry as the slowdown in national housing activity caused prices to drop further below their March peaks. By September, softwood-lumber prices were actually below year-ago levels, after having lost one-half of the 50-percent increase recorded between January 1968 and March 1969, and softwood-plywood prices meanwhile traced a similar pattern. Lumbermen fear that the Administration's 75-percent reduction in new Federal construction contracts will exert further downward pressure on prices by reducing demand for heavy timbers, concrete-form plywood, and other heavy-construction items.

Copper prices went up this summer, under

## Cutback in Auto Financing

During the midsummer months, major Western banks sharply reduced the number of loans made for both new- and used-car purchases. In contrast, these banks suffered little if any decline from year-ago levels during the January-June period. . . . This summer, banks lagged behind the year-ago pace in every loan-maturity category, but they recorded the sharpest cutbacks in lending activity in the longest maturities.



the pressure of strong European demand and overseas production problems. In early August, the producer price for refined copper increased 2 cents a pound, and a month later increased another 4 cents, to a range of 52-52¼ cents a pound. Prices—now at an all-time high—have risen 37 percent since the settlement of the industry-wide strike a year and a half ago.

Pacific Northwest aluminum producers experienced booming market conditions during the third quarter. Strong domestic and foreign demand enabled producers to raise prices in early August by about 4 percent on products accounting for nearly one-half of total aluminum mill shipments. Then, in October, the same forces helped boost prices for ingot and a wide range of mill products. The 1-cent increase for ingot raised the price to 28 cents a pound, the highest level in many decades.

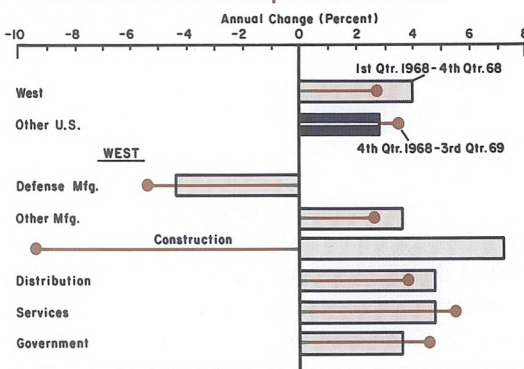
Silver producers breathed a sigh of relief when the price of the white metal turned upward after declining for several months. Strong demand by industrial users and coin dealers raised the price from \$1.56 an ounce in late June to \$1.89 an ounce in late September. The \$1.89 price was the highest market quote since last February.

Western steel production drifted somewhat this summer but then rose moderately in September, partly reflecting seasonal influences. At that point, production was well above the year-age pace, when customers were liquidating inventories in the wake of the mid-'68 labor settlement. On the basis of an exceptionally strong first-quarter performance and the likelihood of further gains, the industry is looking forward to a new production record in 1969.

### Oil bonanza

Petroleum refining activity increased in the District during the third quarter, as the volume of processed crude oil rose 5 percent above the year-age pace. However, District

## Slower employment growth reflects weakness in defense, construction



crude-oil production did not rise as much as refinery requirements, and this situation helped boost the demand for imports of crude from Canadian and other sources.

On September 10, the state of Alaska held its first sale of oil and gas leases since the discovery of a major oil field a year-and-a-half ago. Oil firms submitted 1,105 bids in this sale, and the state received \$900 million for 164 tracts (413,000 acres) of prospective oil-bearing land on the North (Arctic) Slope.

Results of drilling activity prior to the September lease sale were closely guarded by oil companies. Fragmentary reports released to date suggest that estimates of 5 to 10 billion barrels of oil reserves in the Prudhoe Bay area may actually have been conservative. In addition, at least three new oil fields may have been found, although no estimates of the reserves in these fields have been released.

### Farming steady

Crop-production estimates released this fall forecast a 1-percent year-to-year gain in District production. However, there are wide variations within the index, with processing vegetables showing a 19-percent decrease and citrus fruits showing a 45-percent gain.

Field-crop production should equal last year's performance. In the major field crops, wheat and cotton are expected to decrease by

10 and 8 percent, respectively, while sugar beets and potatoes should increase by 8 and 9 percent, respectively. Cotton production should fall because a decrease in yield per acre is expected to offset the effects of an increase in planted acreage.

Tomatoes are responsible for the drop in processing-vegetable production. On the basis of a record-breaking '68 crop, canners' inventories at mid-year were at a record level, nearly double last year's figures. Despite production cutbacks of 28 percent, total canner supplies should still be above normal entering 1970, with prices holding somewhat below the 1968 level. Fresh-vegetable production meanwhile is expected to decline by nearly 5 percent.

Deciduous-fruit production should increase some 13 percent over the year-ago level, with apple and cherry production rising sharply, and only plums and prunes showing a smaller output. As a result of this overall increase in output—and also the shift away from cyclamate-treated foods—canned-fruit prices have been averaging about 10 percent below year-ago prices.

Wholesale slaughter steer prices declined steadily during the third quarter, after reaching a 1969 peak at mid-year. At the beginning of the third quarter, prices averaged 15 percent above year-ago figures, but prices more recently have fallen to 4 percent above year-ago quotations.

*Regional staff*

## Mounting Pressures

Third-quarter changes in the balance sheet of Western banks clearly show the cumulative effect of 1969-style restrictive monetary policy. Total loans of Twelfth District commercial banks declined \$1 billion in the July-September period (seasonally adjusted), offsetting more than half the preceding quarter's increase. (Business borrowing, which was the major factor in the rapid loan expansion of the first half of the year, leveled off in the third quarter.) And despite the decrease in lending, Western banks further reduced their investment in securities, by close to \$1 billion (seasonally adjusted). This combined \$1.9-billion reduction in loans and investments—a 13.6-percent annual rate of decline—thus wiped out the small (2.2-percent) credit expansion which had occurred in the first half of the year.

The sharp contraction in Western-bank lending was directly attributable to the accelerated rate of deposit loss from July

through September. District banks suffered an attrition of over \$1 billion in time deposits (seasonally adjusted), or nearly three times the second-quarter loss. In addition, they posted a slightly lower level of private demand deposits during the quarter, on a daily-average basis.

To offset this loss in deposits—their traditional source of funds—Western banks intensified their utilization of other sources. They obtained a substantial amount of funds from outright sales of loans to their own bank holding companies, affiliates, and foreign branches, or to others. In fact, the large volume of these outright sales significantly affected major banks' balance sheets, accounting for more than half the third-quarter loan decrease.

Even after allowance for the heavy sales of loans out of portfolios, the third-quarter contraction in Western-bank lending contrasted with a continued (albeit slackening) rate of

expansion nationally. In addition, Western banks' securities holdings (particularly municipals) continued to decline at a faster pace than elsewhere. For the quarter, then, the 13.6-percent annual rate of decline in Western bank credit compared with a 0.5-percent decline nationally. On the other hand, the third-quarter decline in District banks' total deposits was slightly less than at banks elsewhere, despite a greater rate of attrition in time deposits.

**Pressure increases**

Borrowing by District member banks from the Federal Reserve discount window rose 8 percent in the third quarter, to a daily average of \$141 million, and net borrowed reserves remained unchanged at \$115 million (daily average). In contrast, discounting and net borrowed reserves declined slightly for member banks elsewhere in the nation.

As another indication of the continuing pressure on reserves, District banks' net purchases of Federal funds increased sharply during the July-September period. (Federal funds are idle balances of banks on deposit with the Federal Reserve.) Net purchases

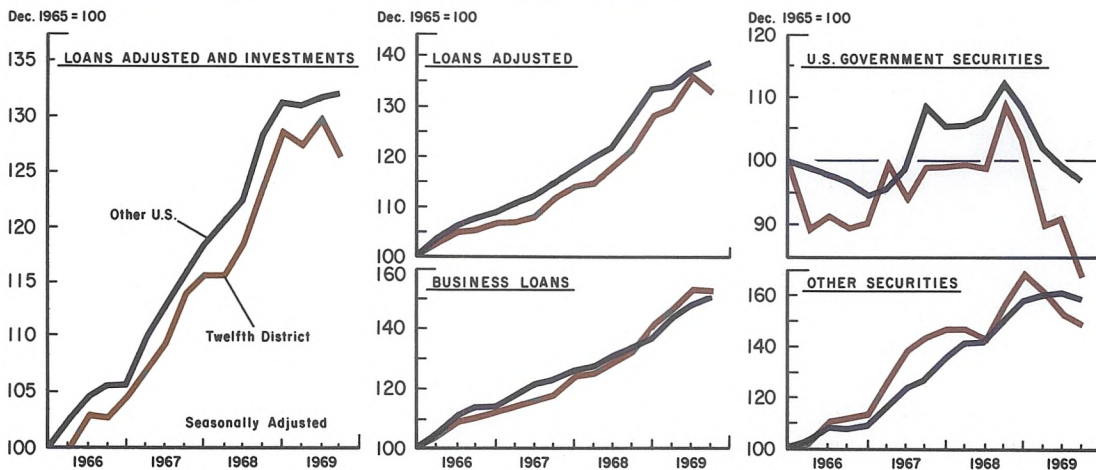
(borrowings) of funds averaged \$84 million per day on interbank transactions, compared to \$21 million daily in the previous quarter. And there was a comparable increase in purchases of funds from brokers and dealers—\$64 million daily average, compared to \$17 million in the previous period. These aggregate data, however, tend to conceal the large net sales of funds made by some banks, and the very large offsetting purchases of funds by other banks.

The steady pressure on bank reserves also showed in the amount of funds borrowed from other sources. Large District banks' borrowings under repurchase agreements, other than those with brokers and dealers, rose 10 percent over the quarter. And as mentioned above, banks also obtained a substantial amount of funds from outright sales of loans. Overall, the third quarter witnessed a further increase in the proportion of bank assets financed through borrowings.

**Business borrowing slackens**

On the heels of a large second-quarter expansion, Western commercial banks reduced their loan portfolios in July and August and then recorded a small increase in September

**Western banks experience decline in total loans —and suffer a further decline in security portfolios**



# FEDERAL RESERVE BANK OF SAN FRANCISCO

(seasonally adjusted). All major loan categories, except mortgages, declined over the quarter as a whole. However, the decreases in business and consumer loans on bank balance sheets were a result of large outright sales of these types of loans from bank portfolios.

Business loans, as reflected on banks' balance sheets, declined during July but made up most of that loss with increases in August and September (seasonally-adjusted basis). Corporate borrowing over the September tax date was far below the usual level, but large seasonal demands from food-liquor-tobacco processors, commodity dealers, and retailers boosted borrowings in the latter part of the month. Balance-sheet data disguise the continued expansion in total business borrowing which occurred in the third quarter, but even

after adjustment to include business loans sold outright, the seasonally-adjusted rise in business loans was only half as great as the second-quarter gain. The major strength in third-quarter demand came from the public-utilities sector, although machinery and transportation-equipment manufacturers, construction firms, and service firms also added to their bank debt in this period.

The record cost of borrowing, as well as the growing shortage of lendable funds, acted as a deterrent to business borrowing. Interest rates on commercial and industrial loans shot upward in the wake of the June increase (to 8½ percent) in the prime rate. As a result, the average borrowing cost on short-term business loans made by West Coast metropolitan banks reached 8.75 percent in the August survey period—up from 7.83 percent

## 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			
		Sept. 24, 1969	Third Quarter 1969			3rd Qtr. 1968	Sept. 24, 1969	Second Quarter 1968	
			Dollars	Percent				Percent	Percent
<b>Total loans gross and investments</b>	<b>\$49,746</b>	<b>-1,218</b>	<b>- 2.39</b>	<b>+ 4.03</b>	<b>\$182,360</b>	<b>- 1.19</b>	<b>+ 3.40</b>		
Loans gross adjusted and investments <sup>1</sup>	48,528	-1,784	- 3.55	+ 4.68	177,592	- 1.25	+ 4.35		
Loans gross adjusted <sup>1</sup>	36,602	-1,313	- 3.46	+ 1.84	131,095	- 0.71	+ 2.38		
Commercial and industrial loans	14,223	+ 399	- 2.73	+ 0.07	63,845	+ 0.10	+ 0.51		
Real estate loans	10,906	+ 80	+ 0.74	+ 2.55	22,864	+ 1.52	+ 2.07		
Consumer installment loans	5,383	- 39	- 0.72	+ 3.10	14,618	+ 2.58	+ 3.75		
Agricultural loans	1,419	- 2	- 0.14	- 0.15	675	+ 2.74	- 1.89		
Loans to nonbank financial institutions	1,654	+ 14	+ 0.85	- 5.73	9,607	- 2.41	- 2.18		
Loans for purchasing and carrying securities, total <sup>2</sup>	578	- 660	-53.31	+85.13	5,920	-14.28	+22.62		
To brokers and dealers <sup>2</sup>	307	- 651	-67.96	+65.12	3,414	-20.57	+37.90		
To others <sup>2</sup>	271	- 9	- 3.22	+38.02	2,506	- 3.91	+ 0.82		
Loans to foreign banks	248	- 37	-12.98	+13.10	1,253	-12.19	- 5.09		
All other loans	2,191	- 270	-10.97	-52.06	12,313	- 2.59	+ 0.79		
Total investment	11,926	- 471	- 3.80	+12.11	46,497	- 2.77	+ 9.23		
U. S. Government securities	4,287	- 103	- 2.35	+18.51	17,937	- 1.44	+10.64		
Obligations of states and political subdivisions	6,596	- 291	- 4.23	+10.11	25,973	- 3.57	+ 8.59		
Other securities	1,043	- 77	- 6.88	- 3.44	2,587	- 3.65	+ 4.63		
Total deposits (less cash items)	46,556	-1,114	- 2.34	+ 3.84	150,904	- 2.18	+ 2.87		
Demand deposits adjusted	16,191	+ 119	+ 0.74	+ 2.60	61,740	- 0.93	- 3.18		
Time and savings deposits	28,397	-1,366	- 4.59	+ 3.86	69,502	- 6.33	+ 4.60		
Savings deposits	14,967	- 184	- 1.22	+ 0.52	31,566	- 2.57	- 1.64		
Other time deposits IPC	9,738	- 459	- 4.50	+11.45	28,441	- 8.47	+ 9.70		
Deposits of states and political subdivisions	2,641	- 706	-21.09	- 2.55	5,246	-18.34	+10.37		
(Neg. CD's \$100,000 and over)	2,600	- 544	-17.30	+19.15	9,144	-24.56	+14.94		

<sup>1</sup>Total loans gross less loans to domestic commercial banks

<sup>2</sup>Includes loans made in Federal funds

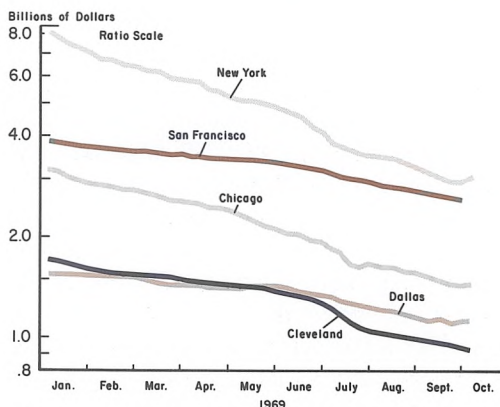
three months earlier. Rates on loans made under revolving-credit agreements rose to 8.63 percent—also up more than 90 basis points above the average rate prevailing in May. Other evidences of the increasing credit squeeze were the more stringent credit requirements for borrowers, the further firming in non-price terms of lending, and the decreased willingness on the part of Western banks to make loans for “non-productive” purposes.

### Mortgage markets tighten

In spite of a further net outflow of savings from both District banks and savings-and-loan associations, mortgage lending continued to rise (albeit at a substantially reduced pace) during the third quarter. District S&L's experienced a \$216-million loss of savings during the summer months, on top of a \$66-million net outflow in the preceding quarter. Most of the net outflow—and then some—occurred in California, as associations in most District states actually posted slight gains over this period. For their part, District banks suffered a \$181-million net outflow in their consumer-type savings, with virtually all of the decline manifesting itself in a steady attrition of low-yielding 4-percent passbook accounts.

Despite this steady hemorrhage of funds, District banks increased their mortgage portfolios by \$80 million, over and above substantial net sales out of their portfolios, while the S&L's increased their outstanding mortgage loans by \$438 million. The S&L's were able to expand their lending largely because of a further liquidation of holdings of cash and U.S. governments, plus another substantial (\$476 million) rise in advances from the Federal Home Loan Banks. (The total of these borrowings consequently reached a new record high of \$3,711 million, somewhat less than half of all such borrowings by S&L's in the entire nation.) At the same time, commitments for future loans dropped by one-

### Western banks more successful than others in retaining CD money



quarter during the quarter to \$443 million, the lowest level since early in 1968.

The growing scarcity of loanable funds was evident too, in new record levels of mortgage rates. In the West, the average rate on conventional new-home loans rose by about 65 basis points over the quarter to 8.90 percent, substantially above the national average rate of 8.25 percent. On the other hand, non-price terms of lending (average maturities and loan-to-price ratios) generally remained stable during the quarter, at levels somewhat more liberal than the national average.

### Disintermediation accelerates

Except for widely fluctuating U.S. Government deposits, demand deposits at District member banks showed little net change in the third quarter (seasonally adjusted basis). Private demand deposits declined in July, rose in August, and then dropped again in September to about the June level.

On the other hand, time-deposit attrition accelerated in the third quarter. District member banks lost over \$1 billion in time deposits (seasonally adjusted), with passbook savings, large CD's and public deposits all contributing to the decline. The outflow of passbook savings from large District banks, which had been unusually heavy in

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the second quarter, slackened in the July-September period. The outflow in this category was substantially smaller here than it was elsewhere; the run-off in public time deposits, in contrast, was relatively much higher here than nationally.

The greatest disintermediation, however, occurred in negotiable CD's in denominations of \$100,000 and over. Large District banks lost over \$500 million in these deposits in the July-September period—an attrition rate of 17 percent. Even so, Western banks have been much more successful than other banks so far this year in retaining CD money. At the beginning of 1969, New York District banks had \$4 billion more than San Francisco District banks in such deposits, but by

the end of September the spread had narrowed to less than \$½ billion. Of course, many New York banks have been able to offset their CD losses through the acquisition of Eurodollars; yet, many Western banks also have acquired Eurodollars in amounts sufficient to offset their CD attrition.

District banks have suffered relatively less than other banks from time-deposit disintermediation, but a larger percentage of their deposits still remains in time-deposit categories. Therefore, the impact of disintermediation is more pervasive at Western banks and, if attrition continues, the pressure on these banks will intensify.

*Ruth Wilson and Verle Johnston*

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### Credit—and Credit Cards

Commercial banks are relative newcomers to the field of “plastic credit,” but their credit-card and check-credit outstandings this June totaled \$2.5 billion—almost triple the level of two years ago. Western banks have dominated this growth from the very outset; in June, they accounted for over one-third of total credit-card outstandings and over one-fifth of total check-credit outstandings. Western banks also have pioneered in the development of the two credit-card organizations which now operate nationwide.

“Credit—and Credit Cards,” by Robert Johnston, has been revised to take account of recent developments in this fast-moving field. Copies of this report are available upon request from the:

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