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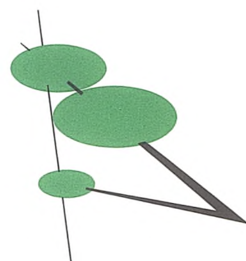

April 1970

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Editor: William Burke

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The 1970 Scene: A Letter

CHAIRMAN OF THE
BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., March 17, 1970.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: I have been giving very careful thought to your request for a specification of a series of possible alternative paths that monetary policy and financial developments might follow in 1970, contained in your letter of February 26. We certainly want to be responsive to the Congress in providing the information it needs in order to plan its domestic economic legislative program and to help it evaluate the performance of monetary policy. And yet I cannot help but be impressed by the many difficulties that surround such an exercise.

A problem in laying out alternative possible courses for monetary and financial developments in 1970 is that much will depend on the specific pattern and character of changes in the performance of the economy as it evolves. A particular dollar estimate for the total value of the national output of goods and services over an arbitrary time period such as a year does not tell us much about the expected state of the economy. How will that output be distributed over the course of the year? What will its composition be, and how will it accord with our notions of economic balance? To what extent will the estimated GNP reflect changes in the real volume of output as against mark-ups in prices of goods and services? What new forces may emerge that will alter expectations for the economy into 1971 and beyond?

These are always important issues, and they are crucially so in the present environment, when all of us are working to reestablish the conditions necessary to a resumption of sustainable, noninflationary economic growth. Monetary policy—and public economic stabilization policy generally—will have to tread a narrow path in the months immediately ahead. We have made real progress over the last year or so in laying the base for an abatement of inflationary pressures. Excess demand has now been generally eliminated from the economy, and I am confident that inflation will gradually subside.

We must now be especially alert to signs that the process that was necessary to the elimination of excess demand pressures in the economy does not spiral on downward into significant recession tendencies, with consequent social and economic costs. Prompt remedial action would be required should it appear that a recession is developing, with the intensity of the action scaled to the indicated magnitude of the

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problem. But we must also guard against actions that would contribute to an overly sharp rebound in output and spending later on. Expectations of inflation over the longer run are still widely held and business confidence appears to remain strong. If incautious public policies should precipitate a strong resurgence in demand, therefore, there could be real danger that inflationary patterns would again be set in motion.

The economic projection for 1970 prepared by the Council of Economic Advisers early this year as a basis for its annual report, as I understand it, traced a path that promised to minimize these possible difficulties. The GNP for the year was estimated in a range of $980-$990 billion, with a period of little or no real growth to be followed by resumption of a relatively moderate rate of expansion beginning in the spring. The price component of the GNP expansion was viewed as declining gradually as the year progresses, and the acceleration in demand growth in the latter part of the year was not seen as large enough to restimulate inflationary expectations. The increase in unemployment accompanying the flatter performance of the economy was expected to be moderate, on average, and recovery in the depressed housing industry was projected to be underway again before too long.

Now if it turns out that this projection is an accurate description of the course of the economy's development in 1970—and I have no basis for disputing its general outlines—then it is not too difficult to visualize how financial conditions might evolve. First, with progress occurring on the inflation front and aggregate demand well within the economy's capabilities, it would seem reasonable to assume that the monetary variables could gradually return to a more normal growth rate—say, 3-4 percent for the narrowly defined money supply and perhaps 6-8 percent for total bank credit. But while one can put such numbers on paper as reasonable expectations, these are by no means the only ones consistent with the GNP projection. Much will depend on the public's preferences as to holdings of financial assets, on the strength of desire by banks and others to rebuild liquidity, and on how aggressive banks prove to be in attempting to regain their earlier market positions.

Next, one might anticipate that interest rates would move generally downward in the year, reflecting not only relaxation of some of the pressures in the financial markets but also investor response to reduced rates of inflation as they in fact began to materialize. Rates could be expected to decline more in short-term than in long-term markets, partly because of the apparent continuing strength in demands for long-term funds. Net savings inflows to the banks and other depositary institutions should also recover as the relative attraction of high market rates to savers tended to diminish. Once again, however, these are speculations based on specific assumptions concerning the development of the economy in 1970.

Finally, it would be logical to expect on the basis of these assumptions that the total flow of credit—through institutions and markets combined—would expand

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somewhat from the relatively low levels reached in the second half of 1969. This would reflect mainly an increase in the availability of funds to those who were rationed out of the market in the restrictive credit environment of 1969, and also the gradual increase in savings flows consistent with expansion in current dollar GNP and aggregate incomes. A large increase in credit flows would not be expected in the short-run, however, since it takes time to get the process of credit generation going again in some sectors, such as mortgage finance.

I want to emphasize, however, that one can readily imagine important variations in this path of money and credit market developments, if the course of the economy does not evolve as specified above. The resurgence in economic activity, when it comes, could prove substantially stronger than anticipated, in which case rates of money and credit expansion would need to be restrained. Or the upturn could come more slowly and without the force anticipated, suggesting the need for additional encouragement to private spending through higher rates of expansion in the monetary factors and associated sharper short-run declines in interest rates. Total bank credit expansion could well run higher relative to growth in the money supply in these circumstances.

Economic developments in the weeks and months immediately ahead, of course, will be fundamental in shaping the course of monetary policy, including changes in interest rates and credit availability that actually emerge. Some major business indicators recently have shown recessive tendencies. If these deepen and intensify, the arguments for corrective action will become more forceful, and I would expect monetary policy to be modified accordingly. If, on the other hand, more positive signs appear on the economic scene, this will have to be taken into account in policy formulation. As I stated at the outset, the problem of economic stabilization policy for the time being is to walk the narrow path between the threats of recession, on the one hand, and restimulation of inflationary expectations, on the other.

As we move toward a more suitable economic environment once again, I would expect the monetary aggregates to resume a more normal rate of growth and interest rates to decline to more viable levels. But I cannot assure you that this will in fact develop. Patterns of economic change can readily be imagined that would call for either unusual monetary stimulus or continued monetary restraint, the results of which would be reflected not only in the rates of change in monetary aggregates but also in the level and pattern of interest rates and overall credit flows. Monetary policy is by nature one of the most adaptable instruments of economic stabilization, and it is my intention to do everything within my power to keep it flexible and responsively attuned to unexpected variations in the performance of the economy as they occur or come into prospect.

Sincerely,

ARTHUR F. BURNS

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Earnings: Records Shattered

In 1969, Western banks reaped the advantages which accrue to any seller of a commodity in short supply. While credit demands remained strong throughout the year, monetary pressure reduced the supply of lendable funds, and loan rates climbed to historic highs. Against this background, net operating income of District member banks soared to $724 million—18 percent above the previous (1968) record. Net profits, after taxes and securities losses, meanwhile reached a new high of $458 million—about 17 percent above the 1968 level. But record income in this year of monetary restraint was realized only at the expense of a severe reduction in liquid assets and a large attrition in time deposits.

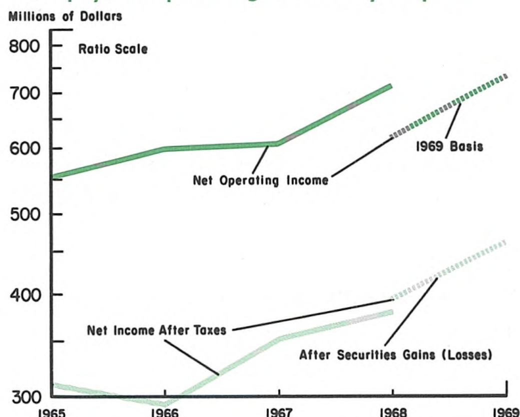
Analysis of 1969 bank earnings is complicated by the fact that a number of major changes were made last year in supervisory requirements for reporting bank income. Wherever possible, individual items on 1968 income reports were restated to make them roughly comparable with 1969 reporting requirements, but adjustments could not be made for inclusion of earnings from subsidiaries or for changes in accounting methods. Therefore, 1968-69 comparisons are not precise for some individual income and expense items, as well as for net income after taxes and securities losses. (See technical note.)

High rates boost revenues

Tight monetary policy held District member banks' outstanding credit in 1969 to virtually the same level as in 1968, but operating revenue nevertheless topped the $4-billion mark, for an 18-percent ($637 million) gain over the 1968 level. Increased loan revenue accounted for more than 90 percent of this gain in total revenue; in the two preceding years, in contrast, loan income contributed only one-half and three-fourths, respectively, of the gain in revenues.

High interest rates on loans prevailed throughout all of 1969, and were the major cause both of the record $2,981 million received from interest and fees on loans, and of the $99 million returns from sales of

Western banks boost earnings sharply, despite tight-money impact



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Federal funds. The prime rate reached 8½ percent on June 9—a full percentage-point rise on top of the earlier increases of ¼ percent (January) and ½ percent (March). Since other rates are tied to the prime rate, which applies to business borrowers with top credit ratings, the whole structure of loan rates moved sharply upward during the year. The average yield on loans made by District banks reached 7.94 percent—70 basis points above the average 1968 yield.

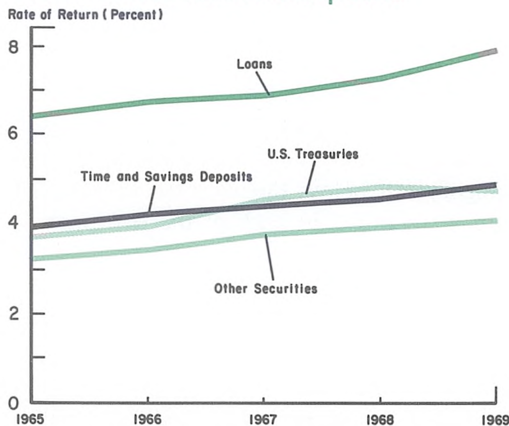
The volume of loans in District member-bank portfolios expanded by only 5½ percent over the course of the year, in contrast to 1968's 14-percent gain. However, 1969 year-end balance-sheet data do not include over $1 billion of loans which were initially made by District banks but were then sold to their bank holding companies (or to others) during the second half of the year. On the other hand, revenue from these loans, prior to their outright sale, is included in loan income. For the year as a whole, business loans and consumer loans each rose about 6 percent, and mortgage loans increased about 4½ percent, although all three categories weakened in the last half of the year.

Smaller holdings reduce revenues

District banks meanwhile posted almost a 5-percent decline in security revenues, on the basis of $549 million earned on their own portfolios and $13 million earned on trading accounts. The decline was caused mostly by a reduction in security holdings, since as credit demands outpaced available funds, District banks ran-off or sold securities to obtain funds to meet the needs of their loan customers. The cutback centered in U.S. Treasuries, particularly short-term issues, although banks also substantially reduced their holdings of municipals and U.S. Government agency issues.

The decline in security revenues also reflected a somewhat surprising drop, from

Loan rates rise more rapidly than interest rates on deposits



4.27 to 4.17 percent, in the average yield on banks' security portfolios. The average yield on Treasury issues declined because of the large reduction in high-yielding shorter-term issues. However, the average yield on "other" securities rose, reflecting the general escalation in money-market rates, and these higher yields served to offset at least part of the revenue loss resulting from the reduced volume of security holdings.

The steady upward trend in revenue from trust-department operations continued in 1969; the $108 million earned from this source was 12 percent above the 1968 figure. Service charges on deposit accounts, at $203 million, produced slightly less income in 1969 than in 1968. Income from other charges (including equipment leasing and fees for loan servicing) amounted to $134 million, while all other operating income (including revenue from trading accounts, foreign branches, Edge Act subsidiaries and other majority-owned subsidiaries) reached $94 million. The totals in these latter two revenue categories are not strictly comparable with earlier data because of reporting differences — particularly for the residual item, which now includes consolidated income from subsidiaries and from trading accounts.

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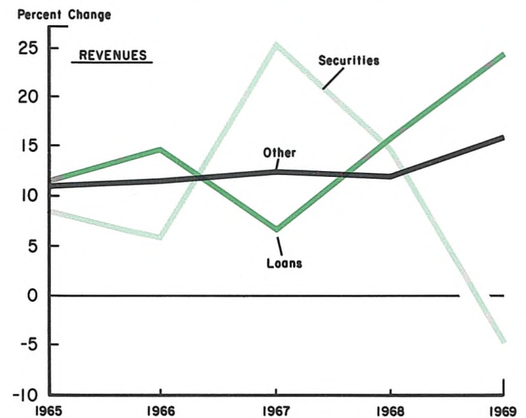
High money costs boost expenses

Total operating expenses of District member banks, rising at the same rate as operating income, reached a total of $3.4 billion in 1969. Interest paid on time deposits continued to be the largest expense item ($1.5 billion), but the 10-percent increase in that category fell below the increase of over 14 percent recorded in each of the two preceding years.

Time deposits actually declined 11 percent over the course of the year, but the *average* level of these deposits for the year as a whole was higher than the 1968 figure, and thus resulted in higher interest expense. Moreover, the average interest paid on deposits rose from 4.58 to 4.97 percent, even though Regulation Q ceiling rates remained unchanged during the year. This reflected the large ($1.5 billion) shift in individual savings deposits, from regular passbook accounts paying 4-percent interest to open-

Banks post sharp rise in loan income but decline in security revenues



CONSOLIDATED REPORT OF INCOME
Twelfth District Member Banks
(millions of dollars)

	1969p	1968	Percent Change
Earnings on loans (including Federal funds sales)	3,080.0	2,475.5	+ 24.4
Interest and dividends on investments			
Excluding trading account	549.1	n.a.	
Including trading account	(562.0)	590.2	− 4.8
Trust department income	107.7	96.0	+ 12.2
Service charges on deposit accounts	202.7	206.5	− 1.8
Other income[1]	228.3	162.2	+ 40.8
Total operating income	4,167.8	3,530.4	+ 18.1
Salaries, wages, and benefits	990.4	861.1	+ 15.0
Interest on deposits	1,508.9	1,361.1	+ 10.9
Interest on borrowed money (including Federal funds)[2]	223.6	85.1	+162.7
Net occupancy expense; furniture and equipment	259.1	233.6	+ 10.9
Provision for loan losses	74.2	75.3*	− 1.5
Other operating expenses	387.6	366.8	+ 28.9
Total operating expenses	3,443.7	2,917.0*	+ 18.1
Net income before income taxes and securities losses	724.1	613.4*	+ 18.1
Applicable income taxes	248.7	199.4*	+ 24.7
Net income before securities gains or losses and extraordinary charges	475.4	414.0*	+ 14.8
Net securities losses	− 16.5	− 23.5*	− 29.8
Extraordinary charges; minority interests	− 1.3	n.a.	....
Net income	457.6	390.5*	+ 17.1
Cash dividends paid	219.8	182.4	+ 27.3

[1]Other service charges, fees and operating income including income from foreign branches; in 1969 includes trading account income and wholly-owned subsidiaries (including Edge Act)
[2]Includes $14.9 million in interest on capital notes and debentures in 1969 and $15.5 million in 1968
*Partially estimated and restated on 1969 reporting basis
p—preliminary n.a.—not available
Note: Details may not add to total due to rounding; 1968 data adjusted for change in member bank universe
Source: Federal Reserve Bank of San Francisco

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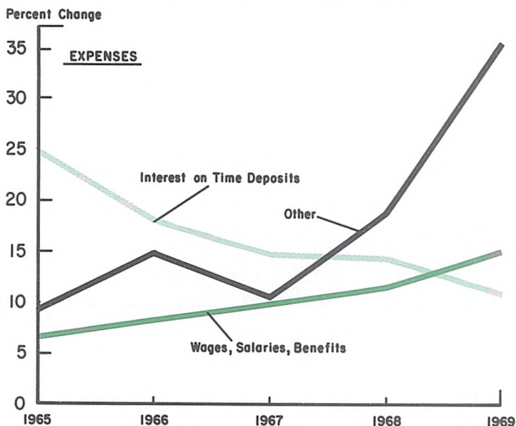
. . . while reporting lag in interest and rapid rise in other expenses



account deposits (in passbook or statement form) paying 5-percent interest.

The cost of salaries, wages and employee benefits climbed steeply (15 percent) to $990 million, following the pattern recorded in other industries. The number of new employees increased nearly 7 percent — slightly under the 1968 expansion in employment—and average salaries and wages rose at a slightly faster rate than in 1968. But employee benefits, with a 20-percent increase, were the major element behind the sharp rise in employment costs.

Nonetheless, the most rapidly rising cost item was interest on borrowed funds, which nearly tripled to $224 million in 1969. Over two-thirds of that total represented interest expense on purchases of Federal funds—that is, borrowings of unused reserves of other member banks. This increase reflected a higher level of borrowings, since District banks were net purchasers of Fed funds in 1969—in contrast to 1968—but it also reflected the higher cost of Fed-funds borrowing, with the average rate rising from 5.66 percent in 1968 to 8.22 percent in 1969.

Similarly, costs increased on borrowings from the Federal Reserve Bank; District banks' borrowings doubled, and the discount rate rose from 5½ to 6 percent (effective April 1969). Costs also increased because District banks relied heavily on Eurodollar borrowings — from their own foreign branches, or from other sources either directly or through brokers and dealers. Rates on these high-cost funds averaged over 9½ percent in 1969, and they even ranged as high as 12½ percent at one time or another during the year.

In 1969, for the first time, a provision for loan losses was reported as a current operating expense. In computing this $74 million expense item, banks generally adopted a for-

SELECTED OPERATING RATIOS OF TWELFTH DISTRICT MEMBER BANKS

(Percent Ratios)

	1969p	1968	Change
Earnings Ratios:			
Return on loans (including Federal funds)	7.94	7.24	+ .70
Return on U. S. Government securities[1]	4.72	4.80	− .08
Return on other securities[1]	4.01	3.88	+ .13
Net operating income to capital accounts	17.87	15.80[2]	+2.07
Net income (after taxes and securities losses) to capital accounts	11.27	10.06[2]	+1.21
Cash dividends to capital accounts	5.43	4.70[3]	+ .73
Interest paid on deposits to total time deposits	4.97	4.58	+ .39
Time deposits to total deposits	55.61	56.88	−1.27

[1]1969 ratio based on banks' own investments—excludes trading accounts
[2]1968 ratio based on restated 1968 operating income and net income
[3]1968 ratio restated to exclude interest paid on capital notes and debentures
p—preliminary
Note: These ratios are computed from aggregate dollar amounts of income and expense items. Capital accounts, deposits, loans and securities items on which these ratios are based are averages of Call data as of December 1968, June 1969, and December 1969; and as of December 1967, June 1968, and December 1968. (Securities data for December 1968 partially estimated.)

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mula relating actual loan-loss experience to loans held for a five-year period, including the current year.

Higher taxes . . . smaller losses

With the deduction of operating expenses from operating income, net operating income of District member banks reached a record $724 million in 1969—18 percent above 1968 adjusted earnings. Finally, after deduction of taxes, securities losses, extraordinary charges and minority interest, net profits reached a record $458 million, for a 17-percent increase over the 1968 figure (restated as far as possible on the 1969 reporting basis).

Income taxes applicable to operating earnings amounted to $249 million—a sizable increase over estimated 1968 taxes on such earnings. Both the 1968 surtax and the 1969 tax legislation adversely affected banks' 1969 tax liabilities. Meanwhile, District banks took capital losses on some of the securities they sold during 1969, although the $37-million *gross* loss (before tax effect) was about one-third below the loss recorded in 1968, another "security-loss" year for most District banks. The 1969 securities loss, net of tax effect, amounted to only $17 million.

New factors for 1970

Several early-year developments will materially affect banks' earnings prospects for 1970—in particular, January's revision of the Federal Reserve's Regulation Q to permit payment of higher interest rates on most categories of time-and-savings deposits. Since this revision permits a ½-percent increase in interest on the more than $15 billion in regular passbook savings on deposit at District member banks, and since most District banks are now offering the new ceiling rate, they will pay out roughly $75 million more in interest payments this year for that one category alone.

To the extent that higher rates induce an inflow of deposits, banks may be able to reduce their reliance on high-cost funds obtained through special borrowing. Moreover,

SELECTED ASSET AND LIABILITY ITEMS OF ALL MEMBER BANKS
Twelfth District, December 31, 1969
(millions of dollars)

	As of Dec. 31, 1969p	As of Dec. 31, 1968*	Changes from December 1968 Dollar	Percent
Gross loans and investments[1]	52,220	52,152	+ 68	+ .13
Loans gross[1]	39,498	37,405	+2,093	+ 5.60
Commercial and industrial	15,002	14,149	+ 853	+ 6.03
Real Estate	11,162	10,681	+ 481	+ 4.50
Loans to individuals	7,563	7,145	+ 418	+ 5.85
Agricultural	1,446	1,379	+ 67	+ 4.86
U. S. Treasury securities[2]	4,939	6,344	−1,405	−22.15
Other securities[2]	7,782	8,403	− 621	− 7.39
Total Assets	65,462	63,308	+2,154	+ 3.40
Total deposits	53,740	55,553	−1,813	− 3.26
Demand	24,998	23,929	+1,069	+ 4.47
Total time and savings	28,742	31,624	−2,882	− 9.11
Savings	15,270	16,377	−1,107	− 6.76
Other time, IPC	9,583	10,052	− 469	− 4.67
Public	2,769	3,897	−1,128	−28.94
Capital accounts	4,160	3,935	+ 225	+ 5.72

p—preliminary
*1968 data adjusted for change in member bank universe; data are not on a fully consolidated basis
[1]Gross loans include Federal funds sold
[2]Includes securities in trading accounts
Note: Details may not add to total due to rounding

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a reversal of the time-deposit attrition experienced in 1969 could relieve some of the liquidity squeeze on banks and permit a more rapid expansion in their earnings assets. Even so, a substantial inflow of time-deposit money probably will not occur without a narrowing of certain still-continuing differentials between money-market rates and time-deposit rates.

Another recent development affecting earnings prospects was the late-March reduction in the banks' prime rate, from 8½ to 8 percent, which came on the heels of substantial declines in security yields in the early months of the year. Since rates of return on both loans and securities are now somewhat below their 1969 peaks, operating revenues may be dampened by that factor also.

Despite these adverse developments, net operating income of most District banks will rise between first-quarter '69 and first-quarter '70, largely because loan volume and loan rates are both still above their levels of a year ago. But if loan rates and security yields continue downward, District banks may report less favorable earnings in later quarters of the year.

Banks may be more reluctant to take security losses this year because of the 1969 tax law's elimination of the former "offset" provision through capital gains. In 1970, then, security losses may be less than in the past two years—or banks may even report net gains. Moreover, expiration of the surtax should reduce banks' tax liabilities, and this too should have a plus effect on net income after taxes and security transactions.

Ruth Wilson

TECHNICAL NOTE

Principal changes in the 1969 report of income include:

1. Consolidation of income and expense to include transactions of wholly-owned and majority-owned subsidiaries, including Edge Act subsidiaries.
2. Provision for loan losses to be reported as a current operating expense, instead of a non-operating deduction.
3. Allocation of income tax applicable to current year's operating income before income taxes and securities gains or losses or extraordinary charges or credits.
4. Reporting of securities gains or losses net of tax effect.
5. Exclusion of transfers to and from reserves on loans and securities in computing net income.
6. Exclusion of reserves or allowances against loans and securities set up in connection with prospective but undetermined losses from capital accounts. (These are reported in a separate section relating to reserves on loans and securities.)
7. Requirement for accrual accounting for all banks with total deposits of $50 million or more, as of December 31, 1968.

Income data for 1968 have been restated in accordance with 1969 reporting requirements where reasonable estimates could be made. Estimates were based on published income reports of those District banks which had restated their 1968 income data to conform to 1969 reporting requirements. (These banks account for over 80 percent of the District totals of the items involved.)

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Central Banking: Twelfth District

In 1969, the Federal Reserve Bank of San Francisco played an important role in the formulation and execution of monetary policy, and meanwhile carried out a number of central-banking operations for the Western states. The San Francisco office and its branches at Los Angeles, Portland, Salt Lake City, and Seattle served commercial banks and governmental units in Alaska, California, Hawaii, Idaho, Nevada, Oregon, Utah, Washington, and most of Arizona.

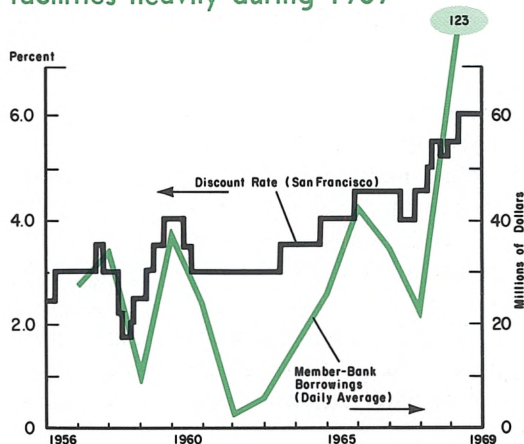
As one aspect of the nation's restrictive monetary policy in 1969, the Federal Reserve Bank of San Francisco raised its discount rate for member-bank borrowing from 5½ percent to 6 percent in early April—the highest rate since 1921. Twelfth District member banks utilized the discount window heavily; borrowings amounted to $123 million on a daily-average basis, nearly double the 1968 figure, as activity at the discount window accelerated from June onward.

As further evidence of this restrictive policy, the Board of Governors increased reserve requirements on demand deposits in mid-April. (Member banks are required by law to keep a specified percentage of their deposits in a reserve account at their Federal Reserve Bank.) But despite the limited reserves supplied by the System, Twelfth District member-bank reserve accounts rose 3 percent over the course of the year—to $3.8 billion at year-end—after increasing by 6 percent in the preceding year.

Transfer of funds using the San Francisco Reserve Bank's facilities continued to expand in 1969, topping the 1968 total of over a trillion dollars by some 30 percent. On an average day, this Bank's five offices handled 1,152 outgoing and 1,116 incoming transfers of funds, representing a total of $5.3 billion. This activity included the transfers of funds for adjustment of member-bank correspondent and reserve-account balances, as well as for Federal-funds and private-account transactions.

The Reserve Bank processed some 804 million checks during 1969—up 6 percent for the year—as Westerners continued to write checks at a rapid rate. In dollar terms, the processing of checks for clearing

Western banks utilized discount facilities heavily during 1969



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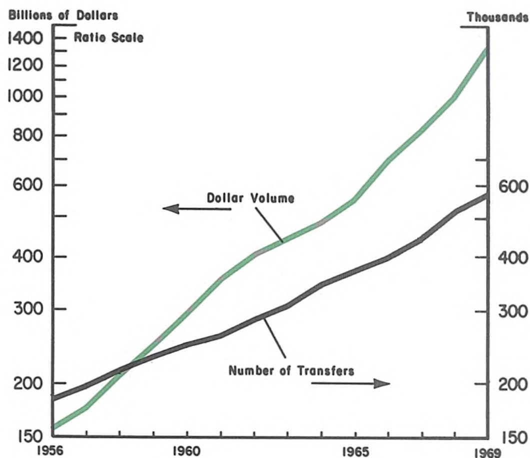
Transfers of funds
expanded sharply during year



purposes increased more than 9 percent to $193 billion. Fortunately, high-speed electronic equipment was used for processing approximately 94 percent of all checks in 1969.

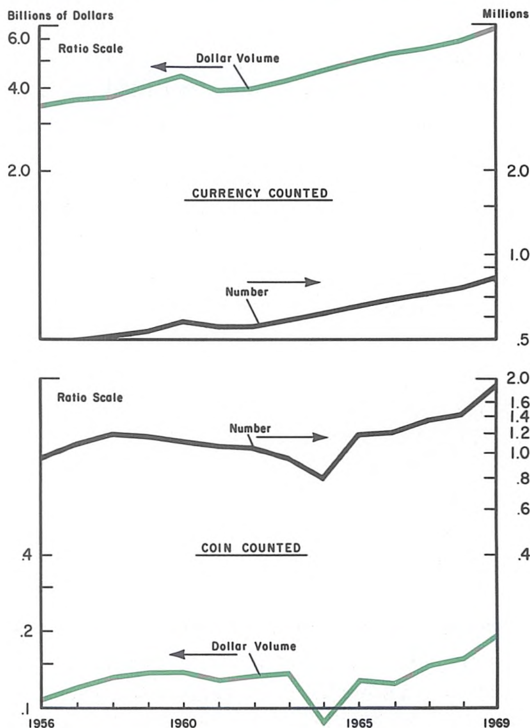
The number of noncash items handled decreased for the second straight year—from 825,000 in 1968 to 774,000 in 1969. But the dollar value of these items increased 15 percent over the previous year, reflecting continued growth in the processing of Government letters of credit.

Coin and currency operations continued to expand, in line with increases in business activity throughout Twelfth District states. Currency received and counted increased 9 percent over the previous year, in both number of pieces and dollar amount. Coin handling registered more spectacular gains, however, as volume increased 32 percent and dollar totals rose 24 percent. In collaboration with the Treasury, the Reserve Bank in early 1969 completed its program of reclaiming silver from coins, and at mid-year announced that currency in denominations of $500 and over would no longer be issued.

The San Francisco Reserve Bank expanded its activity last year as fiscal agent for the Federal government. In this function, it issues and redeems Government securities and administers the tax-and-loan accounts of District banks.

Record-high yields—and the publicity surrounding those yields—sparked the interest of the small investor in U.S. Treasury bills during 1969. At the offering of December 31, 1969, for example, 4,579 subscribers entered tenders for $104 million on a noncompetitive basis with the Reserve Bank. (This compared with 1,038 tenders and $38 million for the same weekly offering a year earlier.) As a result of the activity in this and other Treasury offerings, the total volume of Government securities handled by

Coin and currency operations
expanded as business expanded



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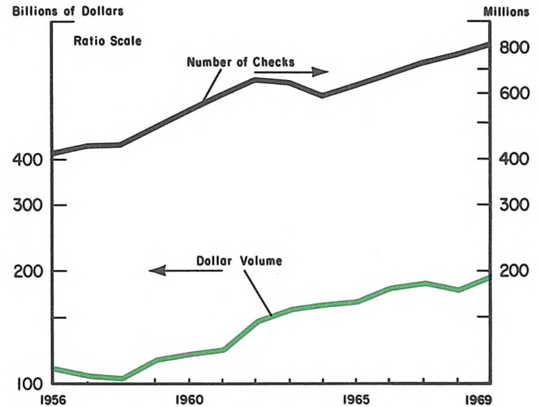
the Reserve Bank was up nearly 40 percent in number and 30 percent in amount over the previous year. In 1969 there were 146 Treasury offerings, including the regular 13- and 26-week series of Treasury bills.

The Reserve Bank experienced a modest 2-percent increase in dollar transactions in U.S. Savings Bonds and Notes during 1969. To stimulate interest in this program, the Treasury increased the interest on Savings Bonds from 4¼ percent to 5 percent, retroactive to June 1, 1969, and shortened the maturity for E bonds from 7 years, 9 months, to 5 years, 10 months. Also, it announced at year-end that the sale of Savings Notes (Freedom Shares) would be discontinued after June 30, 1970.

The volume of food stamps processed by the Reserve Bank increased substantially during 1969, as large numbers of counties in the District entered the program sponsored by the U.S. Department of Agriculture. During the year, the Bank's five offices handled almost 90 million coupons with a value of $121 million.

In its continuing supervisory function, the

Reserve Bank increased check processing to almost $200 billion



Reserve Bank examined all state-chartered member banks and their trust departments during the year. These included 34 banks, 238 branch offices, and 31 trust departments located in California, Idaho, Nevada, Utah, and Washington. Also, seven foreign banking corporations headquartered in the District were examined.

In addition, this Bank participated in the

VOLUME OF OPERATIONS

	Dollar Amount (Millions) 1967	1968	1969	Percent Change 1968-69
Checks collected	$ 182,531	$ 176,469	$ 192,800	+ 9.3
Noncash collection items	4,090	4,423	5,100	+15.3
Coin counted	147	154	192	+24.7
Currency counted	5,5,499	5,960	6,493	+ 8.9
Transfers of funds	823,723	1,021,000	1,328,000	+30.1
U. S. Savings Bonds handled	1,1,341	1,314	1,322	+ .6
Other Government securities handled	58,745	63,200	82,000	+29.7

	Number (Thousands) 1967	1968	1969	Percent Change 1968-69
Checks collected	716,757	756,525	804,200	+ 6.3
Noncash collection items	827	825	774	− 6.6
Coin counted	1,343,486	1,415,600	1,875,700	+32.5
Currency counted	716,429	760,133	829,233	+ 9.1
Transfers of funds	438	505	575	+13.9
U. S. Savings Bonds handled	26,243	28,186	28,739	+ 1.96
Other Government securities handled	851	1,032	1,441	+39.6

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preparation and implementation of Regulation Z (Truth in Lending). Efforts to acquaint creditors and others with the provisions of the regulation began in February, when the regulation was first published, and continued through the remainder of the year.

At the close of 1969, the total assets of the Federal Reserve Bank of San Francisco reached $11.0 billion, compared with $10.4 billion at the end of 1968. This increase reflected larger holdings of Government securities in the Federal Reserve System's open-market account. The San Francisco Bank's share in this account totaled $7.9 billion at year end. The average rate of earnings on these holdings was 5.89 percent, compared with 5.32 percent in 1968 and 4.66 percent in 1967. Due to the higher yield and increased daily-average holdings, earnings from this source increased by $73 million over 1968, to more than $450 million.

COMPARATIVE PROFIT AND LOSS STATEMENT

(Thousands of Dollars)

	1967	1968	1969
Total earnings	$302,002	$390,669	$474,309
Net expenses	22,677	24,594	27,666
Current net earnings	279,325	366,075	446,643
Net addition (+) or deductions (−)	+341	+1,131	−26
Distribution of Net Earnings:			
Net earnings before payments to U. S. Treasury	279,666	367,206	446,617
Dividends	4,513	4,889	5,146
Interest on Federal Reserve notes	270,023	356,754	439,261
Transferred to surplus	5,130	5,563	2,210
Total	279,666	367,206	446,617

COMPARATIVE STATEMENT OF CONDITION

(Thousands of Dollars)

	December 31, 1967	December 31, 1968	December 31, 1969
ASSETS			
Gold certificate reserves	$1,318,498	$1,286,391	$1,639,536
Federal Reserve notes of other banks	81,883	106,948	102,147
Other cash	37,040	22,756	19,016
Discounts and advances	63,000	7,000	700
Total U. S. Government securities	6,992,563	7,694,527	7,925,956
Uncollected items	997,972	908,061	977,154
Bank premises	8,960	8,741	8,736
Other assets	252,377	340,492	324,689
Total assets	$9,752,293	$10,374,916	$10,997,935
LIABILITIES AND CAPITAL ACCOUNTS			
Federal Reserve Notes	$5,155,150	$5,656,691	$5,950,144
Deposits:			
Member banks—reserve accounts	3,441,491	3,656,371	3,780,382
U. S. Treasurer—general account	119,034	1,706	118,043
Foreign	18,200	29,040	17,550
Other deposits	57,568	78,455	66,350
Deferred availability cash items	762,385	727,077	807,268
Other liabilities	40,096	56,081	84,283
Total capital accounts	158,369	169,495	173,914
Total liabilities and capital accounts	$9,752,293	$5,950,144	$10,997,935

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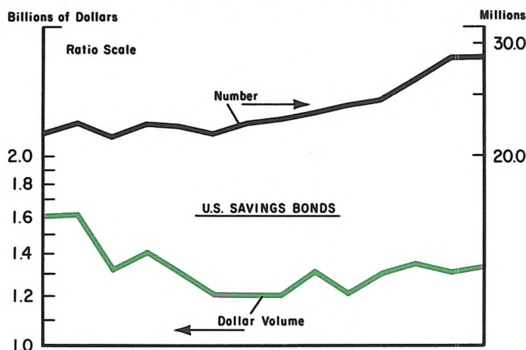
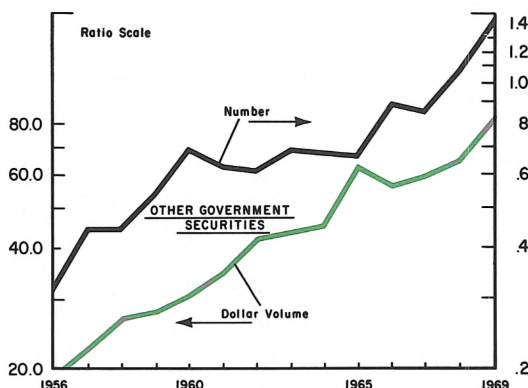
Fiscal operations rose (except for savings bonds) as market yields soared





Earnings on member-bank borrowings increased from $3 million in 1968 to $7 million in 1969, because of both the increased use of the discount window and the higher discount rate. In addition, the daily-average participation of this Bank in foreign currency holdings expanded over the course of the year. Earnings from this source thus increased from $10 million in 1968 to $16 million in 1969.

These sources all contributed to a substantial growth of total current earnings, from $391 million in 1968 to $474 million in 1969. The Bank's net expenses in 1969 were $28 million, compared with $25 million in 1968, with nearly half the rise in expenses coming from increased salaries and related employee benefits. Dividends of $5 million were paid to member banks, and $2 million was transferred to surplus to bring that account to the level of paid-in capital stock. Remaining net earnings of $439 million were paid to the U.S. Treasury as interest on Federal Reserve notes, for an $82-million increase over the 1968 figure.

Karen Rusk

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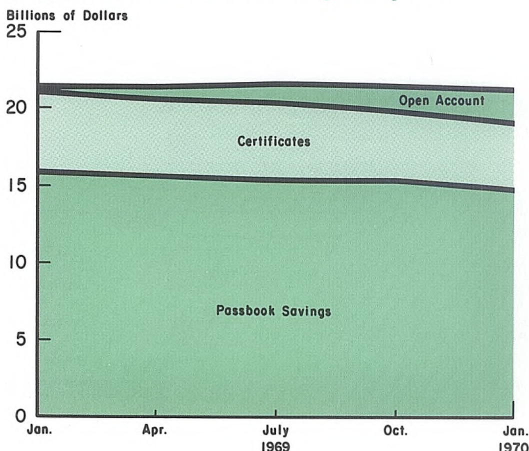
Deposit Drain of '69

As money-market rates skyrocketed during 1969, commercial-bank rates on time deposits remained at their Regulation Q ceilings — and consequently, businesses and individual savers withdrew substantial amounts of deposits from banks and placed those funds in other instruments with higher rates of return. Although the Reg Q ceilings were raised in January 1970, that change came too late to halt the heavy deposit outflow around the turn of the year, especially the outflow of large-denomination time certificates held by businesses and foreign institutions and of certain other types of deposits held by rate-sensitive investors. The Federal Reserve quarterly deposit surveys provide ample evidence of the extent of this disintermediation at Twelfth District member banks.

Between January and July last year, District banks were able to maintain a stable level of individual savings deposits, but meanwhile they lost over 15 percent of their business deposits. Between July 1969 and January 1970, however, banks experienced both a net loss of individual deposits and an accelerated outflow in business time deposits. (Data were collected at the end of each survey month.)

Banks lose individual savings, as consumers search for higher yields



Outflow in consumer savings

During 1969, Western banks lost 1½ percent ($330 million) of their individual savings deposits—that is, regular passbook accounts, consumer-type open-account time deposits (generally in "passbook-type" form), and time certificates held by individuals. This outflow may be attributed in part to the reduction nationwide in the savings ratio—from 6.5 percent of disposable income in 1968 to 6.0 percent in 1969—but it may be due even more to the widespread consumer search for higher yields for their savings dollars. Indeed, as interest rates climbed, Western banks not only failed to attract the increased savings of individuals, but they also lost a substantial amount of their existing consumer-type deposits.

Between the January 1969 and January 1970 survey dates, banks lost 6½ percent ($1,049 million) of their regular passbook savings. Very heavy outflows occurred in the early months, and again in the final months of 1969; somewhat smaller declines occurred during the summer and fall months of the year.

A $350-million January-April decline was partly seasonal, as Western savers withdrew funds from their passbook accounts to

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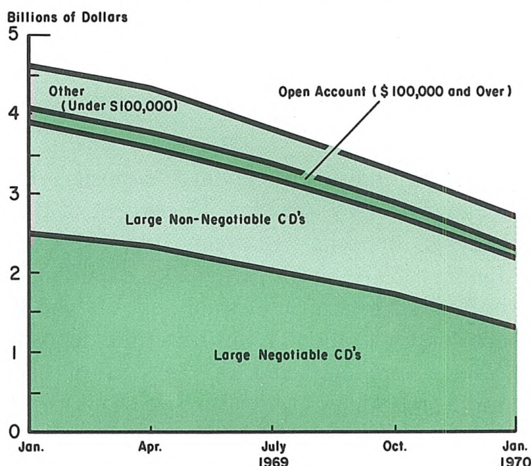
Banks lose vast amounts of business deposits, especially large CD's



pay Federal and State income taxes. But in this as in later periods, the passbook attrition also reflected transfers of funds from regular passbook accounts to the newer "consumer-type open accounts." Between October 1969 and January 1970, though, the decline in passbook savings exceeded the rise in this alternate type of savings instrument, as consumers increasingly invested their funds in Treasury bills and other money-market instruments with higher yields than banks could offer.

Mixed trends—by type, by state

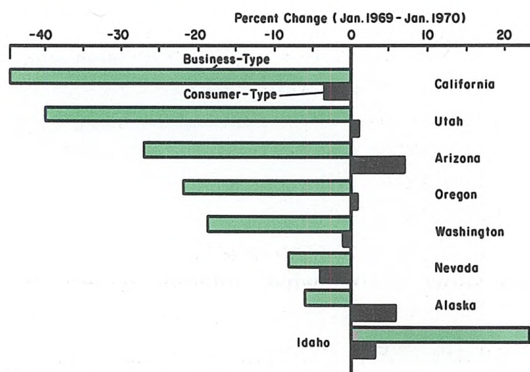
Consumer-type open accounts at District banks jumped from $472 million to $1,988 million between January 1969 and January 1970. The largest spurt of growth occurred between January and April 1969 — when these deposits more than doubled. They continued to increase during the next nine months, but at a somewhat slower pace, as higher rates elsewhere attracted consumer deposits from commercial banks. This type of consumer instrument, which first became popular in the West in 1968, offers a higher rate of interest than regular passbook accounts (5 percent as against 4 percent). Most District banks require an initial deposit of $500 (with a lower minimum for any increments), but the range among banks is quite wide—$100 to $1,000.

Consumer-type time certificates (in denominations under $100,000) declined by 16 percent ($796 million) over the twelve-month survey period. This run-off occurred even though District banks almost universally offered the 5-percent maximum rate on certificates. Most banks offered short-term (3-to-12 month) maturities on these certificates, but required a minimum deposit of $1,000. (The range was from a $100 to $5,000 minimum.)

Despite the bleak overall picture, some District states fared considerably better than others in the savings competition. In aggregate consumer savings, Arizona, Alaska, and Idaho reported increases of 7, 6, and 3 percent, respectively, while Oregon and Utah each posted 1-percent gains.

Arizona and Alaska even managed to show increases in regular passbook savings, while the other states reported declines ranging from slightly over 1 percent (Washington and Nevada) to 6 percent (Oregon and California). All states reported sizeable increases in consumer-type open ac-

Almost all Western states post large declines in business deposits



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counts—except for Alaska, which had no deposits of this type. Four states reported significant (8-to-10 percent) increases in consumer-type certificates—Oregon, Idaho, Utah, and Alaska—but the other states all reported decreases. California, in fact, posted a 23-percent decline.

Run-off in business deposits

Between January '69 and January '70, Western banks experienced the effects of disintermediation to a much greater extent in their business-held deposits than in their consumer deposits. The overall decline amounted to 40 percent for total business-type deposits — large time certificates (CD's), small business-held CD's, and business-held open-account deposits. The largest attrition occurred in the final months of the period: an 18 percent ($600 million) run-off between October 1969 and January 1970.

Large negotiable CD's, in denominations of $100,000 or more, showed the largest losses between January and January. Being especially rate-sensitive, these deposits dropped 48 percent ($1,220 million), as the spread widened between money-market rates and the ceiling rate on CD's. Indeed, the runoff was almost twice as great in the July-January period than in the preceding six-month period, as a consequence of the sharp widening of the rate spread over the course of the year.

All District states except Idaho shared in the severe loss of business deposits. In particular, California suffered a 44-percent decline between January and January, while Utah posted a 40-percent loss and Arizona a 27-percent drop.

Survey data for the January-October period show a somewhat different pattern of outflows for commercial banks nationwide than for Western member banks. In that nine-month period, all U.S. commercial banks posted a 3-percent *increase* in consumer-type savings, as against a slight decline at Twelfth District member banks. Yet, banks nationwide suffered a substantially larger run-off in business-type deposits than did banks in the West—in particular, a 50-percent (as against 34-percent) decline in large negotiable CD's.

Raising the ceiling

The Federal Reserve Board raised the maximum permissible rates on time deposits on January 21 of this year, so as to permit banks' deposit rates to come more into line with going yields on market securities and to permit "greater equity" in the rates paid for smaller savings balances. The ceiling rate for passbook savings was raised from 4 to 4½ percent. Rates on time certificates in denominations under $100,000 were revised to allow a ½ to ¾ percent differential above the original 5-percent ceiling, depending on maturity. Rates on single-maturity time deposits in denominations of $100,000 and over were lifted from a 5½-6¼ percent range to a new range of 6¼ to 7½ percent, depending on maturity. By early February most District banks were paying the new maximum rate on each type of deposit offered.

The outflow of business and consumer time deposits from large Twelfth District banks began to abate somewhat after the Reg Q ceiling increase. This shift reflects both the upward movement of bank-deposit rates and the downward slide of other money-market rates. Commercial banks' maximum rates are still, in many cases, below the competitive money-market rates which have drawn off banks' deposits so rapidly over the past year, but the differential is becoming less effective as an incentive for withdrawal of deposit funds.

Molly Anderson

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Western Digest

Bank Credit Expands

Total credit at large District banks expanded $496 million in March as security holdings rose $579 million and loans declined $83 million. Banks rebuilt their security portfolios mainly in short-term issues—both Treasury bills and municipal warrants. . . . Although business loans rose sharply over the mid-month corporate tax date, the increase over the month was only $12 million. Real estate loans also showed only a nominal gain, while consumer installment loans declined by $36 million.

Savings Show Seasonal Increase

Deposits at large District banks rose $552 million during March, with gains in all categories except U.S. Government deposits. Regular passbook savings increased $90 million, representing primarily an accumulation of funds for April tax payments. A large—$204 million—rise in large negotiable CD's contributed even more to the substantial increase in total time deposits.

Aerospace Employment Drops

During February some 8,500 more aerospace workers were cut from payrolls in the District, leaving employment in the regional industry at 648,000. (Over 750,000 were employed at the December 1967 peak.) This drop, one of the sharpest monthly reductions of the last two years, was concentrated in Washington plants rather than California facilities.

Gasoline Prices Boosted

Petroleum refining activity in the West dropped sharply in late February and early March, as inventories of refined products rose rapidly. Nevertheless, many major oil firms in early spring announced increases in the wholesale gasoline price of nearly a cent a gallon.

Copper Demand Lags

Deliveries of refined copper to fabricators, although rising in February, still lagged behind the pace of a year ago. Stocks of refined copper meanwhile increased for the second straight month. . . . Despite these signs of sluggish demand, prices for refined copper on the dealer and exchange markets rose sharply in March. As a result, the differential between these prices and the U.S. producer price widened further—and eventually led producers to raise mine quotations from 56 to 60 cents a pound.

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