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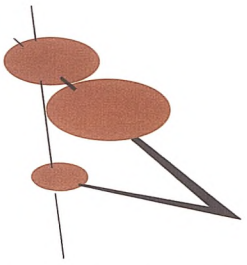
In this issue



October 1970

Food Stamps and the Banks

. . . Commercial banks are closely tied in with a program that is designed to subsidize food purchases by low-income families.

Downhill Racers' Dollars

. . . Western ski resorts may see twice as many skiers this season as they did a decade ago—if the snow falls and the economy rises.

Fed-Funds—Western Style

. . . Major money-market banks reported twice as much Fed-funds activity in tight-money 1969 as they did in tight-money 1966.

Time-Deposit Rebound

. . . In 1970, Western banks have recouped most of their earlier time-deposit losses, aided by an easing of Regulation Q.

Editor: William Burke

Food Stamps and the Banks

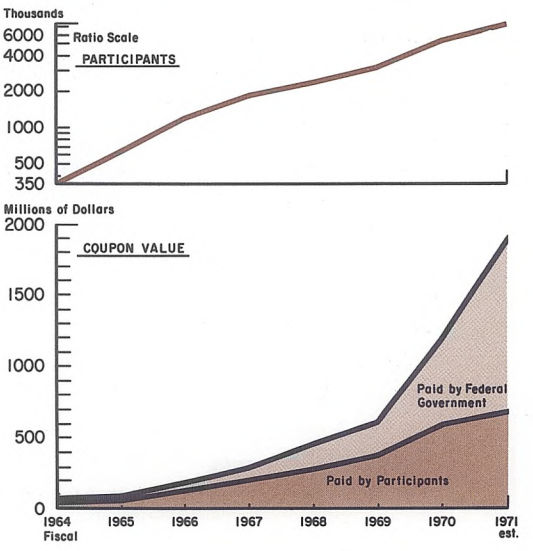
Low-income families purchased about $1,180 million worth of food products with food stamps in fiscal 1970, only six years after the program began operating on a permanent basis. The food-stamp plan, designed with the dual purpose of subsidizing the food purchases of low-income families and raising the incomes of farmers through the resultant expansion of food consumption, is administered by the U.S. Department of Agriculture with the aid of the states and their county welfare organizations. But the commercial-banking system is also involved, to a much greater extent than it is with other welfare programs, as will be explained later in this article.

The Federal Government initiated the current food-stamp plan with a test program in 1961, and placed it on a permanent basis with the passage of the Food Stamp Act of 1964. The number of people participating in the plan has risen from 360,000 in fiscal 1964 to more than 5.2 million in fiscal 1970. Through 1969, the Government subsidy averaged just under 40 percent, so that the stamp buyer had to pay a little over 60 cents to get stamps with a retail value of one dollar. In fiscal 1970, however, the Government increased the subsidy element to about 50 percent, and the subsidy may rise to almost 65 percent in fiscal 1971.

The program should expand sharply in the current fiscal year, as a number of new states and counties enter the plan, and Federal expenditures on the plan should rise even more rapidly as Washington absorbs a greater share of the program's cost. The value of stamps issued will approach $1,875 million, with the Federal Government paying for $1,200 million of that total, and the number of participants should approximate 7.5 million.

This expansion occurs partly at the expense of an older program, the Direct Commodity Distribution system, which provides food to low-income families directly out of agricultural surpluses. This plan has several shortcomings, compared to food stamps. The variety of food is limited to those available through other agricultural programs, and these foods do not coincide with the food needs or preferences of welfare recipients. Furthermore, a distribution system must be set up to store and issue the surplus food. The food-stamp program, in contrast, provides the recipient with a choice among the types of food purchased, and it utilizes the existing retail food-distribution system.

Food-stamp program expands sharply within six-year span



Workings of the plan

The Department of Agriculture contracts with states to set up distribution programs for food stamps, and the states in most cases then delegate the task to county welfare departments. (If the county or state decides to issue stamps, it must close down its commodity-distribution operations.) The counties are responsible for certifying the eligibility of families or individuals for the plan, and for arranging for the issuance of stamps. Most of the recipients already are receiving welfare payments of some kind, but other low-income families (pensioners, for example) can qualify. Total family income and the number of persons in each family determine the actual prices paid for the stamps.

As indicated above, the plan is a subsidy program: the families buy stamps at a price that is usually substantially below the retail value of the stamps. The buyer can then use his stamps to purchase food and food-related products at retail stores. But there are some limitations: the stamps cannot be used for cigarettes, liquor, or imported foods.

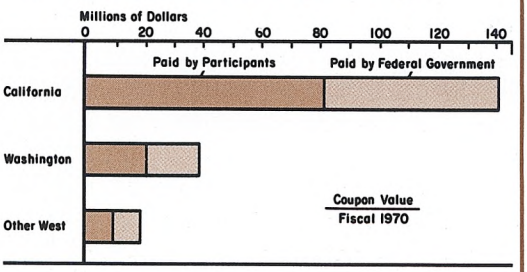
The family eligible to buy food stamps receives an authorization by mail each month, which states the prices it must pay to obtain stamps and the total amount available. The authorization may be for a monthly, biweekly or weekly purchase, according to the needs of the family concerned. (Usually it is the same as the frequency of welfare payments.) As an example, a family of four

Western Stamps

Food-stamp programs are now in operation, or in the planning stage, in all Twelfth District states except Nevada. (In that state, and in a number of counties in California, Idaho, and Oregon, local authorities continue to rely on the direct commodity-distribution program rather than the food-stamp program.) About $198 million worth of food coupons were issued to Western recipients during fiscal 1970. The Federal subsidy amounted to $88 million—about 45 percent of total retail value, or somewhat below the nation's 50-percent average.

By June of this year, 1,134,000 Westerners were participating in the program — 806,000 in California, 222,000 in Washington, and the rest scattered among four other states with ongoing programs (Oregon, Utah, Alaska, and Hawaii). Idaho started its plan in June, and Arizona is just now preparing to issue stamps. California authorities issued $141 million worth stamps in fiscal 1970, while Washington accounted for $39 million, and the other states, about $4 million to $5 million each. Alaska, with a high incidence of welfare recipients in some of its back-country villages, was a relatively important participant in the program; stamp issuance in that state amounted to $4.6 million, with the Federal subsidy accounting for fully 80 percent of the total.

Stamps account for $200 million of West's retail-food spending



with a $360 monthly income can buy $106 of food stamps monthly for $82, while a family with a $100 monthly income can obtain the same amount of stamps for only $25. The subsidization element ranges from 23 percent up to nearly 99 percent. The actual stamps are printed in booklets of $2 to $20, in $2 and 50-cent denominations.

In most areas, the individual takes his authorization to a designated seller of stamps, most often a commercial bank. In some counties, however, the buyer must obtain his stamps by sending a money order to the county welfare department, which then mails out the stamps.

At the moment, welfare departments are not authorized to deduct directly from welfare checks for stamps; instead, they send out the stamp-purchase authorizations at the same time as welfare checks. This timing helps insure that cash is available to buy stamps, and it increases the likelihood that stamp authorizations are fully utilized.

The retail merchant, on receiving stamps, checks on the identification of the person presenting the stamps for payment and makes certain that only eligible items are purchased. Any change due on the purchase is supposed to be made by use of a credit voucher, not cash. From then on the merchant treats the stamps as he would a customer's check, depositing the stamps at his bank at par.

The commercial banks, after separating the stamps from their cash and checks, cancel the stamps and send them to the nearest Federal Reserve Bank for immediate credit. The stamps are treated like cash items. Unlike checks, they do not have to be cleared before receiving credit for them, but unlike cash, they are not eligible to serve as legal reserves during the time the bank holds them. The Federal Reserve Banks, acting as agents for the Department of Agriculture, are responsible for verifying the stamps, crediting the banks' reserve accounts, and finally destroying the cancelled stamps.

The Department of Agriculture is responsible for the general operation of the stamp plan. However, it generally operates through the various state welfare agencies, so that its only direct operational function involves enforcement of the rules covering merchant participants. It negotiates with the states for their participation in the plan, but the actual control over individual authorization and issue is delegated through the states to the county level. This division of responsibility has the advantage of utilizing existing welfare agencies, which have the experience of operating similar plans and have access to the information needed for certifying eligibility for stamps. These procedures obviate the need of setting up any organization which would duplicate the functions of existing welfare agencies. Even so, an additional organization is needed to handle the sale of stamps, because of the separation of stamp authorization from stamp issuance.

Impact on the banks

Banks deal with food stamps at two stages: (1) the sale of stamps to individuals authorized to buy them, and (2) the recept of stamps from merchants. The latter is not too dissimilar from regular commercial-banking operations, since food stamps are basically a special-purpose check. Like checks, they are used once and then are presented for settlement. Even though they do require special handling, food stamps fit into the existing payments mechanism.

Stamp issuance causes greater difficulties for the banks—the principal issuers in most states—primarily because the authorizations are mailed out at the same time as welfare checks at the beginning of each month. This timing coincides with the usual heavy banking business at the first of the month and creates congestion at the offices of banks selling stamps. Even where bi-weekly autho-

rizations are used, they still tend to create a surge of purchases both at the beginning of the month and at mid-month, another busy period for the banks.

As long as stamp recipients are required to buy their stamps, there is no easy way of avoiding this timing. There is only one time when the average buyer will be certain of having sufficient money to pay for his stamp allotment; this is when the welfare check is received. With the existing regulations, there is no suitable way of spreading the stamp purchases more evenly over the month.

Another complication is that buying stamps takes longer than simply cashing a welfare check. The bank teller must first check the buyer's authorization and identity, and then cash the welfare check and sell the stamps. According to bank estimates, it takes about three minutes to process a stamp transaction, compared to under a minute for cashing a check. Where there are a large number of transactions, the time differential intensifies the congestion in bank lobbies.

These problems, moreover, are compounded for those banks which handle most of the stamp business. To become an issuer of food stamps, a bank must bid for a contract with the local county welfare department. Not all banks enter bids and not all who do are successful. As a result, the number of different banks selling stamps varies from county to county. In some counties, most of the major banks sell stamps, while in others only one bank may have a contract. Where only one or two banks are selling stamps, the situation becomes decidedly uncomfortable. The business tends to be concentrated at a few offices which become very crowded at peak stamp-selling periods. Apart from the direct strain on their facilities, they face other indirect costs—in particular, the loss of customers who shift to other banks to avoid this periodic congestion.

The banks bid for the right to issue stamps, and receive as a result of a successful bid a fee of 60 to 95 cents per transaction. A transaction involves the selling of a book or books of stamps to an eligible family; that is, the banks are paid not by the number of books or dollars involved, but by the transaction. As would be expected, the price seems to vary according to the number of banks bidding in each county.

Large-city banks report that, at the existing level of fees, the break-even point would be close to the 95-cent level—and in fact might be higher if all indirect costs were considered. The banks tend to regard food-stamp sales as either a general public service or as a service to states and local governments.

Stamp-issuing banks attempt to reduce their problems in various ways. They take such obvious steps as hiring extra help, bringing in employees from other branches at peak

Expensive Paper

The Bureau of Engraving and Printing prints food stamps on high-grade paper, and thereby makes it difficult for the banks to get rid of the stamps after use. Food stamps are handled only three to four times before being turned in—in contrast to currency, which after prolonged usage becomes well-shredded and thus relatively easy to burn. But food stamps, being practically unused, don't burn so easily, and the Federal Reserve Banks thus are forced to develop new ways of destruction, such as shredding and pulping.

periods, opening extra tellers' windows, and setting aside special areas or even separate floors in large branches to serve stamp buyers. In some cases they actually open up special storefront offices to issue stamps.

In some counties, nonbank issuers are involved, and in some cases they provide imaginative answers to problems of selling stamps. For instance, an armored-car company, which is an issuer in one county, actually sends armored cars to certain locations to sell stamps at appropriate times.

In view of all the problems cited here, Congress is now considering ways of modifying authorization procedures. Specifically, the farm bill now before Congress would permit the price of the stamps to be deducted from the welfare payment, so that the food-stamp booklet could be mailed out together with the welfare check each month. (This system has already been used in some areas, but only on a trial basis.) The same bill would also designate post offices as distribution centers for stamps. These two provisions, if approved, would remove many of the banks' problems and also make the program more convenient to stamp buyers.

Effectiveness?

A continued expansion of the food-stamp program seems all but assured, partly because Congress has voted more appropriations for subsidizing the plan, and partly because the number of participating counties is increasing in response to the recent increase in the amount of Federal subsidization. In addition, several proposed technical changes would also tend to increase the volume of stamps handled: $1 and $5 stamps may be added, and a 25-cent denomination may even be used in a proposed food-certificate program aimed at improving the nutrition of mothers and children.

But how effective has the plan been to date? In one respect, it has been quite successful; food stamps directly raise the effective purchasing power of low-income families and stimulate them to increase their food expenditures. On the other hand, the program has been less successful as a means of raising farm income, since the subsidization is at the retail level and a large part of the increased expenditures for food could be absorbed by higher prices along the chain of processing and distribution which separates the stamp buyer from the farmer.

As it stands, the present program imposes some awkward procedures. Up to the point of authorization, the program simply requires some expansion of existing welfare organizations. But the requirement that the stamps be sold rather than deducted from welfare checks causes problems both for the buyer and the seller. Furthermore, not all states and counties have set up the organizations to issue stamps, so there remain gaps in national coverage. All in all, judged as a means of raising income levels, the limited-purpose nature of food stamps makes them less flexible than straight-forward cash grants, and the special handling of the stamps imposes some costs on the financial system that the use of cash would avoid.

Robert Johnston

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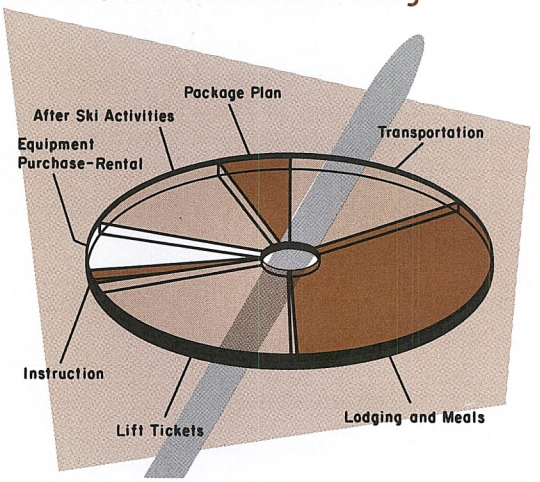
People have been skiing in one form or another for more than 6,000 years, but skiers will tell you that the ancient sport became a modern industry only about the time (circa 1960) when stretch pants came on the scene. Since then, skiing has become big business—especially in the Western states.

This year some 3.2 million skiers throughout the country will contribute their share to the $1.4 billion "ski market." They will take perhaps 8 million separate outings to Western ski resorts—Squaw Valley (California), Crystal Mountain (Washington), Alta and Brighton (Utah), Sun Valley (Idaho), Aspen and Vail (Colorado) and almost 200 other resorts of lesser fame. Although the amount of business handled by these resorts will depend on the vagaries of the weather and the economy, the number of visits may easily be twice the number recorded in the early 1960's.

A recent Commerce Department study provides a profile of the typical Western skier. First of all, he is probably male. Women tend to drop out of skiing as they get older: in the 20-and-under age bracket the sex distribution is about 50-50; by age 30, only one out of four is female; by age 40, only one out of eight is female. Skiers also tend to be young—two-thirds are under 30.

Week-end ski budget allocates smallest share to costs of skiing



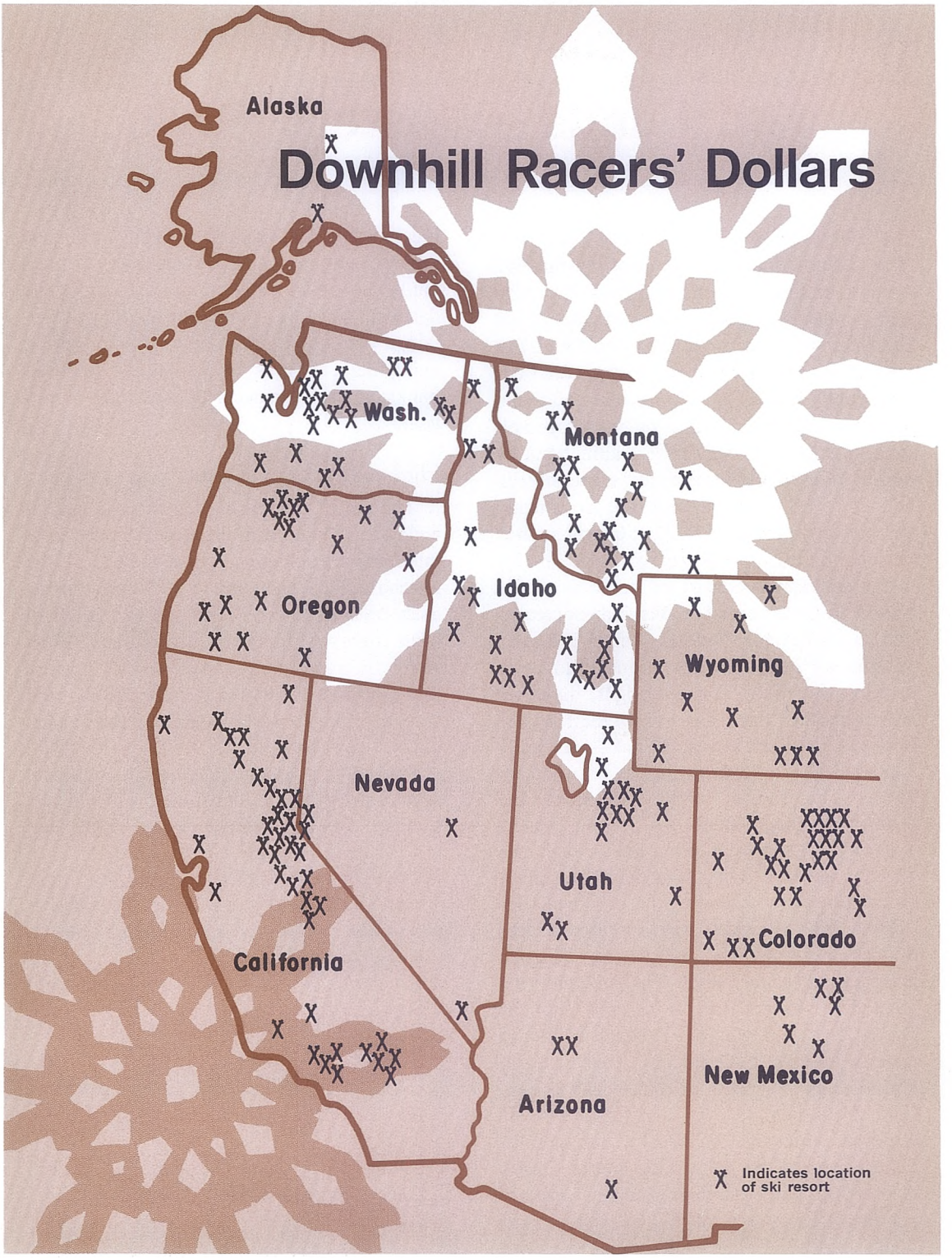
Western skiers report a median annual family income some $2,000 greater than the public at large—one out of five earns $15,000 or more. And they usually tend to spend more than the average vacationer. On a single-day trip a skier will probably spend $11, while a weekend skier will spend $25 a day and a ski vacationer will have daily expenditures of $52.

Ski resorts—ranging from Mom and Pop ski huts to multi-million-dollar jet-setter havens — will spend between $200 and $14,000 apiece on advertising during the average year to attract the Western skier. Equipment and clothing manufacturers, lodging facilities, restaurants, and airlines will also spend heavily to guarantee their share of this lucrative market, which grows between 15 and 20 percent a year.

What makes a skier choose one area over another? Travel doesn't seem to be a deterrent, as most Westerners journey 140 miles on the average to get to their favorite ski slopes. The peripatetic Californian often goes as far afield as Colorado, Nevada, or Utah for his winter fun.

Availability of lift facilities helps to determine the popularity of a ski resort. In 1955, less than 50 percent of Western ski areas offered anything except rope tows. Now 75 percent have cable facilities of some type —gondolas, aerial trams, T-bars, J-bars, or platter pulls. The cable lifts provide a more interesting choice of downhill runs, as they average a 1,000-foot vertical rise as opposed to the typical rope tow's 383-foot average rise. By far the most popular ski areas are those which offer a lift capacity of at least 1,500,000 vertical transport feet per hour. Then, for the very adventurous, some resorts offer skiers a helicopter shuttle to peaks not yet crossed by cables.

Karen Rusk



Fed Funds—Western Style

As monetary pressure increased in 1969, commercial banks suffered a massive outflow of time deposits and thus turned to many relatively new sources of borrowed funds in order to meet loan demands. But banks also increased their reliance on Federal funds — one of the more traditional sources of borrowings. The daily average volume of interbank Fed-funds transactions by major money-market banks nationwide soared to $8.6 billion in 1969, or roughly double the volume of the 1966 tight-money period.

Federal funds consist of balances maintained by commercial banks in reserve accounts with their Federal Reserve Banks. Interbank Fed-funds transactions occur when a bank borrows, for overnight, balances which another bank has to its credit on the books of a Federal Reserve Bank— generally funds which are in excess of its required reserves. The transfer of the funds from the selling (lending) bank to the purchasing (borrowing) bank is effected through the Federal Reserve Bank by a debit and credit to the reserve accounts of the two banks involved. Use of leased wire services insures almost instantaneous completion of such transactions, even though the banks may be located in different Federal Reserve Districts. Banks also sell (lend) Federal funds to dealers in U.S. Government securities and occasionally purchase (borrow) Federal funds from them.

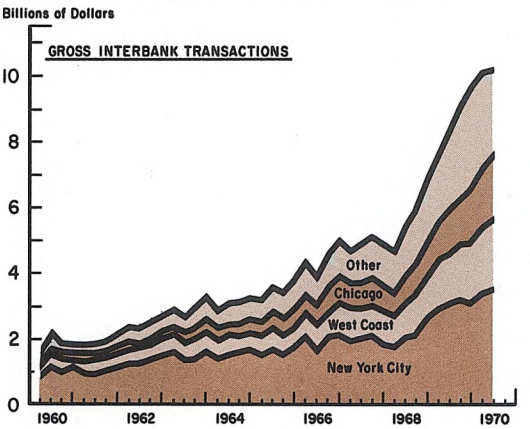
Seven banks on the West Coast are included among the 46 money-market banks that report daily on their Fed-funds transactions. Throughout the 1960's, these seven banks expanded their volume in line with the national transactions volume, and thus they accounted for about one-fifth of interbank Fed-funds transactions throughout the decade. In 1969, furthermore, they maintained a unique position among major banks, being net suppliers of Fed funds to other banks in three quarters of that tight-money year.

High rates spur volume

The rapid growth of this market nationwide has shown up in the expansion of gross interbank transactions, which include all the purchases and sales made by banks during each trading period. With the exception of some quarter-to-quarter fluctuations, gross interbank transactions moved steadily upward throughout the early and mid 1960's, and then accelerated sharply around the second quarter of 1968.

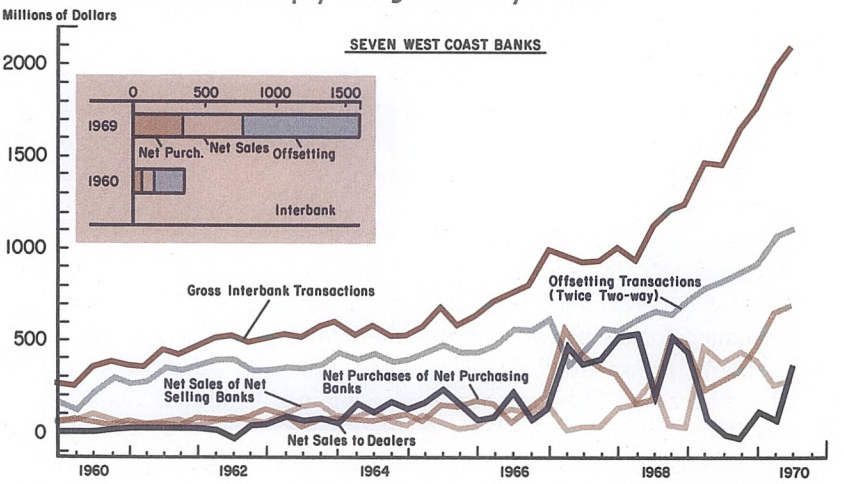
Strong loan demand, deposit attrition, and reserve pressure all contributed to the heavy trading volume nationwide in 1968 and

Gross transactions accelerated in each geographical area in mid '68



1969. In the face of strong bank demand for funds, the cost of Federal funds averaged 8.22 percent in 1969 — and exceeded 9 percent in some months — in contrast to a 5.11-percent figure recorded in 1966, another period of severe reserve pressure. This high rate presented an opportunity cost which banks with temporarily idle funds could not afford to forego. In particular, it helped bring smaller banks into the market, offsetting the transaction costs which generally make it uneconomical for them to participate. The heavy demand for funds also intensified the efforts of larger banks and other Fed-funds dealers to pool available funds of smaller banks, and thus assisted the redistribution of excess reserves from "surplus" banks to "deficit" banks.

West Coast banks keep pace with expanding market and increase sales sharply in tight-money 1969



During the 1960's, several shifts occurred in the market share held by different groups of banks. The seven West Coast banks maintained a 20-percent average share of gross interbank transactions over the period, with relatively minor variations from that average. On the other hand, the eight New York City banks experienced a decline in their proportion of total transactions, from just over one-half in 1960 to slightly more than one-third in 1969. The five Chicago banks doubled their share of gross transactions from 8 to 16 percent during the decade, and the remaining 26 banks in the reporting series also increased their participation, from 21 to 31 percent.

Shifts in two-way trades

The gross interbank figures include "two way" transactions — "offsetting" sales and purchases made by an individual bank within any one trading day. Two-way transactions occur because of the position of many large money-market banks as dealers in Federal funds; they purchase funds from other banks, perhaps pooling funds from small banks, and then resell these funds. Their profit from such transactions comes out of the small differentials in their buy and sell prices.

Correspondent banking relationships have expanded in recent years to include agreements to buy from or supply funds to correspondent banks as needed. Under such an agreement, a bank may have no excess funds of its own, but will purchase funds to meet the needs of its correspondent banks, sometimes without the usual advantage of arbitrage in its buy and sell rates.

Two-way transactions also frequently arise when a bank sells funds early in the day, then unexpectedly faces a deficit in its reserve account, and becomes a purchaser of funds later the same day. Or the reverse situation may arise, when a bank has an unanticipated credit to its account at the Federal Reserve Bank and thus becomes a seller rather than a purchaser towards the end of the day.

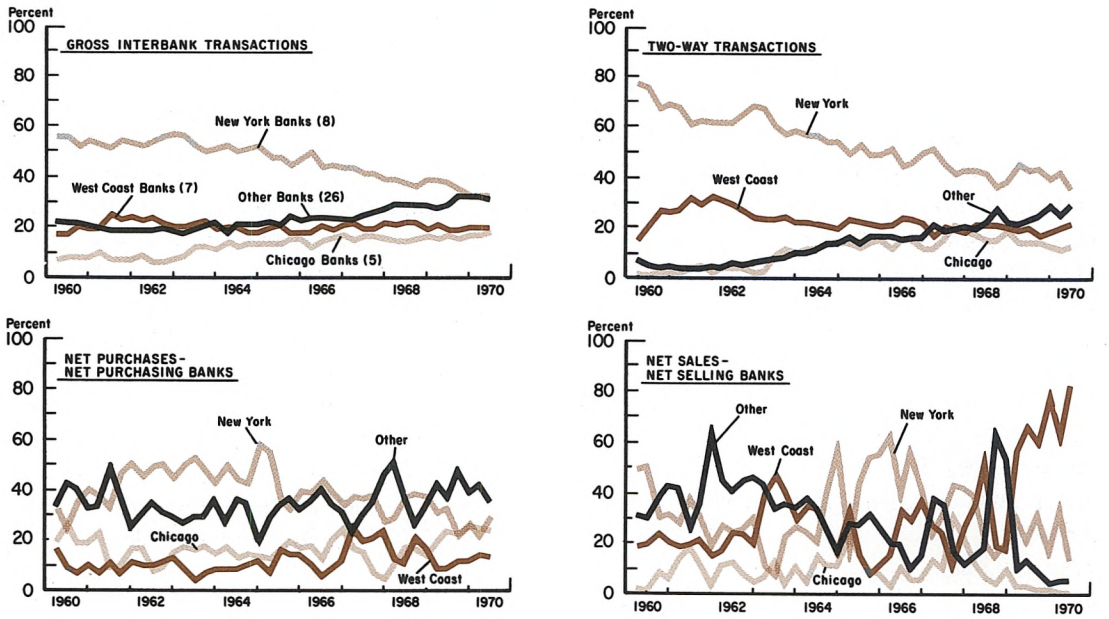
In the 1960's, two-way transactions — the sum of offsetting purchases and sales — averaged 54 percent of the total gross interbank transactions of the 46 reporting banks. For these banks as a whole, the volume of two-way transactions generally kept pace with the expansion in total transactions throughout the decade, despite differences among the different groups of banks.

New York City banks maintained their dominant role as intermediaries in interbank flows of Federal funds, as these transactions accounted for about two-thirds of their total interbank transactions throughout the decade. The seven Western banks also maintained a high proportion of offsetting sales and purchases—albeit a declining proportion in the last several years. In 1960, two-way transactions constituted 62 percent of all interbank transactions made by West Coast banks; by 1969, they represented only 53 percent of the total. By contrast, Chicago banks sharply expanded their role in this regard, posting a gain (from 9 to 45 percent) in their share of gross transactions accounted for by two-way transactions, while the 26 other reporting banks had a similar rise (from 12 to 43 percent). The expansion in transactions of this type helped these two groups of banks to increase their share of total gross transactions over the decade.

Variation in net position

In every quarter of the decade, the 46 reporting banks as a group were *net* Fed funds purchasers on interbank transactions. (Net transactions equal gross less "offsetting" transactions.) However, the volume of net purchases varied widely, from a low of $19 million in the second quarter of 1962 to a high of $3,663 million in the fourth quarter of 1969. The net position among the banks also varied widely by geographic location. New York City banks were net interbank

New York banks' share declines for both gross and two-way transactions . . . West Coast banks' share of sales climbs steeply in recent years



sellers in only one quarter, and Chicago banks were net sellers in four quarters, whereas West Coast banks were net sellers in almost half (17) of the quarters covered. The 26 other banks, however, were net purchasers consistently throughout the 1960's.

More purchases—except in West

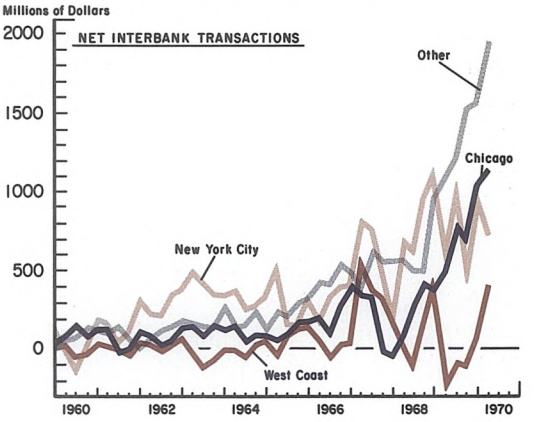
Generally, each substantial increase in the net purchase position of the 46-bank series took place (as might be expected) in a period of monetary restraint, while each significant reduction in net purchases (or shift to a net sales position) took place in a period of easier money. Thus, net purchases rose from a daily average of $545 million in the second quarter of 1965 to $1,321 million in the fourth quarter of 1966. Again, in the more recent period of monetary restraint, net purchases soared from $884 million in the first quarter of 1968 to $3,663 million in the fourth quarter of 1969.

West Coast banks, however, deviated from the pattern of other money-market banks in each of these tight-money periods. In both 1966 and 1969 — especially 1969 — they either reduced their net interbank purchases or were net sellers of funds. Throughout 1969, these banks accounted for over 50 percent of the total sales of all net selling banks in the reporting series, and the percentage soared to 81 percent in the final quarter of the year. They were net sellers of funds to New York banks in two quarters of the year, and were net sellers to other banks outside the Twelfth District in all four quarters.

Why net sellers?

Several special factors enabled West Coast money-market banks to continue as net lenders of funds during the 1969 period of monetary restraint. Their time-deposit attrition last year was relatively less than the attrition nationally, and much less than that experienced

Net position among banks varies widely by geographic location



by New York banks. In addition, they held a somewhat tighter rein on their loan expansion and made relatively larger reductions in their holdings of securities. West Coast banks also obtained funds by selling a large volume of loans from their portfolios to their own bank holding companies and to others—and, like other money-market banks, they relied heavily on borrowings of Eurodollars from their foreign branches (or from foreign banks or dealers) to offset their outflow of domestic deposits.

Aside from these specific factors, Western banks enjoyed certain inherent advantages made possible by the existence of extensive branch-banking systems. A large bank, in effect, "pools" the funds (deposits) from individual offices for allocation to various uses, such as the financing of loans made by individual offices, as well as the allocation of funds to reserves and to the bank's investment portfolio. and for use in the Fed funds market when rates are relatively attractive there. Western branch banks often have such large sums available through such pooling that they can place their funds directly with a final buyer in the market without going through an intermediary, in contrast to the smaller unit banks which frequently must

pool their funds through a correspondent bank or dealer.

Dealer financing—another dimension

The volume of Fed-funds transactions with Government securities dealers varied widely among major money-market banks during the 1960's. New York City banks clearly dominated this field over the decade, accounting for about 70 percent of the total Fed-funds sales (loans) made to dealers by the 46 reporting banks. On their *total* Fed-funds transactions—including both interbank transactions and transactions with dealers—New York City banks were net sellers of funds throughout most of the period, in contrast to their consistent net purchase position on *interbank* transactions.

Many New York banks have formal financing agreements with Government securities dealers, just as they have loan commitments with their commercial and industrial customers. Their dealer loans expand and contract largely according to dealer financing needs; the loans are made in Fed funds, and are a customary part of the banks' total loan portfolios. On the other hand, Chicago banks and the "other" 26-bank group (outside New York, Chicago, and San Francisco) participate only marginally in this type of dealer financing; in the 1960's, they accounted for about 3 percent and 6 percent, respectively, of all such transactions.

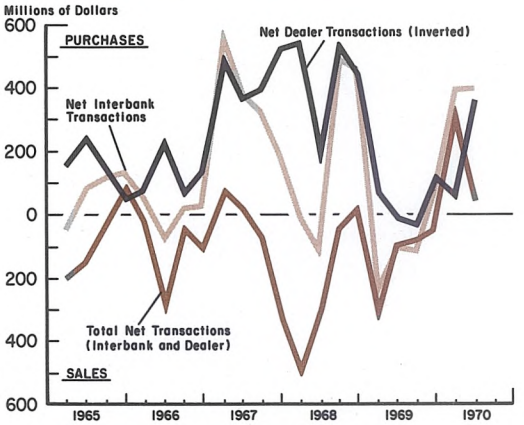
West Coast banks experienced much wider fluctuations in dealer financing during the 1960's, and their relationship to the market also differed somewhat from that of New York banks. Over the decade, they accounted for around 20 percent of the total dealer financing by all reporting banks, but this percentage ranged from 0 to 36 percent of the total. (In two quarters of 1969, they were small net borrowers of funds from dealers.) Unlike New York banks, West Coast banks do not have formal commitments with dealers to provide financing, and therefore they are free to offer credit largely at their own option. Favorable arbitrage between the dealer rate and the interbank Fed-funds rate frequently results in sharp increases in their sales of funds to dealers.

In recent years, the *interbank* transactions of West Coast banks have reflected each substantial increase in such sales to dealers. For example, in first-quarter 1967, and again in third-quarter 1968, when *sales* of funds to dealers more than tripled from the preceding quarter's level, West Coast banks' net purchases of funds from banks rose by an even greater amount. In each case, the increase in net purchases resulted from both an increase in gross interbank purchases and a reduction in gross sales. In each of these periods, West Coast banks stepped up their purchases of funds from New York banks and Twelfth District banks, but by far the greatest shift occurred in transactions with "other" banks outside the Twelfth District.

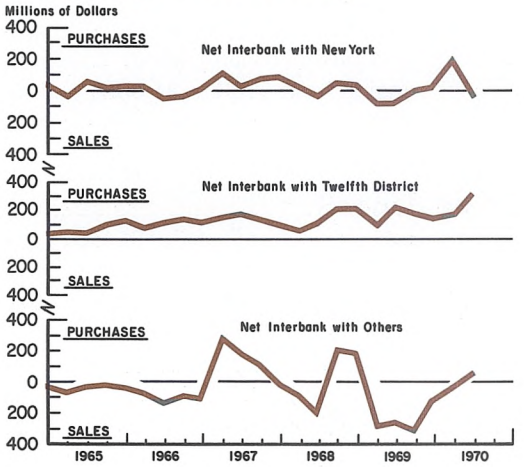
Customarily, West Coast money-market banks are net sellers of funds to banks located outside of New York and the Twelfth District, but this position is apparently reversed when they decide to allocate large amounts of funds to dealers. At almost all times, however, West Coast banks are net purchasers of funds from Twelfth District banks, while their transactions with New York banks fluctuate back and forth between a small net purchase and net sales position.

West Coast banks, along with other money-market banks, engage in other Fed-funds transactions, particularly on the borrowing side. The most common of these is the borrowing of funds through repurchase agreements, generally with corporations or public agencies. These transactions—usually overnight or day-by-day commitments—involve selling Government securities under agreement to repurchase. The volume of such transactions rose sharply in 1969, and served

An increase in dealer loans
by West Coast banks causes . . .



. . . changes in interbank flows, particularly to "other" banks



as another source of funds for money-market banks during that tight-money year.

More purchases in 1970

The uptrend in the volume of gross interbank transactions has continued strong during 1970. In the second quarter, daily average transactions of the 46 reporting banks reached $10,971 million—a rise of $1,394 million over the average for fourth-quarter 1969. The increase was all on the purchase side, as sales of net selling banks declined. Two-way transactions, after a first-quarter rise, returned to approximately the same level as in fourth-quarter 1969.

West Coast money-market banks held a 19-percent share of gross transactions during the first half of 1970. However, these banks were relatively heavy purchasers of funds in both the first and second quarters.

In the January-March period, these banks were under substantial reserve pressure due to continued deposit attrition. Net purchasing banks increased their borrowings in this period, while net sales of net selling banks declined. In the April-June period, these banks sharply increased their sales of funds to dealers, and this resulted in a further increase in their purchases from Twelfth District banks and in a shift from a net sales to a net purchase position with "other" banks. However, even after adjustment for sales of funds to dealers, West Coast banks remained in a small net purchase position on *total* transactions.

West Coast money-market banks hold a pivotal position in the Fed-funds market because of their frequent position as net sellers to other banks. The volume of their transactions is sufficiently great—one-fifth of total gross—so that they materially affect the national market whenever they shift from being a net supplier of funds to a net purchaser (or vice versa). Furthermore, the wide swings they create whenever they divert sales of funds from banks to dealer financing significantly affect those other banks which normally depend on West Coast banks as a source of funds.

Ruth Wilson
and Wayne Willey

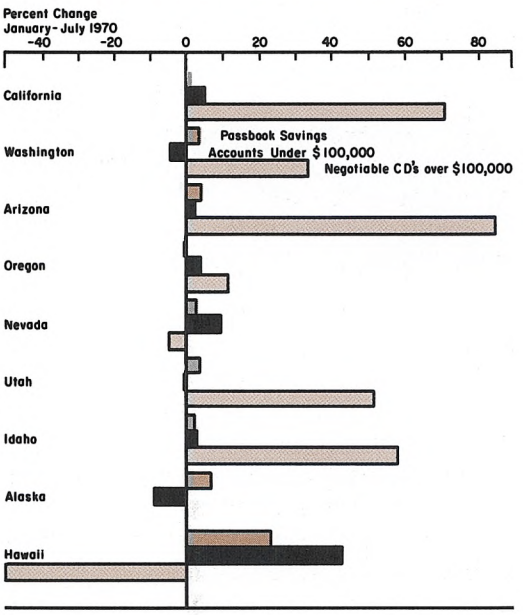
Time-Deposit Rebound

Throughout 1969, money-market rates soared far above the maximum rates which commercial banks were allowed to offer on time deposits, so that some businesses and individual savers withdrew their deposits from banks and placed them in market instruments with higher rates of return. Prime commercial-paper rates reached a peak of 8.84 percent in December 1969, and Treasury bill rates peaked just above 8 percent at the turn of the year—at a time when banks, under the limits imposed by Federal Reserve Regulation Q, could pay only 4 to 6¼ percent on their time deposits, depending on the denomination and type of maturity. During 1969, total time-and-savings deposits of individuals, partnerships, and corporations (IPC) fell almost 8 percent at Twelfth District member banks. Indeed, large-denomination time certificates (CD's) and open accounts held by businesses and other rate-sensitive investors dropped more than 42 percent over this period.

In 1970, however, banks have recouped most of the deposit losses of the previous year, aided by an easing of Regulation Q and of monetary policy generally. The latest quarterly time-deposit survey indicates the success of these shifts in attracting funds back to the commercial banks.

In late January, the Federal Reserve Board of Governors amended Regulation Q to permit banks to pay higher maximum rates, and created a new rate structure for single- and multiple-maturity deposits. (The multiple-maturity change occurred in March but was made retroactive to late January.) The new rate ceilings on deposits under $100,000 permitted banks to pay up to 5¾ percent for certificates or open-account deposits of two years or more, up to 5½ percent for deposits of one to two years. For deposits under one year, the old 5-percent ceiling was retained. These deposits, which include consumer-type open accounts, differ from traditional passbook accounts in that the bank requires a minimum deposit (usually about $500, although ranging from $100 to $1,000) a minimum period of maturity (not less than 30

Time deposits rebound this year on heels of easing in Regulation Q



days from date of deposit), or advance notice of withdrawal of funds of at least 30 days.

The January revision also established new rate ceilings on CD's and open accounts over $100,000—7½ percent on deposits of one year or more, 7 percent on six-month to one-year deposits, 6¾ percent on three-month to six-month deposits, and 6½ percent on short-term (30 to 89 days) negotiable CD's. Despite these revisions, banks were still unable to compete for the funds of large business investors, especially in the face of rates hovering around 8 percent in the commercial-paper market.

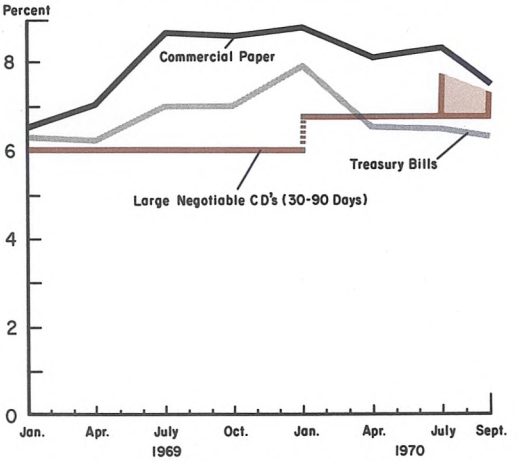
In late June, the Federal Reserve Board amended Regulation Q again, this time completely lifting the rate ceilings on large CD's of 30- to 89-day maturities. The commercial banks reacted immediately; rates on short-term CD's rose to the 8-percent range, where they remained until late July.

Consequently, between the January and July survey dates, total time-and-savings deposits (IPC) rose by $1,789 million at Twelfth District member banks — more than offsetting the $1,580-million net outflow of time deposits in the preceding six-month period. Total time deposits increased 1½ percent between the January and April surveys, but then jumped almost 6 percent between April and July. (Survey data are collected on the last business days of January, April, July and October.)

Consumer savings respond

Passbook savings at these banks declined $558 million (3½ percent) between July 1969 and January 1970, as individuals shifted their savings into Treasury bills, other investments, and higher-paying consumer open accounts. Then, between January and April, passbook savings declined another $126 million, partly due to seasonal withdrawals from savings to pay state and Federal income taxes. (Treasury bills remained very attractive to individuals until early March, when the Treasury raised the minimum denomination offered from $1,000 to $10,000, thus pushing Treasury bills out of reach of the average small saver.) Between April and July, passbook savings increased by $273 million, but despite this rebound, total savings in this form failed to reach mid-1969 levels.

Rates on large CD's again become competitive with other market rates



In contrast, consumer-type open accounts —fixed-maturity deposits under $100,000— jumped sharply in both the tight-money atmosphere of late 1969 and the easier atmosphere of 1970: this category increased 52 percent between July 1969 and January 1970 — more than offsetting the passbook-savings decline in that period — and then rose 30 percent more between January and July 1970. Other consumer time certificates and business open accounts under $100,000 also increased, but at a slower rate, in the January-July period.

Large CD's expand rapidly

The impact of the two Regulation Q revisions was seen most dramatically in the category of large denomination (mainly business-held) deposits, which showed the most sizable losses during the latter part of 1969.

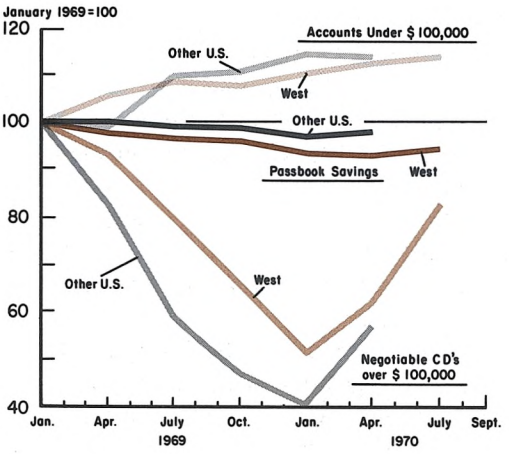
Large-denomination business deposits declined by 30 percent ($1,031 million) between July 1969 and January 1970, with negotiable CD's (the most rate sensitive of all bank deposits) accounting for two-thirds of the total loss. Between January and July of this year, however, total large business deposits increased by 54 percent ($1,277 million), more than offsetting the previous six-months' loss.

In the three months following the January revision in Regulation Q, large negotiable CD's increased almost 20 percent, while other large time certificates and open accounts together rose by about 5 percent. In the May-July period, the complete removal of rate ceilings on 30-to-89 day maturity CD's sparked an additional 33-percent increase in large negotiable CD's and a 40-percent increase in other time certificates and open accounts. As banks responded to the suspended rate ceiling by offering competitive rates, investors (representing mainly business) reacted in turn to these higher rates by depositing their funds again in the banks.

California banks, with about three-fourths of large negotiable CD's outstanding in the District, experienced a 71-percent increase in large CD's between January and July. In percentage terms, however, Arizona banks led the field with a whopping 85-percent gain. Other District states reported increases ranging between 11 and 58 percent, except Nevada, which suffered a slight decline. However, Nevada banks more than offset this loss with a very large increase in other large time certificates and open accounts.

California and Washington banks, which account for practically the entire District total of other large time certificates and open accounts, posted gains of 46 and 35 percent, respectively, in that aggregate category between January and July. These gains more than offset the declines they suffered in the last six months of 1969.

Most Western states post sharp gains in large CD's this year



Rates at maximum levels

On the July survey date, virtually all of the 163 reporting banks in the District were paying the maximum 4½-percent rate on passbook accounts and the maximum 5-percent rate on small-denomination time certificates and open accounts maturing in less than one year. Morever, 93 percent of the reporting banks were paying the maximum 5½ percent on deposits of one to two years, and 97 percent were paying the maximum 5¾ percent on deposits of over two years.

On July 31, rates ranged from 5½ percent to 8¼ percent on short-term negotiable CD's, with no maximum rate ceiling. On the survey date, 48 percent of the (93) issuing banks were paying 7½ percent on large CD's, while 15 percent were paying even more. However, most banks are now offering less than 7 percent on large CD's, in response to this past summer's sharp decline in money-market rates.

The suspension of the ceiling on large CD rates has enabled Western commercial banks to compete successfully for funds of large business investors. CD's have become an at-

tractive alternative to the commercial-paper market, which has experienced some instability in recent months.

In the two months following the July survey date, total time-and-savings deposits (IPC) increased about 5 percent at large commercial banks in the Twelfth District, while large CD's jumped about 25 percent in this period. Therefore, the two Regulation Q revisions this year can be credited with halting the severe deposit drain of 1969, and attracting funds back into the commercial banks. The steady increase in time deposits since last January and the continuing decline in money-market rates can only suggest that the worst of the tight-money period now lies in the past.

Barbara Burgess

Cut in Copper Prices

The nation's leading copper producers reduced prices in late October, most of them cutting prices from 60 cents to 56 cents a pound. The drop in the U.S. producer price reflected the recent slide in prices on the London Metal Exchange, which quotes the so-called world price. This drop, moreover, reversed a prolonged domestic price upsurge, which had pushed prices 58 percent above the level prevailing at the end of the copper strike two years ago.

Prices have declined worldwide because European and Japanese markets, as well as the U.S. market, have felt the effects of the economic slowdown. Also, copper users have kept their stockpiles in check because of the high cost of financing inventory. The U.S. producer price has exceeded the London price in recent months, because U.S. producers have been plagued by strikes and work slowdowns at South American properties, as well as by anti-pollution-imposed curtailments on output at domestic smelters.

An historical background to these developments is presented in the study, "Copper: Red Metal in Flux," published by the Federal Reserve Bank of San Francisco. This monograph describes the growth of the U.S. copper industry, with emphasis on the Western segment of the industry, and also analyzes future marketing possibilities for copper products. Copies of this report are available on request from the Administrative Service Department, Federal Reserve Bank of San Francisco, 400 Sansome Street, San Francisco, California 94120.

Western Digest

Bank Credit Rises

Total bank credit rose $1,985 million at large District banks in September but fluctuated widely, with large gains at the beginning, middle and end of the month. Banks invested $856 million in securities, increasing their holdings of Treasury bills, municipals, and other securities. . . . Mortgage and consumer instalment loans each rose moderately in this period, but the major increase was a rise of $492 million in business loans. However, most of the business-loan gain was the result of re-acquisitions of loans previously sold to bank holding companies.

Bank Deposits Increase

Large District banks gained almost $1.5 billion in deposits in September. Both demand deposits adjusted and U.S. Government deposits rose. All time-deposit categories, except foreign banks and governments, increased for a total gain of $884 million. The $392-million increase in CD's issued to corporations was partially offset by a $104-million reduction in other CD's, largely foreign-held.

Boost for Breakthrough

The Federal Home Loan Bank Board announced in October that the San Francisco Home Loan Bank would make a "special loan" to help six S&Ls finance the construction of a 401-unit, $6.2-million housing project in Sacramento, California. This announcement gives a boost to the financially beleaguered HUD "Operation Breakthrough" program, which is designed to encourage the use of new methods in home construction. The Sacramento project is the first of 10 sites around the country to begin construction under this program.

Aerospace Employment Declines

Washington lost another 3,700 aerospace workers between August and September, leaving total aerospace employment in the state standing at 56,100. This is a reduction of 32,000 workers (36 percent) so far this year . . . California aerospace firms dropped 5,800 employees from the payrolls in September, reducing total employment there from 543,500 to 475,700 to date this year.