Cabinet

FEDERAL
RESERVE
BANK OF SAN FRANCISCO

Monthly Review

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April 1971

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Editor: William Burke

Western Banks' Income

Twelfth District member banks reported record high levels of income in 1970. The gain over the hefty 1969 income increase was rather modest, however—despite a significant expansion in earnings assets—primarily because of the high interest rates paid on the burgeoning volume of time and savings deposits.

Western banks' aggregate net operating income, before taxes, totaled $724 million—only fractionally above 1969's record high. Net income after taxes, security losses and extraordinary charges, meanwhile rose 5 percent, to a record $480 million. (In 1969, in contrast, income increased at least 17 percent on either basis.) Income performance varied widely among individual banks, with the largest District banks generally showing the least favorable results.

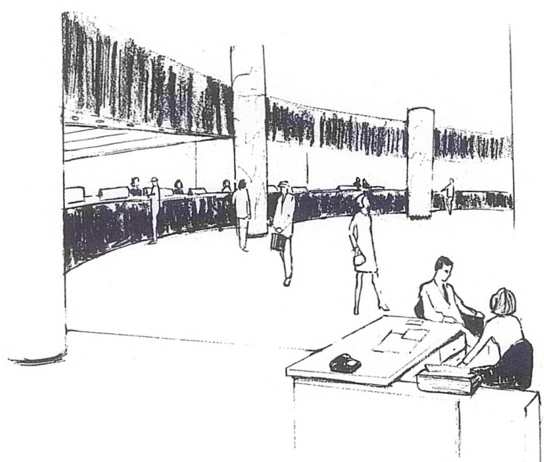
Income was depressed in 1970 mainly because of a sharp rise in interest rates paid on time deposits. The banks' high ratio (55 percent) of time to total deposits made them particularly vulnerable to such increases in interest expense. In addition, unusually high extraordinary charges partly offset the favorable effect of a decline in capital losses on securities.

Loan revenues rise modestly . . .

In line with 1970's moderately easier monetary policy and an almost 10-percent expansion in total bank credit, operating revenues of District member banks rose to $4,601 million, for a 10½-percent gain over the previous (1969) record high. The composition of revenue shifted back to a more traditional pattern, with the increase in loan income accounting for just over 50 percent of the total gain in contrast to 1969's abnormally high 90-percent figure.

An expansion in loan volume and an increase in the rate of return combined to produce loan revenue of $3,320 million; however, this 8-percent increase was only one-third as large as 1969's percentage gain. Loan portfolios expanded at a slower pace in 1970: business loans increased just over 3 percent and mortgage financing less than 1 percent, while consumer loans declined nearly 2 percent. Income from Federal-funds sales (and from securities purchased under resale agreement) rose by a steep 21 percent, but revenue from this source was more than offset on the expense side by an increase in the cost of Fed-funds purchases.

Despite four late-year reductions in the prime rate, which brought the rate down to 6¾ percent by year-end, the average rate of return on loans rose 37 basis points in 1970 to 8.32 percent. Rates remained relatively high through September, reflecting a prime rate of 8½ percent in the first quarter and 8 percent in the second and third quarters. More important, as



borrowers repaid loans made prior to 1969, banks were left with a larger proportion of their total loan portfolios carrying the high rates of 1969 and 1970.

. . . and security income expands

Revenue from securities (excluding trading-account income) rose 16 percent in 1970, to $636 million, while income from trading accounts increased five-fold to $70 million. The large increase in security income reflected a 25-percent increase in District banks' holdings of U.S. Treasury issues for their own account, a 50-percent expansion in holdings of U.S. Government Agency issues, and a 6-percent expansion in municipal securities. In contrast, District banks in 1969 reduced their portfolios of both Treasury and other securities to meet heavy loan demand.

Many of the securities liquidated in 1969 had carried relatively low rates of return, whereas securities acquired in 1970, particularly in the earlier part of the year, carried historically high yields. In 1970, as a consequence, District banks' average rate of return rose 71 basis points on Treasury issues, 85 basis points on U.S. Agency issues and 25 basis points on municipals. These higher yields gave banks a 4.79-percent rate of return on total investments, compared with 1969's 4.17-percent figure, and contributed significantly to the large increase in security income.

Trust-department income rose at a somewhat slower rate than in 1969. On the other hand, service charges on deposits increased, in contrast to a small reduction in the prior year, and other service charges and fees rose 17 percent. Income from trading accounts (as noted above) and earnings from foreign branches—both of which are included in "other operating income"—rose sharply.

CONSOLIDATED REPORT OF INCOME OF TWELFTH DISTRICT MEMBER BANKS

(millions of dollars)

	1970[P]	1969*	Percent change
Operating income—Total	4,601.3	4,160.8	+ 10.6
Interest and fees on loans	3,200.8	2,985.0	+ 7.2
Income from Federal funds sold	119.6	98.5	+ 21.4
Interest and dividends on investments (excluding trading accounts)	635.8	548.1	+ 16.0
Trust department income	116.2	107.4	+ 8.2
Service charges on deposit accounts	207.3	202.3	+ 2.5
Other operating income	321.6	219.5	+ 46.5
Operating expenses—Total	3,877.5	3,437.6	+ 12.8
Salaries, wages and benefits	1,108.9	988.5	+ 12.2
Interest on deposits	1,596.3	1,406.0[1]	+ 13.5
Interest on borrowed funds (including Federal funds purchases)	244.5	220.2[1]	+ 11.0
Net occupancy expense, furniture, equipment, etc.	290.4	258.7	+ 12.3
Provision for loan losses	86.6	74.0	+ 17.0
Other operating expenses	550.8	490.2[1]	+ 12.4
Income before income taxes and securities gains or losses	723.8	723.2	+ .1
Applicable income taxes	223.2	248.9	— 10.3
Income before securities gains or losses	500.6	474.3	+ 5.5
Net security losses after taxes	— 2.3	— 16.2	+ 85.8
Extraordinary charges after taxes	— 18.3	— 1.3	—1,307.7
Net income	480.0	456.8	+ 5.1
Cash dividends paid	227.9	219.7	+ 3.7

[P]Preliminary

*1969 data adjusted for change in the member-bank universe.

[1]An estimated $100 million in interest on Eurodollars has been excluded from interest on deposits, and included in interest on borrowed funds and other operating expenses, to conform with 1970 reporting procedures.

. . . but expenses rise faster

In 1970, operating expenses of District banks accelerated at a faster pace than revenues, rising 13 percent for the year, to $3,878 million. For the first time, the cost of salaries, wages, pensions and other employee benefits exceeded $1 billion. The cost of employee benefits continued to rise at a somewhat faster rate than wages, as it has in other recent years.

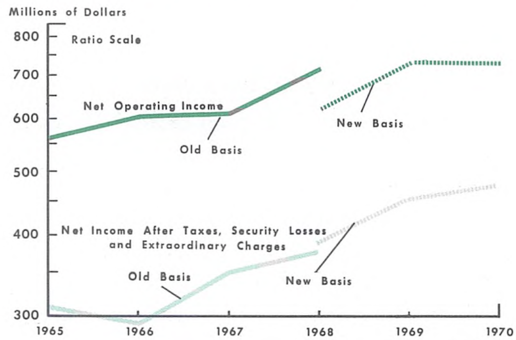
A major factor contributing to the 12-percent rise in wage expense was the expansion (4,152) in the number of employees required to staff the 181 new branch offices opened in District states in 1970. The number of member banks in the District decreased by 15, to 155, but the employment effect was minimal, since mergers accounted for most of this reduction in the banking universe.

. . . as interest expense soars

Interest paid on deposits accounted for 40 percent of District banks' total operating expenses in 1970. This expense item totaled $1,596 million, for a 13½-percent gain over the preceding year's figure. (In making this comparison, 1969 data were adjusted to exclude an estimated $100 million in interest paid on Eurodollars, and this amount has been added to the reported interest paid on "borrowed funds.") This large increase in interest expense stemmed in part from a 20-percent expansion in time deposits. Savings and consumer-type deposits began to increase in the second quarter and continued to rise throughout the rest of the year, while large-denomination CD's jumped sharply in the last half of the year.

The average rate of deposit interest rose 51 basis points in 1970, to 5.15 percent. Most Western banks raised their rates on passbook savings from 4 to 4½ percent early in the year, following the late-January increase in Regulation Q rate ceilings. District banks were somewhat slower in offering the new ceiling rates of 5, 5½ and 5¾ percent (dependent on maturity) on consumer-type time certificates, but most of them eventually adopted these higher rates also. But in particular, the ½-percentage-point increase in the

Western banks lag behind '69 pace with modest gains in net income



passbook-savings rate heavily weighted total interest expenses, since Western banks hold over $15 billion of such deposits.

The January revision in Regulation Q also permitted the payment of higher rates on large-denomination time certificates. Nonetheless, banks failed to recover any significant amounts of CD money until after the June suspension of rate ceilings on 60-89 day maturities. Issuance of large-denomination CD's expanded further in September and October, with the shifting of funds from bank-related commercial paper. Towards the end of the year, offering rates on large CD's were reduced in line with other money-market rates, but interest rates on passbook savings and savings-type certificates remained at the ceilings.

. . . and other costs rise

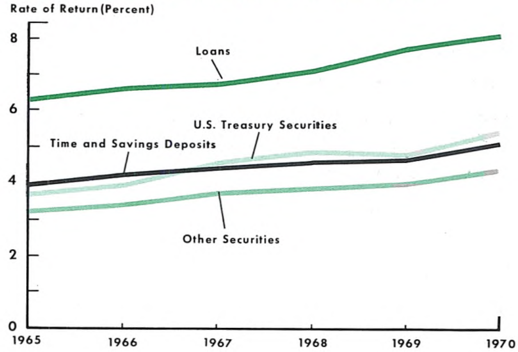
The net cost of Federal-funds transactions—expense of purchases less income on sales—reached $89 million in 1970, or about $19 million more than in 1969. During the year, District banks reduced their borrowings through Eurodollars and bank-related commercial paper and returned to the more traditional form of borrowing through Fed-funds purchases—that is, borrowing of banks' excess balances on deposit at the Federal Reserve Bank. Interest on other borrowed funds, including discounting at the Federal Reserve Bank, decreased from the year-earlier level.

Western banks increased their provision for loan losses by 17 percent in 1970. This was well in excess of the expansion in loan portfolios, indicating the usual upward trend in loan losses during periods of slack economic activity. A rise in net occupancy expense meanwhile reflected the expansion in branch-office operations. "Other operating expenses," which includes costs not specifically itemized, rose 12½ percent.

Result—small net income gain

With the deduction of operating expenses from operating revenues, District member banks' net operating income (before taxes) came to $724 million—less than $1 million above the record set the previous year. Applicable income taxes amounted to $223 million—$26 million less than a year earlier, due to the mid-year expiration of the surtax. Thus, net operating income after taxes showed a $26 million (5½ percent) increase over 1969. Nonetheless, total provision for Federal and state taxes was greater in 1970 than a year earlier, because the tax-reduction effect of transfers from capital reserves to bad-debt reserves on loans was only $10 million, compared with $89 million in 1969, when District banks first applied the new IRS formula for loan reserves.

Banks pay high rates on deposits, but earn much more on securities



District banks recorded relatively low security losses—$3½ million gross—in 1970. (In contrast, they took a $37 million loss in 1969 as they sold securities to meet loan demand.) Thus, after adjustment for the net effect of security losses and for large extraordinary charges, District banks posted a final net income figure of $480 million—$23 million above the previous year's record high.

SELECTED OPERATING RATIOS OF TWELFTH DISTRICT MEMBER BANKS
(percent)

	1970P	1969	Change
Earnings Ratios:			
Return on loans (including Federal funds)	8.32	7.95	.37
Return on U.S. Treasury securities (excluding trading accounts)	5.42	4.71	.71
Return on other securities (excluding trading accounts)	4.40	4.00	.40
Net operating income to capital accounts	17.26	17.82	— .56
Net income (after taxes, securities losses, extraordinary charges) to capital accounts	11.44	11.25	.19
Cash dividends to capital accounts	5.43	5.41	.02
Interest paid on deposits to total time deposits	5.15	4.64[1]	.51
Time deposits to total deposits	55.49	55.59	— .10

PPreliminary

[1]Ratio adjusted to exclude interest on Eurodollars.

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 1969, June 1970, and December 1970, and as of December 1968, June 1969 and December 1969. (Securities data for 1968 partially estimated.)

Small banks—large gains

The largest District member banks—those with deposits of $450 million and over—showed a significantly different earnings pattern from that of other Western banks. The largest banks posted a 1-percent decline in net operating earnings before taxes, compared with a 7-percent increase for other District banks. Net income after taxes, security losses, and extraordinary charges increased less than 3 percent for the largest banks, whereas it rose almost 23 percent for other banks. The latter group recorded a more favorable earnings performance because of a higher rate of gain in loan revenue, very small security losses, and a net credit on extraordinary items.

Earnings in 1970 also varied widely by state. California, Oregon and Washington banks, in the aggregate, showed declines in net operating income, whereas other District states reported moderate to large gains. (But California was the only state to post a decline in net income after taxes, security losses and extraordinary charges.) Large gains in aggregate net income, ranging up to 40 percent, were reported for Idaho, Nevada and Utah.

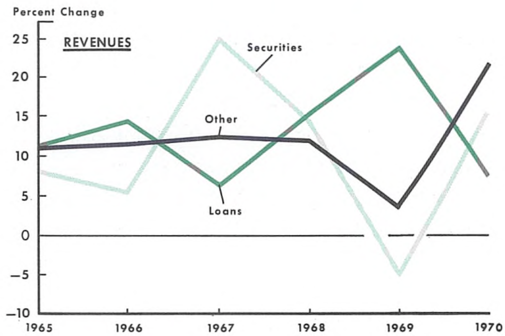
1971—major realignments

Factors affecting bank income changed rapidly in the first quarter of 1971. Loans fluctuated erratically, displaying no sustainable strengthening in bank-credit demand. Western banks lowered the prime business-loan rate five times, from 6¾ percent down to 5¼ percent, and many also announced reductions in rates on mortgage and consumer loans. All these forces combined to place downward pressure on loan revenues. In addition, declines in security yields tended to offset some of the increase in revenue which resulted from rapidly expanding security portfolios.

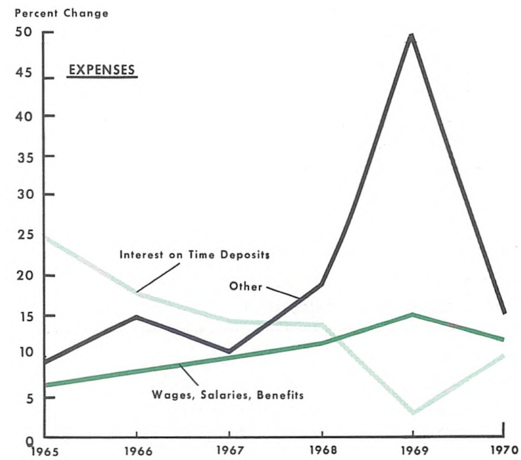
At the same time, banks' costs for funds declined. The Federal Reserve Bank of San Francisco cut the discount rate three times in January and February—each time by ¼ percent, bringing the rate to 4¾ percent. (Reliance on the discount window, however, has been light.) The Fed-funds rate meanwhile fell to a 3-to-4 percent range and Eurodollar rates also moved lower.

During the first three months of 1971, District banks continued to reduce their offering rates on large denomination CD's to bring them into line with declining money-market rates. Banks further pared their interest expense on deposits in late January and early February by cutting the rate paid on consumer-type certificates to 5 percent on all maturities. Then, in mid-

Income from securities rises faster than loan revenue



Interest expense on deposits rises sharply



March, as the prime rate dropped again, major Western banks announced a reduction to 4 percent on passbook savings, effective April 1. Based on deposits as of mid-March, this ½-percentage-point reduction will save District member banks over $60 million in interest expenses in the last three quarters of the year.

Changes in key rates affecting both revenue and expense items have been unusually numerous so far this year, and realignments in related rates have affected almost all items on the banks' income statements. But Western banks' interest expense on deposits increased sharply in the first quarter, due to the extremely large (over $1 billion) increase in passbook savings which still bore the old 4½-percent rate.

Ruth Wilson

SELECTED ASSET AND LIABILITY ITEMS OF TWELFTH DISTRICT MEMBER BANKS
(millions of dollars)

	As of December 31, 1970	As of December 31, 1969*	Changes from December 1969	
			Dollar	Percent
Gross loans and investments[1]	57,238	52,144	+5,094	9.8
Federal funds sold[1]	1,946	812	+1,134	24.0
Other loans	39,291	38,630	+ 661	1.7
Commercial and industrial	15,487	14,988	+ 499	3.3
Real estate	11,207	11,138	+ 69	.6
Loans to individuals	7,427	7,550	– 123	– 1.6
Agricultural	1,455	1,446	+ 9	.6
U.S. Treasury securities[2]	5,881	4,725	+1,156	25.5
Other securities[2]	9,186	7,428	+1,758	23.7
Securities in trading accounts	934	549	+ 385	70.1
Total assets	71,307	65,391	+5,916	9.1
Total deposits	60,238	53,604	+6,634	12.4
Demand	25,737	24,959	+ 778	3.1
Demand IPC	21,320	20,683	+ 637	3.1
Total time and savings	34,501	28,645	+5,856	20.4
Savings	15,762	15,247	+ 515	3.4
Other time IPC	12,610	9,512	+3,098	32.6
State and political subdivisions	4,751	2,765	+1,986	71.8
Capital accounts	4,377	4,176	+ 201	4.8

*1969 data adjusted for change in the member-bank universe.
[1]Including securities purchased under resale agreements.
[2]Excludes securities in trading accounts.
NOTE: Totals may include items not shown.

Western Central Banking

In 1970, the Federal Reserve Bank of San Francisco was responsive to a variety of influences from many financial markets and in wide geographic locations. The San Francisco office and its branches in Los Angeles, Portland, Salt Lake City and Seattle provided central-banking services in all of the Pacific states (California, Oregon, Washington, Alaska, and Hawaii) and in several Mountain states (Idaho, Utah, Nevada, and most of Arizona).

The Federal Reserve Bank of San Francisco lowered its discount rate twice in late 1970, reflecting the year-long downtrend in money-market rates. The discount rate had held at 6 percent since April 1969—the highest level since 1921—but was then lowered to $5\frac{3}{4}$ percent in November and to $5\frac{1}{2}$ percent in early December.

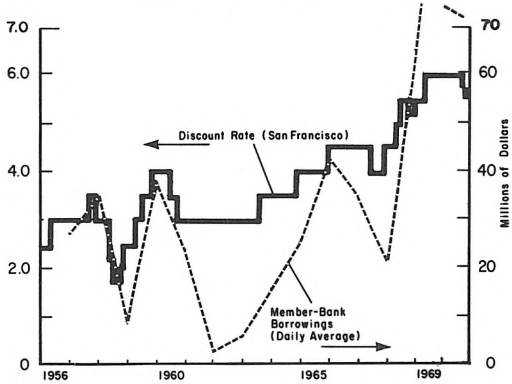
Activity at the Bank's discount window lessened considerably as monetary policy eased over the course of the year. Twelfth District member banks borrowed $71 million in 1970, on a daily-average basis, in contrast to borrowings of $123 million in the tighter conditions of 1969. Indeed, borrowings averaged only $36 million in the last six months of 1970.

District member-bank required reserves, on a daily-average basis, rose $2\frac{1}{2}$ percent in 1970—a rather modest increase in view of the large build-up of total member-bank deposits in 1970. This reflected the concentration of deposit growth in the low-reserve time category, plus the September reduction, from 6 to 5 percent, in the reserves that member banks must hold against time deposits in excess of $5 million. This action, although accompanied by the imposition of reserve requirements on bank-related commercial paper, had a net effect of releasing about $80 million of reserves for District member banks.

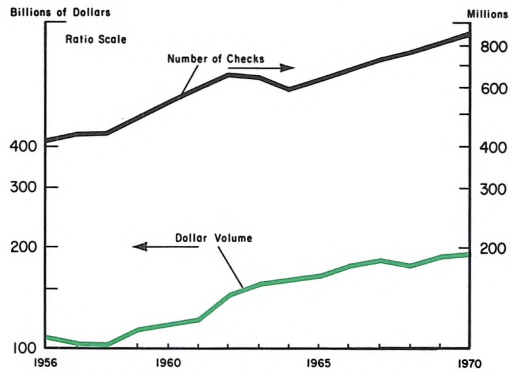
Telegraphic transfers of funds using the San Francisco Bank's facilities expanded rapidly (25 percent) as transfers exceeded the trillion-dollar mark for the third consecutive year. On an average day, the Bank's five offices handled about 2,500 transfers, representing $6.6 billion in funds. This activity included the transfer of funds for the adjustment of member-bank correspondent and reserve-account balances, as well as for customer-account transactions.

In 1970, a new computerized communications system became operational, connecting Federal Reserve banks and branches through a central system located in Culpeper, Virginia. The computerized operation makes it possible to move money balances and data at a speed several times faster than the former wire network. In fact, the volume potential of the new network

Discount-window activity declines as monetary policy eases in 1970



Reserve Bank check-processing activity also grows during year



provides a capacity at least 12 times the present operational load of the Federal Reserve System.

The San Francisco Reserve Bank processed almost 865 million checks in 1970—up 7½ percent for the year. The dollar volume of checks cleared increased 3½ percent to $193 billion. However, the San Francisco and Los Angeles offices, in cooperation with a special banking-industry committee, made a major effort to reduce the ever-increasing volume of paperwork involved in check processing. The cooperating group agreed to establish by early 1972 (on an experimental basis) automated clearing houses that will make it possible to provide automatic "paperless" billing and depositing services to corporate customers of participating banks.

Despite 1970's sluggish business tone, coin and currency operations generally expanded in District states during the year. Currency received and counted by the Bank's five offices increased 7½ percent in dollar volume and 6½ percent in number of pieces. The dollar volume of coin handled rose 4 percent—but the number of pieces dropped almost 11 percent because of a shift in demand for the various denominations of coin. At the San Francisco office, for example, there was a substantial increase in orders for

VOLUME OF OPERATIONS

	Dollar Amount (Millions)		
	1968	1969	1970
Checks collected	$ 176,469	$ 186,364	$ 192,623
Noncash collection items	4,423	5,195	5,512
Coin counted	154	192	200
Currency counted	5,960	6,493	6,980
Transfers of funds	1,021,000	1,328,000	1,662,313
U.S. Savings Bonds handled	1,314	1,322	1,301
Other Government securities handled	63,200	82,000	84,415
	Number (Thousands)		
	1968	1969	1970
Checks collected	$ 756,525	$ 804,200	$ 864,645
Noncash collection items	825	744	699
Coin counted	1,415,600	1,875,700	1,670,393
Currency counted	760,133	829,233	882,238
Transfers of funds	505	574	632
U.S. Savings Bonds handled	28,186	28,739	27,919
Other Government securities handled	1,032	1,441	1,447

quarters but a more than offsetting decline in the turnover of dimes.

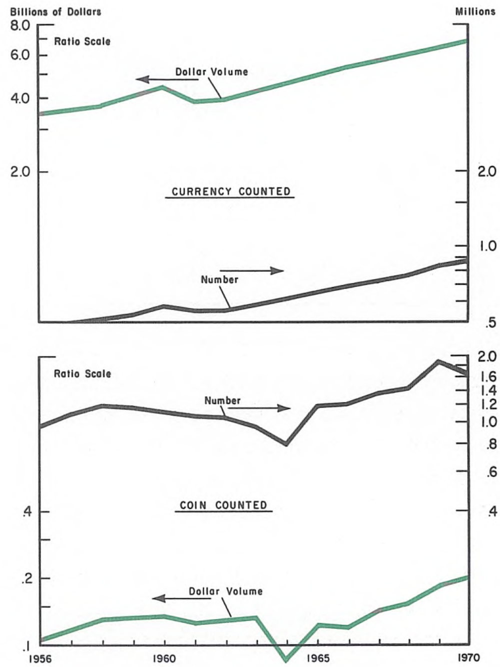
The San Francisco Bank expanded its activity last year as the fiscal agent for the Federal Government. In this function, it issues and receives government securities, and administers tax-and-loan accounts for District commercial banks.

Record high yields—and the publicity surrounding those yields—sparked the interest of small investors in U.S. Treasury bills throughout 1969 and early 1970. At the January 12 auction, for example, 5,384 subscribers entered tenders for $131 million on a noncompetitive basis with the Reserve Bank, in contrast to 1,274 tenders and $47 million for the comparable weekly offering a year earlier.

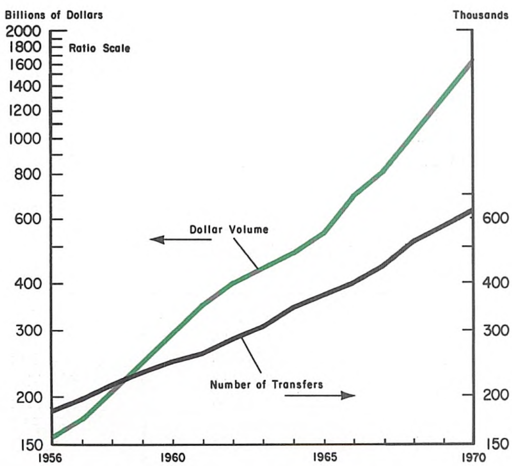
With the number of subscriptions for the minimum $1,000 denomination increasing at every auction during January and February, the Treasury's cost of borrowing continued to mount also. When the Treasury raised the minimum to $10,000 in early March, public participation almost immediately declined. But the $1,000 minimum was retained for new issues of Treasury notes, and the public responded enthusiastically to three cash offerings during the year.

Despite the unusual activity in Government securities during 1970, the total value of marketable issues handled increased only moderately (3 percent). A decline in the number of pieces exchanged or transferred reflected the effect of new book-entry procedures, while an increase in redemptions reflected the run-off of the large volume of Treasury bills purchased by the public in 1969 and early 1970. The number of securities redeemed was up 22 percent over 1969 but the dollar volume was off 2 percent, because of the large number of small-denomination issues purchased by the public that were redeemed as they matured.

Despite sluggish economy, coin and currency operations generally rise



Telegraphic transfers of funds expand sharply during 1970

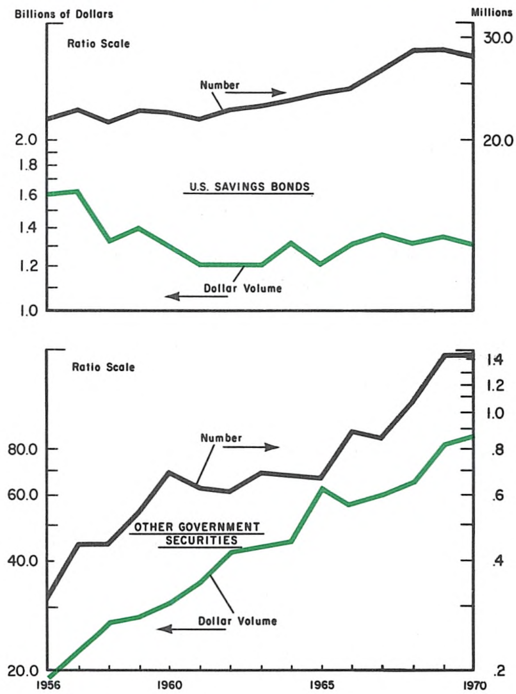


The redemption of savings bonds exceeded new sales in District states by a wide margin again in 1970. Consequently, in order to increase the competitive attractiveness of savings bonds, the Treasury boosted the rate to 5½ percent in August, retroactive to June 1. The sale of savings notes (commonly known as Freedom Shares) was discontinued at midyear.

The volume of food stamps processed by the Reserve Bank mushroomed in 1970, as additional counties in the District entered this program sponsored by the U.S. Department of Agriculture. The Bank's five offices handled 222 million stamps valued at $311 million—in both cases, about a 150-percent increase for the year.

In its continuing supervisory function, the Reserve Bank staff examined all state-chartered member banks and their trust departments during 1970. These included 31 banks, 270 branch offices, and 31 trust departments located in California, Idaho, Nevada, Utah, and Washington. The staff also examined eight foreign-bank corporations headquartered in District states.

Fiscal operations center around marketable securities in early 1970



COMPARATIVE STATEMENT OF CONDITION
(Thousands of dollars)

	December 31, 1968	December 31, 1969	December 31, 1970
ASSETS			
Gold certificate reserves	$ 1,286,391	$ 1,639,536	$ 1,046,032
Special drawing rights certificates	—0—	—0—	49,000
Federal Reserve notes of other banks	106,948	102,147	112,833
Other cash	22,756	19,016	31,811
Discounts and advances	7,000	700	—0—
Total U.S. Government securities	7,694,527	7,925,956	8,769,102
Uncollected items	908,061	977,154	1,333,179
Bank premises	8,741	8,736	8,299
Other assets	340,492	324,689	109,554
Total assets	$10,374,916	$10,997,935	$11,459,810
LIABILITIES AND CAPITAL ACCOUNTS			
Federal Reserve Notes	$ 5,656,691	$ 5,950,144	$ 6,237,354
Deposits:			
Member banks—reserve accounts	3,656,371	3,780,382	3,814,259
U.S. Treasury—general account	1,706	118,043	130,108
Foreign	29,040	17,550	16,250
Other deposits	78,455	66,350	70,833
Deferred availability cash items	727,077	807,268	929,587
Other liabilities	56,081	84,283	84,652
Total capital accounts	169,495	173,914	176,766
Total liabilities and capital accounts	$10,374,916	$10,997,935	$11,459,810

At the close of 1970, total assets of the Federal Reserve Bank of San Francisco approached $11.5 billion, compared with $11.0 billion at the end of 1969. This increase reflected the Bank's larger holdings of Government securities in the Federal Reserve System's open-market account, offset in part by reductions in several other asset items. For example, discounts and advances declined, and the gold-certificate account also declined; a small part of the latter represented a transfer of funds to the new account for Special Drawing Rights.

The Bank's total current earnings rose from $474 million in 1969 to $536 million in 1970, mostly because of a $74-million increase (to $524 million) in earnings on the Government-securities account. The Bank's share of securities in the System's open-market account amounted to $8.8 billion at year-end, or 14 percent of total System holdings. The average yield on those securities reached 6.48 percent—up from 5.89 percent in 1969.

The Bank's net expenses rose from $28 million to $31 million during the year, primarily because of a slightly larger staff and higher salaries and benefits. Dividends of $5 million were paid to member banks, and over $1 million was transferred to surplus to bring this to the level of paid-in capital stock. Remaining net earnings of almost $500 million were paid to the U.S. Treasury as interest on Federal Reserve notes, for a $60-million increase over the 1969 figure.

Donald Alexander

COMPARATIVE PROFIT AND LOSS STATEMENT
(Thousands of dollars)

	1968	1969	1970
Total earnings	$ 390,669	$ 474,309	$ 535,554
Net expenses	24,594	27,666	30,705
Current net earnings	366,075	446,643	504,849
Net addition (+) or deductions (−)	+1,131	−26	+1,501
Distribution of net earnings:			
Net earnings before payments to U.S. Treasury	367,206	446,617	506,349
Dividends	4,889	5,146	5,241
Interest on Federal Reserve notes	356,754	439,261	499,683
Transferred to surplus	5,563	2,210	1,426
Total	367,206	446,617	506,349

Publication Staff: Karen Rusk, Editorial Assistant; Janis Wilson, Artwork.

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Farm Prospects in '71

Optimism was somewhat lacking at the U.S. Department of Agriculture's annual outlook conference this February, at least in part because of the general belief that net farm income might decline again in 1971, for the second year in a row. Perhaps to emphasize this point, the "Poor People's Ad Hoc Committee on Rural Poverty" staged a demonstration at the meeting to call the conferees' attention to the problems of the rural poor. But other farmers, too, were having problems.

Net income of Western farmers dropped 3 percent in 1970 to below $1.9 billion. Elsewhere in the nation, net income declined 2 percent to $14.0 billion. Despite a drop in the number of farms, net income per farm also fell in both the West and the nation as a whole, as all District states except Oregon, Nevada, and Hawaii suffered declines.

Receipts rise, but net declines

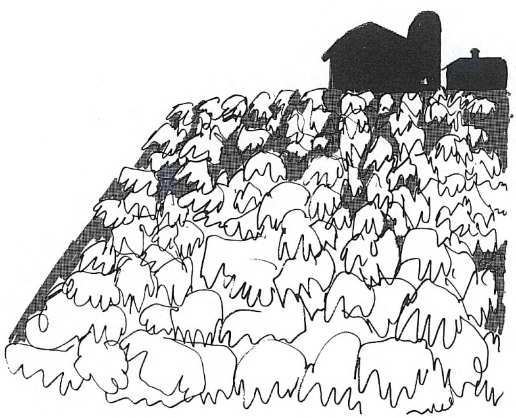
Western producers in 1970 posted a 1-percent increase in crop marketing receipts, to $4.1 billion, and a 4-percent gain in livestock receipts, to $3.3 billion. Farmers elsewhere recorded a 5-percent increase in crop receipts, to $15.5 billion, and a 2-percent gain in livestock receipts, to $25.8 billion. Western producers, unlike their counterparts elsewhere, sharply reduced the physical output of both crops and livestock. Despite this, they managed to boost their marketing receipts because of rising crop prices and a second straight year of high red-meat prices.

Net income nonetheless declined because of a continuation of the long-run uptrend in farm production expenses. Last year, expenses rose about 6 percent in the West and 5 percent elsewhere, roughly in line with the trend of the past decade. Production outlays continued to account for a larger proportion of gross income in the West than elsewhere because large-scale Western farming requires greater reliance on nonfarm inputs such as hired labor.

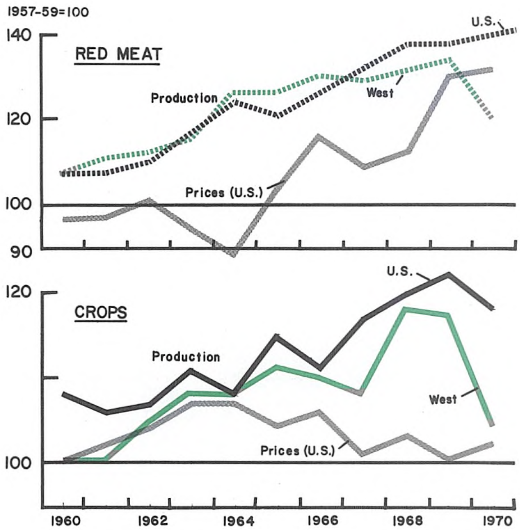
Higher demand, higher prices

For 1971, the U.S. Department of Agriculture foresees a strengthening of domestic demand for farm products, on the basis of rising population and per capita income as well as an expansion of various food-distribution programs. Moreover, the USDA envisions an increase in export demand, because of the general expansion of foreign economies as well as developing shortages of cotton and food and feed grains in some overseas markets.

USDA analysts also see a continued rise in retail food prices, although perhaps not so great as last year's 5½-percent increase. Their expecta-



Westerners cut output, but benefit from rising crop and livestock prices



tion is for some weakness in farm prices but for an offsetting increase in marketing margins. A slowdown in retail prices may be unlikely, as marketing margins are not very responsive to price reductions at the farm level. For example, the farm value of the food market basket dropped 8½ percent between late 1969 and late 1970, but retail prices continued to rise, reflecting higher costs of packaging, plus greater-than-productivity increases in marketing employees' wages.

Gross farm income nationally is expected to set a new record in 1971, as an increase in crop marketing receipts more than offsets a decline in government payments. An expansion in crop output is anticipated, plus some advance in prices consequent to the recent reduction in carryover stocks.

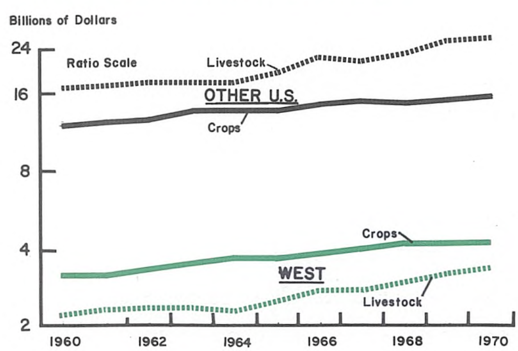
According to the March survey of planting intentions, farmers nationally will have 4 percent more acreage in production than a year ago. Among other things, farmers are now planting considerably more spring-wheat acreage than had been expected earlier in the year. Thus, if marketing conditions remain strong, the continued expansion in acreage may alter the USDA's earlier forecast of a 1971 decline in farm income. Meanwhile, livestock receipts are expected to hold near the record 1970 level.

Mixed picture for the West

Western farmers expect a smaller gain in crop receipts than their national counterparts, partly because of a smaller (3 percent) anticipated increase in crop acreage, and partly because of the difference in structure between the regional and national farm economies. On the national scene, increased output and higher prices are expected for feed grains, soybeans, and wheat—but wheat is the only one of those crops that plays a prominent part in the Western economy.

In this region, the production of field crops should exceed the year-ago level. A modest increase is expected in acreage planted to wheat, judging from plantings of winter wheat and planting intentions for the spring-wheat crop. (Last year's sharp increase in wheat production by California farmers, undertaken to make up for a feed deficiency, will probably not be repeated this year.) A 7-percent increase is now expected in cotton acreage—contrary to January planting reports—as anticipated strength in the export market more than offsets the cutbacks planned by some large farmers because of the new ceilings on government payments to individual producers.

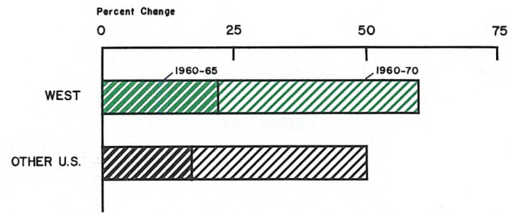
Westerners post stronger gain in livestock than in crop receipts



In addition, Western farm receipts should be boosted because of a projected increase in the output of deciduous fruits—especially grapes, pears, and apricots. Also, there may be a modest increase in output of canning tomatoes, despite heavy inventories of tomato products. But cling-peach producers may limit their individual harvests, because of a large carryover from the 1970 canning pack and large supplies of fruit coming from new acreage.

The marketing of Western livestock and livestock products should rise modestly in 1971. The number of cattle on feed is about the same as a year earlier, but prices are now substantially higher than before. In addition, beef prices should be bolstered later in the year as the nation's supply of pork products declines. Cash receipts should also be boosted if the anticipated increase occurs in the production of milk, eggs, and turkeys—all important Western products.

Production expenses rise faster in West than elsewhere



On the basis of the trends outlined above, marketing receipts of Western farmers should expand in line with the national increase. Moreover, net income may match the 1970 level, despite the USDA's original forecast of a decline, if the advance in production expenses is kept within bounds.

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