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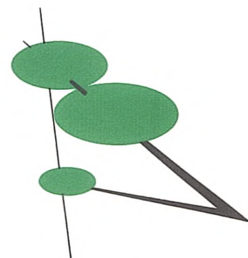

May 1971

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Variable Spring

. . . A variety of statistics mirrored the diversity in the nation's economic situation during the early spring months.

Variable Statistics

. . . The business upswing was somewhat stronger in the West than elsewhere in early '71, with the crucial exception of aerospace.

Inundated with Savings

. . . Deluged with savings flows, Western banks intensified their search for new investment and lending outlets early in the year.

Editor: **William Burke**

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Variable Spring

THE ECONOMY showed definite signs of life in early spring, but each individual's assessment of the outlook depended upon his own vantage point. A broker on Wall Street, after watching demand soar in the midst of the sharpest stock-market recovery in history, naturally waxed optimistic even in the face of the market's May correction, but the aerospace engineer in Seattle, after watching the jobless rolls lengthen as demand sagged further for his industry's products, tended to see the world in a somewhat different perspective. And foreign bankers meanwhile viewed the American scene with completely different eyes, as the May financial crisis demonstrated.

Recent statistics mirrored the nation's diverse situation. GNP bounced back after the strike-beset fourth quarter, and price indexes in the first quarter showed some signs of deceleration. Yet despite the stimulus afforded by the year-long easing of monetary and fiscal policy, significant amounts of resources remained unemployed in early 1971. The jobless rate hovered close to six percent in the January-March period, just as it had in the preceding three-month period, and manufacturers continued to utilize less than three-fourths of their total capacity.

GNP increased by $31 billion to an annual rate of $1,021 billion—a 13.1-percent annual gain, or 7.5 percent after adjustment for rising prices. Roughly two-thirds of the quarterly advance was attributable to the recovery from the fourth-quarter auto strike, but the expansion also received solid support from residential construction and state-and-local government spending. The overall GNP price deflator rose at a 5.6-percent annual rate in the January-March period, as against the preceding quarter's 5.9-percent increase, and the rise in the deflator for the private sector of the economy was held to 4.8 percent, down from the preceding period's 5.8-percent increase.

Turnaround in defense?

In the government sector of GNP, total Federal purchases moved sideways in the first quarter at a $98-billion annual rate, with the defense component continuing to edge down to $74 billion. State-and-local government purchases meanwhile jumped more than $5 billion to a $130-billion rate; despite the fiscal squeeze, there was a speed-up in the growth of payrolls, and because of the monetary ease, bond flotations increased and provided a base for increased local-government spending on construction.

A turnaround in defense spending can be expected on the basis of a series of pay increases for military and civilian personnel over the past several years. Pay raises added $1 billion to fiscal 1970 expenditures, and will add almost $3 billion to the fiscal 1971 total and over $5 billion to fiscal 1972 spending, even without making allowance for higher pay scales included in recent House legislation. Exclusive of these, defense purchases will drop significantly in both fiscal 1971 and fiscal 1972.

Total obligational authority—an important indicator of future defense spending—should

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grow by $4 billion in fiscal 1972, partly because of a rise in research-and-development expenditures, but mostly because of heavy pay increases, including those related to the creation of an all-volunteer army. But it is still questionable whether this turnaround in allocation of funds will dampen the three-year-old decline in defense-related employment, which has now dropped more than 20 percent from the peak of 8 million reached in fiscal 1968.

Rebound in investment?

Business fixed-investment spending rebounded by $4 billion in the January-March period, to a $105-billion annual rate. Much of that recent strength was due to auto and truck purchases which had been postponed from the strike-affected fourth quarter, but spending on structures also rose strongly to a new high.

For this year as a whole, manufacturers plan much less spending than in 1970, with a significant turndown in the current half-year, but with a 2-percent rise in spending expected between the first and second halves. This increase at first glance seems surprising, in view of the recently depressed levels of capacity utilization. However, businessmen expect to see soon an increase in their cash flow, not only because of hopes for continuation of the brighter (pre-depreciation) profits picture, linked to the recent improvement in sales, but also because of the proposed liberalization of depreciation rules.

Public utilities meanwhile plan a sharp 17½-percent increase in spending this year, on the heels of consecutive 13-percent increases in the last two years. The severe strains on capacity that have developed over the last several years have helped create substantial spending programs in this sector. In fact, the carry-over from on-going projects amounts to almost two years' work at the recent pace of spending by various types of utilities.

Business firms expanded inventories by not much over $1 billion in the first quarter of 1971, despite the sharp build-up in producer stocks of autos and steel. There may even have been a net liquidation in some industries where demand has recently accelerated, such as home goods, textiles and tires.

Despite heavy hedge-buying of steel, deliveries got off to a slow start this year. Mills shipped out about 8 million tons on the average in each month of the January-March period, but imports also added substantially to this flow. During the April-July period, perhaps 10 million tons will be shipped each month. Such a level of shipments would exceed that recorded during the 1968 peak of stockpiling activity and would press hard against the practical shipping capacity of the industry. After August 1, however, there will be a steep fall-off in steel buying, either through a strike or through deliberate liquidation of customers' excess inventories.

Boom in housing?

The rapid recovery of homebuilding from the year-ago low point continued in the first quarter with almost a $4-billion rise to a $36-billion annual rate. New housing starts matched the preceding quarter's figure at 1.8 million units (annual rate), and building activity remained strong during April.

The slow pace of building in several previous years had pushed vacancies so low as to create a notable backlog of demand for new housing. But fortunately, the supply of mortgage funds was exceptionally large in recent months, with inflows to thrift institutions exceptionally large. As lenders' liquidity positions were replenished in this fashion, mortgage commitments more than doubled over the past year, to $6.4 billion this March. In this situation, mortgage yields have dropped more than a full percentage point since last summer, thus helping to accommodate the pent-up demand for new housing.

Upsurge in consumption?

Consumer durable-goods spending in the first quarter jumped $12 billion, to a $97-billion annual rate, following the sharp decline asso-

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ciated with last fall's auto strike. New car sales through April ran at a respectable 10-million rate, but $1\frac{1}{2}$ million of that total came from sales of imports. Altogether, imports and domestic compacts and sub-compacts made up about one-third of all the cars sold in recent months.

Auto inventory rebuilding helped to boost output somewhat in early 1971, but inventories recently reached 1.7 million units, roughly equal to last spring's level. Thus, auto production may not get much more stimulus from a further build-up of stocks. Indeed, the effective level of existing auto inventories is even higher than it was a year ago, in view of the decision of some producers to dispense with the traditional model change this summer. Perhaps reflecting this factor, auto assemblies in April were 8 percent below the March level.

Consumer spending for nondurable goods rose only $1 billion during the first quarter, to a $273-billion rate, but spending for services rose at a typical $6-billion pace to $276 billion. Along with the ongoing wage inflation, the past year's economic-policy actions have contributed substantially to the consumer-spending figures. During 1970, personal after-tax incomes rose sharply because of the termination of the Federal surtax and the increases in social-security benefits and Federal payrolls. During 1971, similar boosts are occurring because of several tax changes, including increases in the personal exemption and the standard deduction, as well as further hikes in social-security benefits and Federal pay.

Consumers saved 7.3 percent of their disposable income in 1970, and they almost matched that figure in the first quarter of this year. (Given a more "normal" 6-percent rate, they would spend roughly $10 billion more annually than they have actually done.) The high savings rate has been associated with a sharp increase in consumer liquid assets; these increased by 10 percent over the past year, as against a 3-percent increase in the preceding twelve-month period. If past behavior is any guide, rising strength in discretionary outlays should be observable shortly, thereby contributing a needed push to the economic system.

Employment vs. prices

The jobless rate averaged 5.9 percent in the first quarter of 1971, the same as in the preceding three-month period, and the rate edged up further in April. Part of the problem is attributable to a 6.5-percent decline in manufacturing employment over the past year, which more than offset the modest increases posted by other sectors of the national economy.

Since the economy turned sluggish about two years ago, the relative increase in unemployment has been greatest among adult men—a group which normally has a very stable attachment to the labor force. Over the past two years, the number of adult men as a percentage of the total number of unemployed rose from 39 to $47\frac{1}{2}$ percent. The first-quarter jobless rate for adult men, 4.2 percent, was considerably below the overall unemployment rate, but this still represented a quite high rate for this key group.

On the brighter side, the early 1971 statistics signaled some progress on the inflation front. Aside from the modest improvement in the broadest price index—the GNP deflator—consumer prices in the first quarter rose at only a

Unemployment increases most sharply among adult men

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2.7-percent annual rate, in contrast to 1970's average 5.5-percent increase, and wholesale industrial prices rose at a 2.9-percent rate, as against last year's 3.7-percent increase.

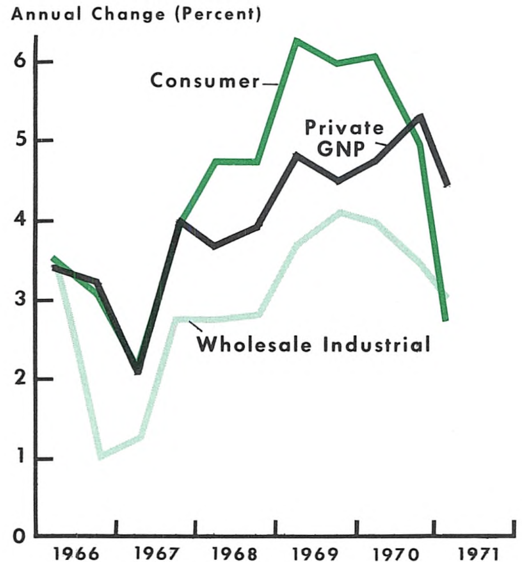
The price trend accelerated again in April, however, and further worrisome surprises may be in store. Food prices, after a relatively modest increase in 1970, rose somewhat faster in the first four months of this year, reflecting sharp gains recently in the wholesale sector. Besides, the price index for consumer services could again rise sharply in the absence of further dampening from a recently falling component, mortgage interest rates. For industrial goods at wholesale, the recent run-up in lumber and copper prices may have moderated, but the already worrisome price trend in steel (especially evident in May) threatens to be accentuated by wage pressures on that industry.

Wages vs. productivity

In that regard, a heavy collective-bargaining schedule is being played out this year, with negotiations in major contracts affecting 4.8 million workers—slightly below the 1970 figure, but far above the average figure for the 1960's. Besides, large wage gains are already effective on the basis of earlier contract agreements; deferred increases average 7.8 percent this year as against 5.6 percent last year. The bargaining schedule is highlighted by the negotiations in steel, where an industry beset by intensive foreign competition meets head-on a union that has fallen behind the wage pace of other unions, and which hopes to catch up by at least matching the 9-percent average annual increase it gained from the can industry early this year.

Policymakers hope for productivity increases this year which will offset the rise in unit labor costs associated with higher wage bargains. The long-term trend in output per manhour in the private sector of the economy has been 3.1 percent a year, but for each of the last two years the increase was less than 1 percent. But then, early '71 came in with a 5-percent increase, reflecting a cyclical improvement as well as a rebound from the strike-distorted fourth quarter of 1970. The earlier weakness in productivity reflected businessmen's reluctance to reduce payrolls, even in the face of declining output, because of difficulties experienced in the earlier period of labor scarcity. But the recent improvement, like the ones recorded in the 1958 and 1961 upturns, demonstrates the effect of a smaller work force turning out a larger amount of output. When firms get more output from their labor and equipment, upward cost pressures resulting from higher wage rates and material costs are at least partially offset, and pressures on the price level are thereby reduced.

Early '71 statistics signal slowdown in price inflation



Because of the continuing inflationary problem, the Council of Economic Advisers recently issued several stern warnings in its third "inflation alert." The report indicated worries about construction wages, lumber prices, and transport costs—including a 48-percent hike in New York taxi fares—but it concentrated most of its fire

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on the steel industry. It urged the industry to resist the temptation for substantial price boosts during the present period of heavy hedge-buying, and it said that wage settlements in excess of productivity increases would cause further deterioration of steel's competitive position at home and abroad.

How much fiscal stimulus?

In view of the basic problem of a sluggish economy, the Administration submitted a budget which estimated an $11-billion deficit in calendar 1971, the same as in calendar year 1970, with expenditures and receipts both rising by about $17 billion (national-income accounts basis). But this assumed a faster growth of GNP (and of tax receipts) than most observers expect. On top of that, the pattern of receipts and expenditures has already been overtaken by Congressional actions. Thus, the economy has now been stimulated through a significant shift in the "full employment" budget in the direction of deficit, which should provide additional stimulus to economic activity. Originally, this hypothetical measure would have yielded a substantial (restraining) surplus on the national-accounts basis.

Already about $3.5 billion in changes have been made in the original budget figures. These came about because of a 10-percent rise in social-security benefits (instead of the 6-percent rise originally planned), a postponement to January 1972 of the increase in the range of wages subject to social-security taxes, and the Administration's proposed extension of liberalized depreciation rules to more industries than had previously been contemplated.

For businessmen, the impact of the new depreciation rules shows up in higher capital consumption allowances and lower profits on the books, and thus lower tax liabilities. In calendar 1971, roughly $4.6 billion should be involved in higher capital consumption allowances, and the drop in corporate tax liabilities should reach over $2 billion with no real change in the effective tax rate. However, critics claim that the revised rules would cause a permanent revenue loss to the Government while providing little economic stimulus, and their criticisms may yet have some effect on the final shape of the regulations.

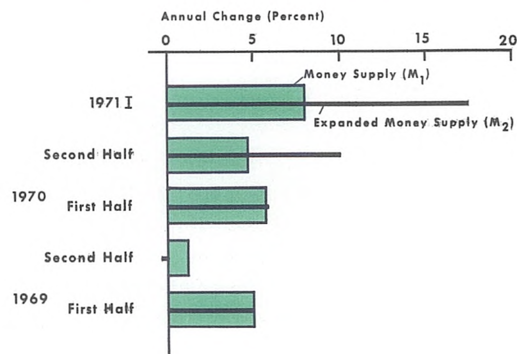
Fiscal analysts realize that the recovery now in progress, while real enough, is hardly spectacular, so they have been proposing ways of bridging the gap between actual and potential GNP. Proposals include restoring the 7-percent investment-tax credit, raising social-security benefits again, deferring further the intended rise in the social-security tax base—and advancing to this year the effective date of some tax-relief measures scheduled for 1972 and 1973. About $4.5 billion would be made available to the private spending stream simply by pushing forward these tax changes into 1971.

How much monetary stimulus?

Monetary policy, like fiscal policy, assisted in the expansion of early 1971, although officials remained mindful of the need to avoid excessive monetary ease. The Federal Open Market Committee in January voted to "promote accommodative conditions in credit markets and moderate expansion in monetary and credit aggregates," and its February meeting reflected a similar policy stance.

As it turned out, the money supply (currency plus demand deposits) increased at an 8.9-per-

Growth in money supply supports economic expansion



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cent annual rate in the first quarter, as against the 5.4-percent average growth of 1970 and the 3.4-percent fourth-quarter rise. The broader version of the money supply (currency plus private deposits except large CD's) grew at a 17.8-percent rate in the first quarter as against 1970's 8.2-percent average rate, and an even broader version which includes deposits of thrift institutions grew at a slightly faster rate in recent months.

Interest rates fell precipitously early in the year, as they had in late 1970, but rates then stiffened in the early spring months, mostly in the short-term sector, as the monetary authorities moved to constrain the growth in the monetary aggregates. Policymakers tried to support rates on short-term funds—those most likely to flow abroad for higher yields—while trying to hold long-term rates down to help encourage the domestic economic recovery. (The operation was reminiscent of the "Operation Twist" of a decade ago.) The Federal Reserve tailored its open-market purchases to longer Treasury issues, while the Treasury emphasized the issuance of short-term debt.

As an example of this approach, the Treasury in its $8.4-billion refunding of late April offered a new 5-percent 15-month note and reopened a 5¾-percent 3½-year note on a discount basis to yield 5.88 percent. In an effort to avoid upward pressures on long-term rates, the Treasury did not exercise its new authority to issue up to $10 billion in bonds outside the 4¼-percent rate ceiling.

Turning upward

In most sectors of the market, rates turned upward again in March (corporate bonds in February). For example, the three-month Treasury bill rate, which had approached 8 percent not much more than a year ago, fell to 3.31 percent in late March and then rose to 4.04 percent within a month's time. The headlines were garnered, however, by the late-April increase, from 5¼ to 5½ percent, in most banks' prime business-loan rate, which reversed a series of early-year declines. The rise reflected a considerable prior increase in short-term market rates.

Many banks raised their prime rate despite a very low level of bank-loan demand. The sluggishness in demand largely reflected the heavy corporate payoff of bank loans with funds obtained through the recent record volume of corporate-bond financing. Meanwhile, faced with substantial deposit inflows and sluggish loan demands, the banks sharply boosted their holdings of securities, especially municipal bonds, thereby accepting a lesser increase in liquidity in order to obtain better earnings.

The recent run-up in rates does not forestall further declines in long-term yields, especially if any let-up occurs in the surging volume of corporate and municipal bond flotations. Nonetheless, the firming in short-term rates has had one favorable aspect, helping to stem the undesirable outflow of short-term capital abroad. This outflow is centered in the repayment by U.S. banks of Eurodollars, obtained primarily from their foreign branches. After a massive increase in Eurodollar borrowing in 1969, a rapid reversal developed as U.S. short-term rates declined in 1970 and early 1971.

Returning overseas

In the first three months of this year, outstanding liabilities to foreign branches—including holdings of special Export-Import Bank securities—dropped from about $7½ billion to about $4½ billion. Previously, banks had generally found it worthwhile to hold large amounts of these liabilities as a reserve-free base for Eurodollar borrowings under Federal Reserve regulations. But with the progressive decline in short-term rates in this country, banks now found that they could no longer afford to pay the differential cost of funds—roughly 1 percent—and so began to pay down substantial amounts of liabilities.

The troubing aspect of this development has been the tendency for repayments of Eurodollar

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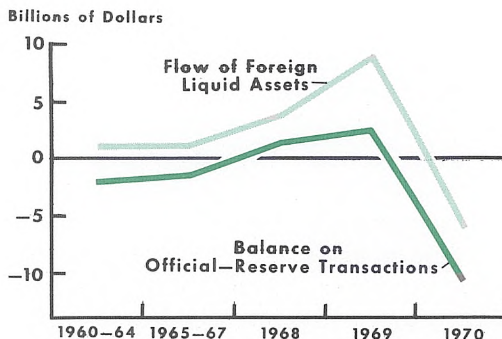
borrowings by U.S. banks to wind up in foreign central banks, thus deepening the deficit in the U.S. balance of payments as measured by the official-settlements basis. In 1970 the deficit was $10.7 billion, and more than half of the total reflected reductions in foreign commercial-bank holdings of liquid dollar balances in the U.S.

In an attempt to avoid further foreign official accumulation of dollars, the Export-Import Bank in January and March sold altogether $1.5 billion of notes to foreign branches of U.S. banks, and the Treasury in April offered $1.5 billion in 3-month certificates to these foreign branches. The 5⅜-percent rate on the new Treasury notes was the prevailing quotation in London for Eurodollars of the same maturity, but it was 1⅔ percent more than the cost of Treasury bills at home. However, advocates of this move suggest that the high cost of financing abroad is a small price to pay for helping restore stability to the international monetary mechanism.

Despite these actions, speculative pressures in the foreign exchanges intensified in early May. In West Germany, the Bundesbank took into its reserves several billions of dollars on May 4 and 5, but thereafter suspended its support purchases of dollars, in effect allowing the mark to "float" to a new higher level. Many observers expect that West Germany will ultimately peg the mark at a new and higher parity, as it did after a temporary float in the fall of 1969, but German authorities have indicated their intention to return to the old parity once the speculative surge subsides. The U.S. Treasury, on its side, has announced its readiness to cope with the international problem by issuing more special securities to soak up Eurodollars from the private market and to absorb dollars from foreign central banks.

Deepening deficit reflects shift in Eurodollar flows



On the domestic scene, the search for prosperity in this variable spring of 1971 has become the nation's chief concern, and patience with any gradual response is wearing somewhat thin. With monetary policy already providing ample liquidity, the spotlight is now on fiscal policy. After midyear, says President Nixon, "If this economy is not moving as fast as it should, we will act on the tax front and other fronts."

William Burke

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Variable Statistics

THE ECONOMIC upswing was somewhat stronger in the West than in the rest of the nation in the first quarter of 1971. Nonfarm employment rose at a 3.5-percent annual rate to 10.5 million—about half again the rate of gain elsewhere—as the weakness apparent in many industries during the second half of 1970 began to disappear. One major exception was the crucial aerospace industry, which for the tenth consecutive quarter laid off a substantial number of employees. Most other industries recorded a moderate expansion, and construction and government, both of which suffered employment declines in the second half of last year, bounced back rapidly in early 1971.

Jobless scene—improved?

The unemployment statistics also improved somewhat in recent months, although they still presented a bleak picture in many Western localities. The jobless rate in Twelfth District states dropped from 7.1 to 6.9 percent during the first quarter, whereas the rate increased from 5.6 to 5.8 percent in the rest of the nation. (The statistics worsened again in April, however.) The regional jobless rate thus remained a full percentage point above the national average, just as it has throughout most of the last half-decade.

In March, unemployment rates continued high in Southern California aerospace centers; San Diego had 6.7 percent unemployment and both Los Angeles-Long Beach and Orange County posted 7.5-percent jobless rates. (A year ago, the rate in each of these communities was below 5 percent.) In Seattle, which a year ago had the same unemployment rate as Los Angeles does now, the jobless rate was 12.9 percent in the first quarter. In contrast, the San Francisco-Oakland area, with its more diverse economy, continued to post a rate in line with the national average.

Aerospace—further cutbacks?

The prolonged decline in the regional aerospace industry continued in early 1971, as employment dropped to 532,000. At that level, the industry has lost 30 percent of its entire work force over the last three years. The industry suffered several sharp blows in recent months. For Boeing in Seattle, it was the Congressional rejection of further Federal funding for the supersonic transport; for Lockheed in Southern California, it was the flat $200-million loss on the C5A transport contract and the questionable future of the L1011 airbus because of the bankruptcy of its engine supplier.

Some further cutbacks in employment may be in store (especially in Washington), reflecting such things as a 15-percent drop during 1970 in the national total of aircraft-industry backlogs. On the more favorable side, the regional industry is banking on a continuation of the late-1970 upturn in defense contract awards. In support of such optimism, President Nixon promised that "California and the Pacific Northwest will get special consideration" when he held his recent press conference at the Western White House. Still, it will be some time before aerospace regains its normal one-third share of the West's manufacturing industry; today, it accounts for only one-fourth of total manufacturing jobs.

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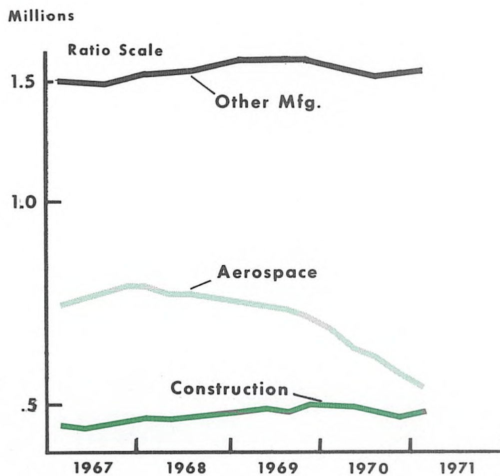
Aerospace slump continues, but other industries post gains



Boom in housing?

In construction, housing starts in the West jumped 13 percent in the first quarter to a record 450,000-unit annual rate, reflecting the high level of permits issued in District states in late 1970 and early 1971. The recent pace of homebuilding contrasted with the slight decline recorded elsewhere, and was above the peak figure reached at the crest of the Western housing boom in 1963. All states except Alaska and Hawaii recently reported gains above a year ago, despite weakness in Seattle and some Southern California communities.

Nonresidential and heavy construction activity rose modestly in District states in the first quarter, but fell behind the national pace in doing so. (In these sectors, activity also lagged considerably behind the region's early 1970 pace.) Virtually all of the recent gain represented a heavy volume of contracts for hydroelectric facilities in Oregon. In other Western states, the drop in nonresidential and heavy construction more than offset the rise in residential building.

In response to the nationwide upsurge in homebuilding, orders for Western lumber and plywood grew sharply early in the year, but then (somewhat surprisingly) showed little strength in the spring buying season. Prices rose sharply during the early-1971 order upsurge; in March, softwood lumber prices were 19 percent above a year ago and softwood plywood prices up 27 percent. Fearing a price upsurge similar to the one that occurred in the severe 1968-69 episode, the Council of Economic Advisers launched an investigation into lumber prices in mid-March. The Council suspected that other factors were at work besides the recent upturn in housing activity, such as a shortage of railroad cars and speculation in wood products. Yet whatever factors were involved, the price upsurge proved rather short-lived. In late March and April, the order inflow slowed down and prices reacted accordingly.

Trend in extractive industries?

Western steel production lagged about 5 percent below the year-ago pace, reflecting the regional slowdown in nonresidential construction. In contrast, steel production elsewhere ran ahead of the 1970 pace, because of both post-strike buying by the auto industry and anticipatory pre-strike purchasing by major steel users. By early May, the strong demand for steel throughout most of the country encouraged steelmakers to raise prices by 5 to 9 percent on products accounting for roughly four-fifths of total industry shipments.

Pacific Northwest aluminum plants continued to operate at less than full capacity as shipments lagged behind the year-ago pace. List prices remained unchanged throughout the January-April period, but widespread discounting was prevalent throughout the industry.

Copper prices declined early in the year, but then turned upward again in later months. In mid-January, domestic producers lowered the price of refined copper from 53 to 50⅜ cents per pound, about 15 percent below last September's peak. In late March, however, as prices shot upward in world markets, these producers boosted the price back up to 52¾ cents per

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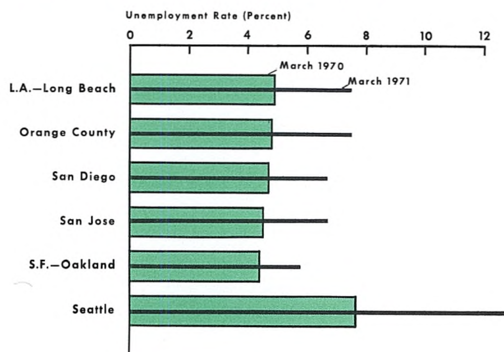
pound, because of hedge-buying in anticipation of a strike in U.S. copper facilities this summer, and also because of production problems arising from the nationalization of Chilean mines.

Prices of several other nonferrous metals also firmed in early spring. Domestic zinc producers, responding to increased buying by their steel-industry customers, raised prices by ½ cent a pound in late March, thereby returning the price of prime Western-grade zinc to the 15-cent level which had prevailed until last summer. Similarly, improvement in silver demand helped to boost the price of silver in the New York market from a low of $1.57 an ounce in late February to almost $1.74 an ounce in early April.

Petroleum refining activity during the first quarter increased slightly from a year earlier. However, output of crude petroleum from District sources declined somewhat, leading to a year-to-year increase in imports of foreign oil. Meanwhile, access to California offshore supplies was held back by state and Federal restrictions on drilling and geophysical activity. In addition, legal restrictions stemming from conservationist opposition and native land claims continued to delay construction of a pipeline to move crude oil from Alaska's North Slope to domestic markets; even if pipeline construction is authorized, three years or more may elapse before supplies flow to domestic markets.

In Western agriculture, meanwhile, farm receipts during the first quarter of 1971 were 2 percent higher than a year earlier, as against a 3-percent decline in the rest of the country. Livestock receipts were maintained at the 1970 level in the District, while dropping 5 percent elsewhere in the nation; sharply lower pork prices had little impact on Western receipts, as hog marketings are relatively unimportant in this area. Higher crop prices, especially for fresh vegetables and citrus fruits, helped bolster District farm returns. Increased crop receipts boosted California farm returns by 5 percent, but in contrast, lower potato prices contributed to a 10-percent year-to-year decline in Idaho.

All major areas suffer rise in joblessness over past year



On balance, the Western economy improved in line with the national upturn early this year, but it remained bedeviled by the conversion problems of its major industry. According to a special Administration study of the regional economy, a resumption of rapid growth in the national economy will not resolve these problems, because of the specialized nature of the aerospace industry. The Council of Economic Advisers has proposed such solutions as providing selective increases in aerospace procurement and accelerating Federal programs in nondefense areas that utilize high-technology resources. Perhaps these are the lines along which the President's recent promise may be fulfilled.

Regional staff

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Inundated with Savings

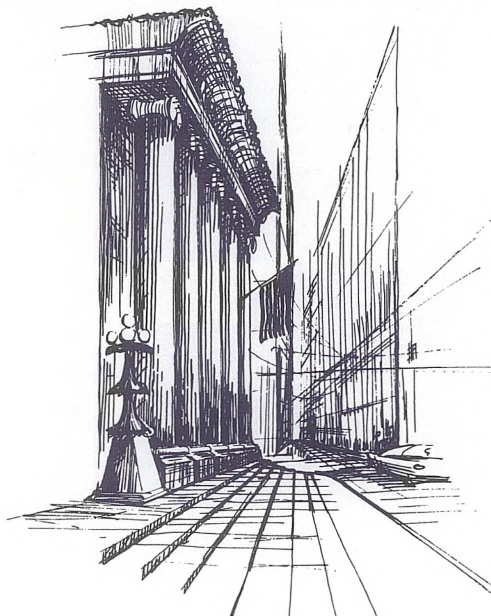
WESTERN BANKS were deluged with passbook savings in the first quarter of 1971, in sharp contrast to the pattern of outflows which prevailed a year or so ago. The inflow of time deposits accelerated in each month of the quarter, as individuals increased their savings dollars and also transferred substantial amounts to their savings accounts from maturing Treasury issues and other investments. In order to utilize these funds, banks intensified their search for new investment and lending outlets. The result was a 6-percent ($3.9 billion) rise in Western banks' total credit—a rate of increase more than double the expansion rate nationally—on the basis of a 4-percent expansion in loans and an 11-percent increase in securities. (All data seasonally adjusted.)

Regular passbook savings accounted for nearly three-fourths of the 6-percent ($2.3 billion) time-deposit increase posted by District banks during the first quarter of the year (daily-average basis). Individuals turned to this "old" form of savings instrument because of its ready accessibility, without substantial sacrifice of interest, for current needs or for other investments. However, other consumer-type time deposits also increased during this period, despite the reductions in rates which some banks posted on longer-term certificates. Large-denomination CD's increased only moderately, as a reduction in CD's issued to foreign banks and institutions partially offset increased issuance of CD's to domestic corporations. On the other hand, public time deposits registered a first-quarter decline, due to greater-than-seasonal withdrawals in March.

A small 1-percent ($233 million) rise in net demand deposits accompanied the time-deposit gain. However, the private demand-deposit component increased 3½ percent, rising steadily throughout the three-month period.

Lower costs . . . higher income

In the first three months of 1971, Western banks had to adjust to a rapidly changing rate structure, as substantial declines in money-market rates brought sharp reductions in the cost of bank funds. They paid less for their Federal-funds purchases and also for borrowing at the discount window, although they made relatively little use of the latter. As the flow of domestic deposits continued, banks further reduced their high-cost Eurodollar borrowings and cut offering rates on large-denomination CD's. In February, many banks cut rates on longer-maturity consumer-type time certificates to 5 percent.



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Later, in March, most District banks reduced the rate paid on passbook savings from 4½ to 4 percent; however, the effective date for this reduction was April 1, so that first-quarter interest expense on this rapidly expanding deposit category was left unaffected.

As the cost of funds declined, Western banks also suffered a decline in their rates of return on earning assets. During the first quarter, they reduced the prime rate on business loans five times —from 6¾ to 5¼ percent—and many also cut rates on mortgage and consumer loans. Lower yields on securities reduced the rate of return on this type of earning asset as well. However, bank portfolios still contained a large carryover of loans and securities which bore the high rates of 1969 and 1970.

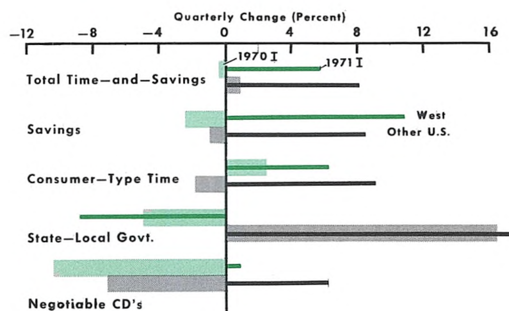
Despite all these shifts, most Western banks reported substantial year-to-year increases in both operating income and net income (after securities gains and losses). Some banks recorded sizable gains from securities trading and/or from capital gains on their own investment portfolios. On the other hand, several banks announced substantial increases in their reserves to provide for possible loan defaults, thus indicating the extent of the problems that may be faced in the later months of this year.

Unchanged reserve pressure

Because of the increase in deposits, District member banks had to maintain an additional $208 million in required reserves during the first quarter of 1971 (daily-average basis). However, pressure on reserves showed little change from fourth-quarter 1970. Daily-average borrowings from the discount window were only $11 million, and net free reserves $5 million, in each case representing little change from the levels of the preceding quarter.

During the first quarter, major District banks purchased fewer Federal funds, but also sold somewhat fewer funds to brokers and dealers, than they had in the preceding three-month period. On total Fed-funds transactions, they

District banks (and others) improve sharply on 1970 deposit performance



were net purchasers (borrowers) of $512 million —about $250 million less than in the October-December period. District banks also reduced liabilities to their foreign branches, mainly Eurodollar borrowings, but increased somewhat their borrowings under repurchase agreements with corporations and public agencies.

Expanded bank credit

District banks expanded their holdings of U.S. Government securities during the January-March period, offsetting the contra-seasonal decline in December. The increase was heavily weighted by intermediate and longer-term Treasury issues, unlike the situation in late 1970, when the emphasis had been on rebuilding short-term maturities. In early 1971, banks also continued to add substantially to their holdings of other securities, but in this case, the largest gains were in short-term municipal warrants and notes.

Total loans (less loans to banks) expanded during each month of the quarter, with March posting the largest gain. However, 40 percent of the total increase represented loans for purchasing and carrying securities, mainly loans to brokers and dealers in one-day Federal funds. Thus, basic demand for bank loans was not so strong as the data otherwise might indicate.

In the business-loan sector, public utilities were the heaviest first-quarter borrowers, but petroleum and construction firms also increased their bank debt. Transport-equipment and primary-

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metals manufacturers also increased their borrowings, but these were offset by large repayments of loans by machinery manufacturers. Nonbank financial institutions relied very heavily on bank credit in the first quarter, the 12-percent quarterly increase contrasting sharply with the 14-percent decline in the comparable year-ago period.

Consumers continued to be wary of bank debt in early 1971, although credit was both cheaper and more readily available than in the preceding year. Even the upturn in auto sales failed to result in more than a modest increase in borrowing.

Mortgage markets active

District commercial banks and savings-and-loan associations both had ample amounts of mortgage funds available in first-quarter 1971. The heavy inflows—$2.3 billion in savings and consumer-type deposits at large District banks and $2.2 billion in savings and certificate accounts at S&L's—contrasted sharply with the net losses sustained during 1970's opening quarter.

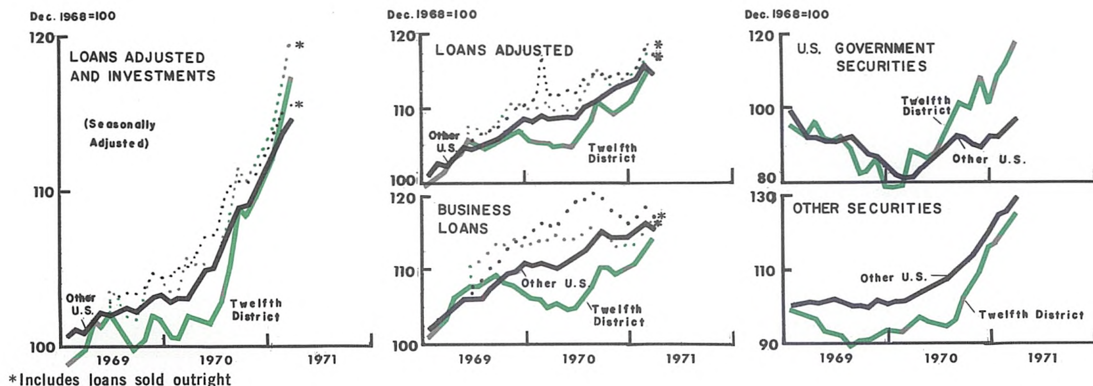
On the other side of the ledger, District banks expanded their mortgage holdings by a modest $65 million, despite efforts to boost mortgage financing, while the S&L's increased their mortgage portfolios by $872 million. The S&L's also boosted their loan commitments by more than half to a record $1,025 million at the end of March, and still had enough available to repay some $547 million in borrowings from the regional Federal Home Loan Banks.

Reflecting the increased availability of mortgage funds, lending rates continued to decline during the quarter. In the West, the average yield on a conventional new home loan dropped by 100 basis points in the January-March period, on top of the 40-basis-point decline of 1970's closing quarter. The end-March figure, 7.65 percent, was only slightly above the national average and was substantially below the West's year-ago level of 9.40 percent.

New situation?

The Western financial scene shifted as the first quarter ended, with short-term rates moving sharply upward in a reversal of the early-year decline. As Treasury-bill yields rose, banks paid more for Federal funds, and the Fed-funds rate moved considerably above 4 percent in April. Many banks raised their prime business-loan rate

District banks expand credit at double the national rate in first quarter, partly because of much faster business-loan pace



*Includes loans sold outright

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in mid-April, and others followed in early May, despite the absence of strong loan demand over the April 15 tax date.

The heavy inflow of savings deposits ended abruptly in April, as individuals made larger-than-seasonal withdrawals from their passbook savings. Unseasonally large state income-tax payments in California, where there is no income-tax withholding, were partially responsible for the large outflow. In addition, there may have been some diversion of funds into the rising stock market or into the S&L's, whose rate differential became more favorable in April after banks reduced their passbook-savings rate to 4 percent.

Ruth Wilson and Verle Johnston

SELECTED ASSET AND LIABILITY ITEMS OF WEEKLY REPORTING LARGE BANKS

Data Not Seasonally Adjusted

(Dollar amounts in millions)

	TWELFTH DISTRICT				OTHER U.S.
	Outstandings	Net Change			Net Change
	March 31, 1971	Dec. 30, 1970 to March 31, 1971		Dec. 31, 1969 to Mar. 25, 1970	Dec. 30, 1970 to Mar. 31, 1971
		Dollars	Percent	Percent	Percent
Loans Gross Adjusted[1] and Investments	56,521	+ 954	+ 1.72	— 2.69	— 1.05
Loans Gross Adjusted[1]	39,792	— 118	— 0.30	— 3.61	— 2.76
Commercial and Industrial Loans	15,351	+ 49	+ 0.32	— 4.93	— 1.04
Real Estate Loans	11,310	+ 64	+ 0.57	0	+ 0.65
Agricultural Loans	1,354	+ 23	+ 1.73	+ 0.66	— 2.25
Loans to Nonbank Financial Institutions	2,244	+ 239	+11.92	—14.12	— 5.39
Loans for Purchasing or Carrying Securities:					
To Brokers and Dealers	1,168	— 485	—29.34	— 8.76	—24.51
To Others	290	+ 71	+32.42	—15.63	— 3.88
Loans to Foreign Banks	155	— 3	— 1.90	—35.08	—18.47
Consumer Instalment Loans	5,727	+ 39	+ 0.69	— 2.49	— 1.89
All Other Loans	2,193	— 115	— 4.98	— 3.07	— 3.50
Total Investments	16,729	+1072	+ 6.85	+ 0.15	+ 3.18
U.S. Government Securities	6,250	— 83	— 1.31	— 5.09	— 0.56
Obligations of States and Political Subdivisions	8,692	+ 953	+12.31	+ 2.66	+ 4.54
Other Securities	1,787	+ 202	+12.74	+ 8.08	+12.40
Total Deposits (less cash items)	55,286	+1513	+ 2.81	— 2.92	+ 1.80
Demand Deposits Adjusted	17,799	— 147	— 0.82	— 5.76	— 7.87
Time and Savings Deposits	35,866	+1964	+ 5.79	— 0.30	+ 8.12
Savings Deposits	17,115	+1685	+10.92	— 2.40	+ 8.49
Other Time IPC	13,107	+ 678	+ 5.45	+ 2.21	+ 7.51
Deposits of States and Political Subdivisions	4,217	— 409	— 8.84	— 4.99	+17.36
(Neg. CD's $100,000 and over)	4,410	+ 41	+ 0.94	+10.53	+ 6.23
Capital Accounts	4,373	+ 152	+ 3.60	+ 0.42	+ 2.73
Total Assets/Liabilities and Capital Accounts	71,227	+2058	+ 2.98	— 4.29	+ 0.64

[1]Total Loans Minus Loans to Domestic Commercial Banks

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