Cabinet

FEDERAL RESERVE BANK OF

SAN FRANCISCO

Monthly Review

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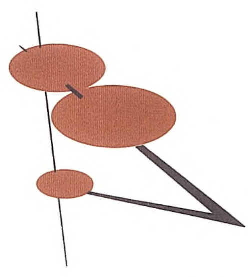


October 1971

Start of Phase II

. . . The nation's new incomes policy will be built around a pay board, a price commission, and the existing Cost of Living Council.

New Americans from Asia

. . . In the wake of new immigration legislation, the number of Asian immigrants tripled over the course of the past decade.

Time-Deposit Pendulum

. . . Individual and corporate time deposits at Western banks rose by 19 percent — a massive $4.8 billion — in a year's time.

Editor: William Burke

Start of Phase II

The President outlined in early October the shape that the nation's incomes policy will take after the expiration of the wage-price freeze on November 13. He sketched a comprehensive program of controls, built around a newly created "price commission" of seven private citizens and a newly created "pay board" of five management, five labor and five public members — plus the existing Cost of Living Council.

Phase II machinery also will include an "interest and dividend committee" headed by Federal Reserve Chairman Arthur Burns, with five other official members. In addition, committees on medical costs and state-local government costs will advise the other stabilization groups regarding problems in these inflation-prone sectors.

Under Phase II, major businesses and big unions will have to ask government permission in advance to raise prices or wages. Medium-sized economic units will have to report promptly as soon as they take a wage or price action, while small businessmen, landlords and the like will also be asked to abide by some sort of wage and price standards. The duration of these Phase II controls has been officially labeled "indefinite."

Numerical standards for price and wage increases will probably be developed by the pay board and the price commission before November 14, or else the Cost of Living Council could issue interim standards. (As in the current freeze, the new controls will exempt "raw agricultural products" entirely.) To meet the program's goal of a sharply lower rate of increase in the price indexes, wage increases would probably have to bear some relation to increases in productivity. As for price guidelines, officials say that they will "take profits into account" in determining acceptable increases, although profits will not be curbed directly.

At the start, interest and dividends will continue to be the subject of purely voluntary appeals for restraint. But the President will ask Congress to add stand-by powers to bring these forms of income under mandatory control, if needed, when he asks for a one-year extension of his authority under the Economic Stabilization Act. That legislation is now due to expire next April 30.

Sanctions under Phase II will be the same as under the present freeze — a fine of $5,000 per item, along with a court injunction to obey orders. A new "service and compliance administration" will be organized under the Internal Revenue Service, regrouping some 3,000 agents who are already at work enforcing the freeze. This special staff will work out of 360 field offices, making investigations of complaints and requests for exceptions. The staff will be mainly responsible for enforcement among businesses and unions too small to deal directly with Washington. But it will also collect data for analysis in the pre-reporting big-business and union sectors, and will do the initial review of reports in the post-reporting middle-size sector.

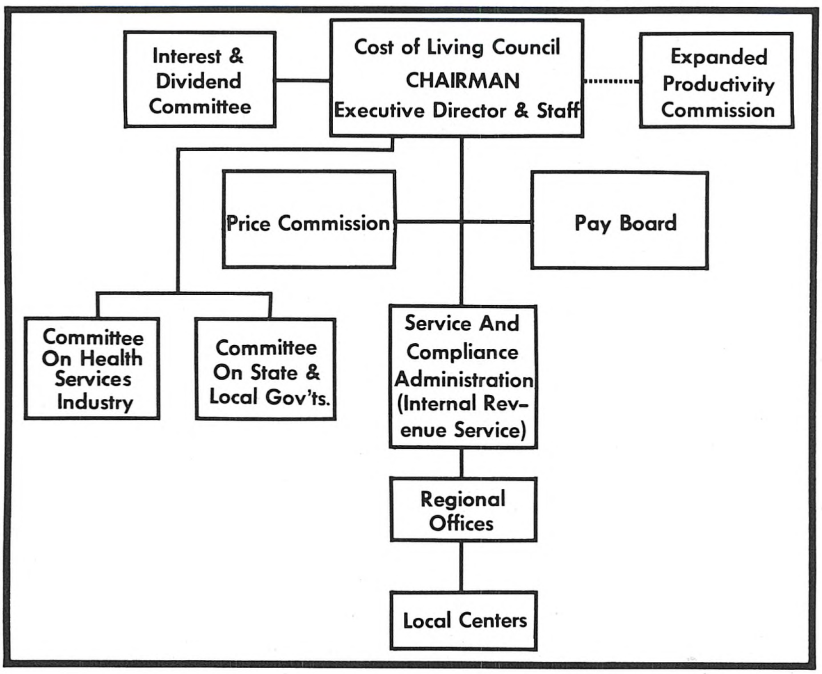
The Administration meanwhile reported a favorable by-product of the freeze — a significant drop in wholesale prices during September. Most of the 0.4-percent decline was due to a sharp drop in prices of farm products, which aren't covered by the freeze, but there were also freeze-related declines for processed foods and industrial commodities.

The Administration's attempt to stimulate the economy through fiscal actions progressed as the House passed and sent to the Senate a bill incorporating a number of reductions in individual and business taxes. Immediate action by the Senate is uncertain, however, because of attempts there to add to the bill some further income-tax cuts as well as welfare-reform provisions.

Under the House bill, which differs in some respects from the Administration proposals, businesses would get a 7-percent tax credit on equipment acquired since August 15 or ordered since April 1, while about half the corporate-tax benefits from the Treasury's new liberalized depreciation rules would be eliminated. The 7-percent excise tax on autos would be repealed, effective August 15, and the 10-percent excise tax on small trucks would be repealed as of September 23.

For individuals, the House bill would increase the personal income-tax exemption this year from \$650 to \$675, and would increase the minimum standard deduction for low-income persons from \$1,050 to \$1,300 in 1972. The bill also would push forward (from 1973 to 1972) the scheduled increase in the personal exemption to \$750, and the increase in the general standard deduction to 15 percent of adjusted gross income with a \$2,000 ceiling. The standard deduction currently is 13 percent with a \$1,500 ceiling.

The case for fiscal stimulus remained strong, since unemployment rates for most major labor-force groups were essentially unchanged between August and September, although the overall jobless rate edged down from 6.1 to 6.0 percent. At the same time, employment rose substantially in September to a record high of 79.5 million. Manufacturing employment posted its largest month-to-month gain in over five years, with the exception of several months affected by the aftermath of major strikes.



New Americans from Asia

The United States is a nation of immigrants. Throughout the nation's history, men and women and their families have journeyed here in search of opportunity, and in turn have provided the manpower to help build and run our factories, mines and farms.

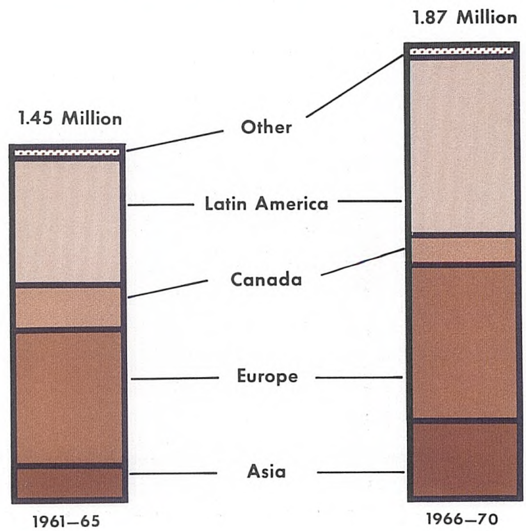
Since the time of Columbus, most of the immigrants have come from Europe, Africa, and (more recently) Latin America, but relatively few were from Asian nations. Over the last several years, however, a sharp shift began to show up in U.S. immigration patterns. Whereas only about one-sixth as many Asians as Europeans came to this country in the first half of the 1960's, more than one-half as many immigrated in the second half of the decade. Altogether, the number of Asian immigrants jumped from 108,000 in the 1961-65 fiscal period to 323,000 in the succeeding five-year period. (All data are on a fiscal-year basis.)

This shift is attributable to the Immigration Act of October 1965, which abolished the 40-year-old "national origins" quota system in favor of a system according equal treatment to all foreign immigrants. Total annual immigration, however, is limited to 120,000 from the Western Hemisphere and 170,000 from the Eastern Hemisphere. The Act not only facilitates immigration by close relatives of American citizens, but also seeks to attract professional and other needed workers who can contribute their skills to the American economy.

The new Act has benefitted particularly the various Asian peoples who faced discrimination under the terms of the Exclusion Acts of 1882 and 1924. With the discarding of this earlier legislation and the enlargement of quotas, there has been a tremendous increase in the inflow of Asian immigrants — especially Filipinos, Chinese, Indians, and Koreans.

The West Coast has long been the point of entry for most Asian immigrants and also the most concentrated area of their residence. Many newcomers are drawn to where earlier generations of the same nationalities have settled. Thus, the unique Asian contribution to the economy and society of the Pacific states can be expected to grow in future decades.

Asian immigration soars in wake of new immigration legislation



Shift in legislation

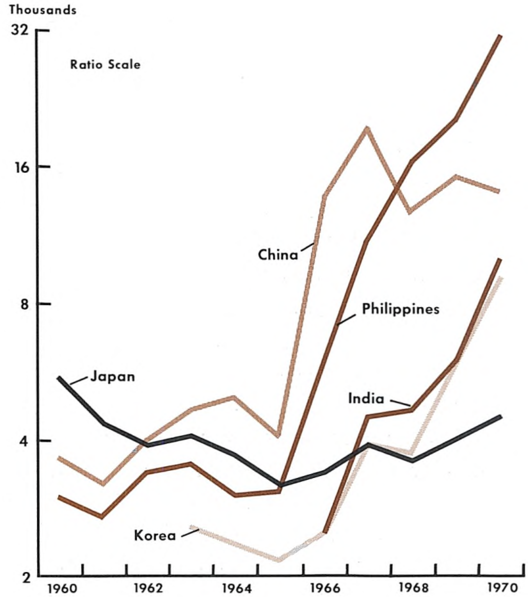
For a prolonged period, Asian immigration was practically barred under the Exclusion Acts of 1882 and 1924. For other nations, immigration in recent decades was governed by the "national origins" quota system set up in final form under the Immigration and Nationality Act of 1924, with each nationality's quota limited to 2 percent of those residing in the U.S. at the time of the 1890 Census. (Quota means restriction of immigrant visas under numerical limitation; non-quota means freedom from numerical limitation for certain classes of people.)

The shift from an exclusion policy to a quota system for Asians was begun during World War II. In 1943 Congress repealed the Exclusion Act and granted China a token quota of 105 persons annually, and in 1946 Congress permitted Chinese wives of U.S. citizens to enter the U.S. on a non-quota basis. Further legislation in 1952 granted quotas to each of the 19 nations in the "Asia-Pacific Triangle" — 185 for Japan, 105 for China, and 100 for each other nation — and also removed all restrictions on the non-quota immigration of Asian wives, husbands and minor children of U.S. citizens. The Refugee Act of 1953 permitted entry for 2,000 non-quota refugees of Chinese origin, and an executive order in 1962 permitted entry of more Chinese refugees from Hong Kong.

The 1965 revision of the Immigration and Nationality Act was a much more radical step, however, since with this legislation Congress recognized the equal rights of persons from all nations to immigrate to the U.S. under a broadly uniform system of regulations. The legislation permits up to 170,000 immigrants from the Eastern Hemisphere annually, with a limitation of 20,000 for any one country, and up to 120,000 immigrants from the Western Hemisphere annually, with no limitation by country.

The new legislation is concerned with family reunification and the selection of workers who could benefit the U.S. economy. First and second preferences (40 percent of the total) go to un-

Filipinos and Chinese lead upsurge in Asian immigrant flow



married children of U.S. citizens plus spouses and unmarried children of resident aliens. Third preference (10 percent) goes to professionals, scientists and artists, and farther down the list, another 10 percent of the total goes to workers in short-supply occupations. Parents of U.S. citizens are admitted on a non-quota basis.

Shift in ethnic make-up

The new law has changed the ethnic make-up of this decade's new Americans, with an emphasis on the developing nations of the world. The flow of British, Germans and Canadians, who once flocked to this country in large numbers, has dropped sharply. Immigration from Asia — especially China, India, Korea and the Philippines — meanwhile has shown a dramatic rise. New Americans from Asia accounted for one of every 15 new immigrants in 1965 but for nearly one of every four in 1970, as the numbers admitted from Asia almost quintupled between those two years.

Other geographic areas still provide more immigrants than does Asia, however. In 1970, there were 137,000 immigrants admitted from Latin America, with Mexico alone accounting for 44,000 of that total. (The largest number admitted from any one country in any single year of the past decade was the 99,000 Cubans admitted in 1968.) In 1970 also, there were 118,000 immigrants admitted from European nations, with Italians accounting for 25,000 of that total. Asia in the same year supplied 93,000 immigrants, but that area (unlike the others) showed a striking uptrend over the last half-decade.

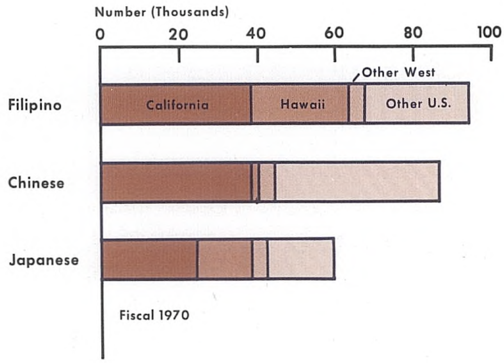
The Philippine Republic, which ranked second only to Mexico as a source of immigrants in 1970, led the Asian nations with 86,000 immigrants altogether in the 1966-70 period, while China (including Taiwan) furnished 76,000 immigrants during the period. India and Korea also scored large gains, with 28,000 and 26,000, respectively, during the 1966-70 period. But Japan was somewhat atypical, with hardly any increase over the course of the decade.

The number of Asians admitted under the quota system jumped from 5,000 to 68,000 between fiscal 1965 and 1970. The immigration totals were bolstered, however, by a substantial number of non-quota immigrants, mostly wives and other relatives of U.S. citizens. Non-quota immigrants increased from 15,000 to 24,000 between 1965 and 1970.

Females accounted for 55 percent of Asian immigrants last year, as against 52 percent of the total for non-Asian countries. (India was the only Asian country with a majority of male immigrants.) This preponderance of females may be due in large part to the immigration of the wives of U.S. citizens as non-quota immigrants; almost one-sixth of all Asian immigrants last year fell into this category.

Individuals in the prime age brackets (20 to 39 years) accounted for 57 percent of all Asian immigrants last year, as against only 42 percent of the total for non-Asian countries. Indian and Japanese immigrants were most heavily concen-

Immigrants concentrated in a few Western states



trated in the 20- to-39 age group, while Filipino immigrants were disproportionately represented in the under-20 group and Chinese immigrants most heavily represented in the over-40 group.

Concentration in the West

Asian immigrants are found throughout the nation, but the largest concentrations are in a few Western states, especially California and Hawaii. According to the traditional pattern of immigration, new immigrants from China, Japan, Korea and the Philippines usually choose the place where their relatives or friends have already settled, which means the Western states. This concentration will likely continue, since roughly one-half of new Asian immigrants last year indicated their intention to settle in this region.

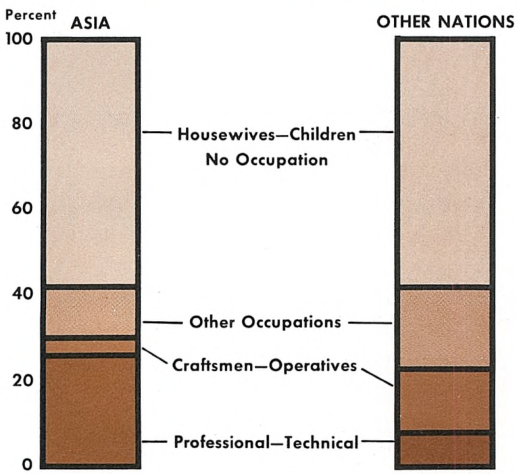
Considerably more than half of the Asian immigrants who had been admitted to permanent resident status (prior to naturalization) reported residence in Western states last year, according to the Immigration Service's annual alien registration. Over one-half of the 86,000 Chinese, over two-thirds of the 94,000 Filipinos, and over two-thirds of the 59,000 Japanese registered in this survey lived in the West. (This region had smaller shares of the 21,000 Indian and 20,000 Korean immigrants.) About 100,000 of these Asians (40 percent of the national total) lived in California, mostly in the San Francisco and Los Angeles areas, and about 40,000 lived in Hawaii. Washington, Oregon and the Mountain States followed in importance.

The only other concentrations of Asian immigrants are in New York and Illinois. New York last year had about one-tenth of the total registrants, including more than one-fifth of the Chinese, and Illinois had about one-twentieth of the total. The great bulk of these people lived in New York City and Chicago.

Students shifting status

Asian non-immigrants — temporary visitors who come to this country for business, study or pleasure — totalled 429,000 last year, and a large proportion of these temporary residents may eventually wind up in the immigration totals. (The number has increased sharply from 160,000 in 1965.) In 1970, for example, 23,000 of the 93,000 Asian immigrants were not new arrivals, but rather were earlier temporary residents who had adjusted to immigrant status. About 43 percent of Chinese immigration and 38 percent of Indian immigration last year fell in this category. This type of immigration is more common among Asians than among non-Asians; Asians accounted for two-fifths of all status adjustments last year.

Professional-technical workers make up large share of total



Students and their families accounted for almost half of all the Asians who adjusted their status to permanent residents last year. Moreover, this group accounted for the vast bulk of all status adjustments among foreign students in this country. Chinese students and their families were most prominent in this group, followed by Indians and then Koreans.

Professionals immigrating

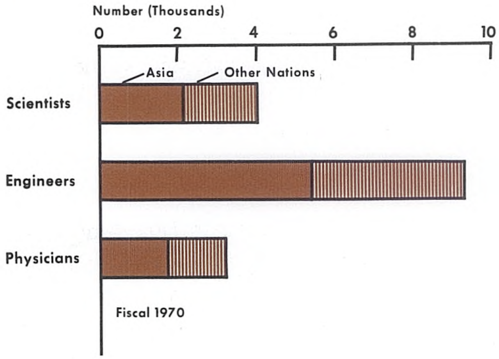
Less than half of all Asian immigrants last year were classified by occupational status; most of those listed were housewives, children or unclassified. Nonetheless, the available occupational data show a heavy concentration of professional and technical workers among Asian workers. More than 26 percent of all Asian immigrants, as against less than 8 percent of immigrants from other nations, fell into this category. Conversely, non-Asian nations provided a much larger proportion of immigrants with experience in blue-collar work.

In actual numbers, Asian professional-technical workers soared from 2,000 in 1965 to 24,000 in 1970. Filipinos accounted for the largest share of the 1970 total, but Indians and Chinese were also heavily represented in this group. Indeed, Indian professional and technical workers made up more than one-half of all Indian immigrants last year, and Filipinos in this category made up almost one-third of all Filipino immigrants.

Asian immigrants dominate the picture even more when comparisons are limited to the most highly skilled categories — scientists, engineers, and physicians. In 1970, over 9,000 Asian imigrants were numbered in these categories, or more than one-half of the total inflow from all countries. (In 1965, Asia supplied less than 1,000 scientists, engineers, and physicians.) Heavily represented in this elite category were Indian and Filipino engineers, Filipino physicians, and Chinese and Indian scientists.

Many of the professional and technical immigrants from Asian countries are almost certainly not new arrivals, although the exact share is un-

Asian immigrants dominate highly skilled categories



certain; the statistics do not afford a direct measure of the occupation of students and other temporary visitors who change their status to permanent residents. A great number of Asian students settle permanently in this country, as was noted earlier. Indeed, the National Science Foundation estimates that over 80 percent of Asian students in science and engineering may not leave this country after finishing their studies, and that the percentage may be even higher for Indian, Chinese, and Korean students. These foreign students thus are not merely temporary residents, but rather a new type of immigrant.

Japan, however, stands out in striking contrast to this trend, since Japan's booming economy has generated the effective demand to keep its scientists, engineers, and other skilled workers at home. Professional and technical workers accounted for only about one-tenth of Japanese immigrants last year, as against a one-fourth share of all Asian immigrants. Furthermore, Japan showed a far smaller share of students changing to permanent immigrant status than did other Asian nations.

Result: brain drain

These statistics paint a picture of a significant "brain drain" from Asian nations. In many cases, highly skilled cerebral workers get their training in their native countries and then come to this country to apply their skills. Just as frequently, Asian students come to this country for advanced education and then remain after their schooling is completed.

During most of the last decade, the American labor market was largely a seller's market for people of this type. Asian professional and technical workers, along with Asian students trained here, contributed their skills to the U.S. economy — particularly the Western economy — and reaped the benefits in higher income and in the chance to use their advanced training. The U.S. in return offered them — at least until the economy turned sluggish — not only an opportunity to use their skills, but also a general improvement in living standards, and in many cases a refuge from political instability at home.

Adelle Foley and Paul Ma

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Time-Deposit Pendulum

Twelfth District member banks had a massive $4.8-billion (19 percent) increase in individual and corporate time deposits in the twelve months ended July 1971. This inflow was more than double the amount of the outflow during the 1969 period of disintermediation, according to Federal Reserve survey data. The upsurge was marked by a comeback in regular passbook-savings accounts and by a show of rate flexibility for both savings and other consumer-type deposits.

A very high personal saving rate contributed strongly to the upward swing in the time-deposit pendulum during the recent 12-month period. Other contributing factors were the June 1970 suspension of the ceiling rate on short-term, large-denomination time certificates, and the downward movement in money-market rates in the latter half of 1970 and early 1971.

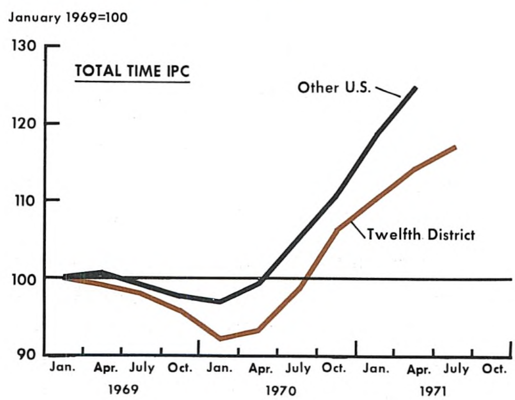
Subsequent to the July 1971 survey, there has been only a small expansion in individual savings at District banks. Savings deposits increased somewhat, but most of this represented quarterly crediting of interest in September, while the growth in other consumer-type deposits decelerated. On the other hand, increased corporate funds available for short-term investment led to a sizable expansion in large-denomination time certificates.

Savings—return to popularity

The most unexpected feature of the turnaround in time-deposit flows from July 1970 to 1971 was the behavior of regular passbook savings, which increased by $1,959 million in contrast to a $401-million decline in the preceding 12-month period. (In calendar 1969, the decline was $1,060 million.) During the late 1960's, this traditional form of savings had lost much of its appeal, as banks began to offer consumers an array of time-deposit instruments at rates above those offered on regular passbook accounts. The attrition in passbook deposits was even greater in the West than elsewhere, as the 1969 disintermediation was followed in early 1970 by large transfers of funds to consumer-type deposits.

By May 1970, however, the attrition was stemmed. After mid-year, passbook savings increased rapidly and culminated in a $1-billion gain in the period February-April 1971. (That three-month period posted one-half of the gain for the entire 12-month period.) Influenced by

Massive time-deposit increase recorded over past year



the uncertainties surrounding the national (and regional) economic outlook — including fears about unemployment — large numbers of individuals utilized this traditional, readily accessible, form of savings as a repository for funds (including U.S. Government securities) and as a repository for the increased savings from their current income flows.

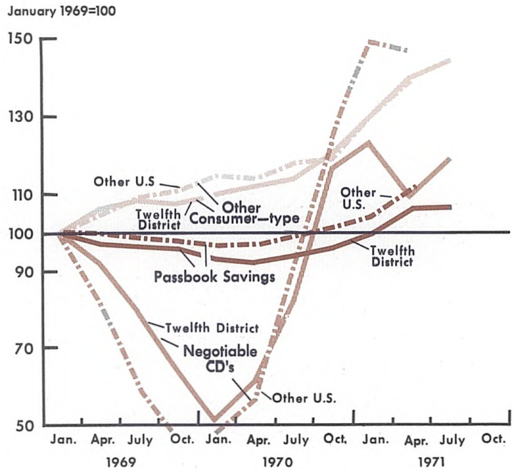
This large influx of savings deposits, coming at a time of rapidly declining loan rates, led many major banks to reduce (as of April 1) the rate they paid on passbook savings. This rate reduction, from $4\frac{1}{2}$ to 4 percent, along with the usual seasonal withdrawals to meet income tax payments, helped bring about a slight decline in savings in the April-June period. But then, as business-loan and mortgage rates began climbing again, banks that had reduced their rate on savings announced a return to the $4\frac{1}{2}$-percent ceiling, effective August 1.

Consumer-type—continued expansion

Consumer-type certificates and open-account deposits increased by $1,867 million between July 1970 and July 1971, as against a $316-million increase in the preceding 12-month period. These categories had expanded at Western banks during 1969 ($612 million) and early 1970, but the gain was not enough to offset the attrition in regular passbook savings. In early 1970, after higher rates on consumer-type deposits were authorized under Federal Reserve Regulation Q, most Western banks began to pay ceiling rates of 5, $5\frac{1}{2}$, and $5\frac{3}{4}$ percent on maturities under one year, 1 to 2 years, and 2 years and over, respectively. But it was not until mid-1970, when money-market rates began their downward slide, that these rates became favorable in comparison to those on other investment instruments.

From mid-1970 until April 1971, consumer time deposits increased at a rapid rate, and in the following three months they rose at a somewhat slower pace. For the entire 12-month period, the largest gain by maturity category was

. . . with strong upturn in all deposit categories



the 70-percent increase in 2-year and over maturities, which carried a $5\frac{3}{4}$-percent interest rate during most of the period.

In late January 1971, after a sharp decline in bank loan rates, some large Western banks reduced their offering rates on customer certificates and open accounts to 5 percent for all maturities, and a few banks stopped offering certificates of over one year maturity. But in early June, following several increases in mortgage loan rates, these banks again offered ceiling rates on consumer time deposits as well as the full maturity range of certificates.

Rate flexibility

The recent introduction of greater flexibility in offering rates on savings and other consumer-type time-deposit instruments has been a major development in rate policy for Western banks. For many years, the offering rates of large District banks, and most small banks as well, had been at the highest levels permitted under Regulation Q. Thus, these rates had been relatively stable, changing only when Regulation Q ceilings were altered. But during the past year, as a gap developed between the higher Regulation Q ceilings and the falling rates on market instruments, Western banks began to operate within that gap, adjusting rates on savings and time deposits to align them more closely with rate movements in business loans and mortgages.

This greater flexibility in rates was most prevalent among California banks, but it was evident among other District banks as well. On regular passbook savings, many Washington and Oregon banks, along with California banks, reduced their rates below the 4½-percent ceiling in April, and later returned to 4½ percent. On consumer time certificates and open accounts, some member banks in all District states except Utah first lowered their rates and then pushed them back up to the ceiling again.

This move toward more flexible rates, particularly on savings, substantially enhances Western banks' control of interest expense on deposits, and thus on net income. Regular passbook savings account for 55 percent of total time-and-savings deposits in the District, and constitute the largest portion of the banks' interest expense on deposits, which is by far their greatest single expense item. The impact of any rate change is much greater for passbook savings than for time certificates. Aside from the larger base involved, the fact that a change in the rate on regular passbook savings applies immediately to the total amount of such deposits, while a change in rate on certificates initially affects only the new inflow of deposits, accounts for the differential aspect.

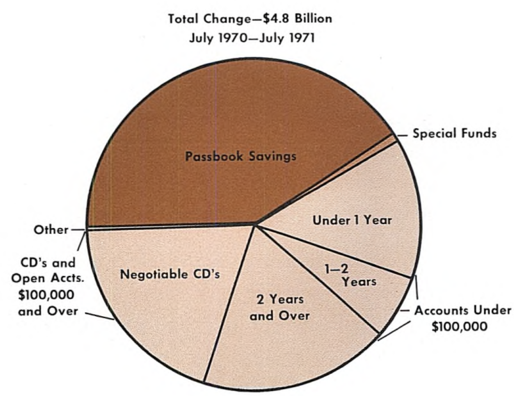
Large CD's—rate-responsive

Large-denomination ($100,000 and over) negotiable time certificates increased by $933 million between July 1970 and July 1971, as against a $63-million increase in the preceding 12-month period. (During 1969, however, CD's declined by $1,224 million.) The upturn in these deposits occurred in January-April 1970, a quarter before the turn-around in individual savings deposits, and the gain since then more than recovered ground lost in the earlier period of disintermediation.

The suspension of rate ceilings on large CD's of 30-89 days maturity in late June 1970 led to an unusually large inflow of CD money in the July-October period. Because of this step, banks were able to bid competitively for corporate deposits to replace funds previously obtained through issuance of commercial paper by their affiliates — funds on which a reserve requirement was imposed effective September 17. From last October to this July, the CD pendulum swung both up and down.

Rates on large CD's have always moved closely with money-market rates, and banks generally have been able to control the flows of this source of funds through rate adjustments — except when Regulation Q ceiling rates were held below money-market rates, as in 1969. Rate adjustments to direct the flow of CD money have been especially noteworthy this year. In the January-April period, Western banks lowered their CD offering rates, in an attempt to reduce their outstanding holdings of these instruments as they acquired less costly deposits from individuals. Conversely, as the inflow of individual deposits tapered off in the following three months, banks actively bid for corporate funds.

Passbook savings account for two-fifths of total increase



Effect of NEP

The current wage-price freeze does not apply directly to interest rates. However, Western banks are already paying the ceiling rates allowed under Regulation Q on their savings and consumer-type time deposits, and therefore would not be able to increase these rates anyway. Of course, there would be no prohibition against a *downward* revision in rates. Rates on large CD's recently have been lower than in the pre-freeze period, but these rates normally fluctuate in line with money-market rates, and they can be expected to continue to move in alignment with such rates, except where they encounter upper limits set by Regulation Q.

Nonetheless, the President's program could have an effect on the volume of banks' savings and time deposits. If consumers step up their spending at a faster rate than their income increases, the saving rate will decline and banks' inflows of individual deposits will decrease. There might even be net withdrawals of bank savings by individuals. In addition, if corporations increase their inventories and their expenditures on plant and equipment, corporate time deposits also would be less available and, in some cases, outstanding CD's might be allowed to run off at maturity.

Ruth Wilson and Sharon Byrne

Western Digest

Prime Rate Drops

Major commercial banks lowered their prime business-loan rate, from 6 to 5¾ percent in late October, reflecting the recent sharp drop in money-market rates. The prime rate had been raised to 6 percent in July, as a consequence of the tightening of rates last spring and early summer . . . In a parallel development, several major New York banks adopted a floating prime rate, tied to the charge on 90-day commercial paper. The rate initially will be set a half percentage-point above the commercial-paper rate, but will be reviewed weekly.

Bank Credit Expands

Total credit at large District banks rose a hefty $1.2 billion in September, outpacing credit expansion nationally. Business loans, augmented by mid-month tax borrowing, rose $259 million. The $120-million increase in real estate loans was below the pace of recent months and, although consumers stepped up their borrowing in the latter part of the month, the gain in instalment loans still was not robust . . . District banks increased their liquidity substantially during September by adding to their holdings of Treasury notes under one year and acquiring over $400 million in short-term municipals . . . A $222-million increase in demand deposits was partially offset by a reduction in U.S. Government deposits. Time deposits soared $941 million, reflecting an expansion in large corporate CD's and the crediting of quarterly interest on savings deposits.

Aerospace Employment Increases

California aerospace firms added 1,100 to their payrolls between August and September. This September gain marked the second consecutive monthly advance and brought aerospace employment in California to 437,000. Some of the increases were due to rehirings at Lockheed facilities in the Los Angeles-Long Beach area, but gains were recorded in the San Diego and San Jose areas as well.

Western Steel Stronger

The Western steel market, despite a substantial decline, has remained stronger than markets elsewhere following the recent labor settlement. In the West, production in August was 26 percent below July's pace, while national production was 42 percent below the July figure. In September and early October the pickup in Western steel production was greater than in the rest of the nation.

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INC. MAY 20, 1914