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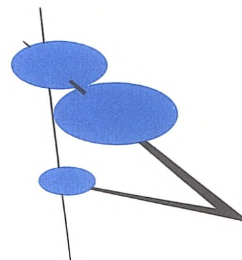
Monthly Review

In this issue

Annual Review Issue



February 1972

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Spectacular Year

... The failure of the economy to live up to expectations forced the Administration to adopt the spectacular New Economic Policy.

Uneven Year

... The West benefited from a boom in homebuilding, yet suffered from the continued cutbacks in the aerospace industry.

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Spectacular Year

In terms of policy, 1971 was a truly spectacular year; in terms of performance, it was decidedly disappointing. Yet it was precisely this failure of the economy to live up to domestic and international expectations that led the Administration to adopt a stimulative fiscal policy and an anti-inflationary incomes policy, all the while that it was attempting to repair the ravaged international payments system.

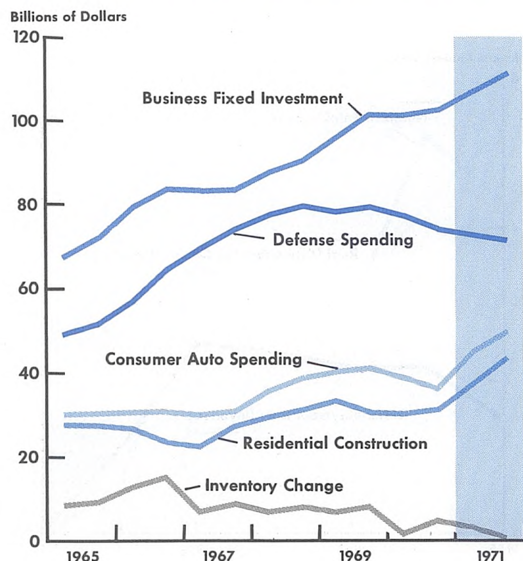
GNP rose to $1,047 billion in 1971, but in real terms this represented only a 2.7-percent gain—much better than 1970's decline, of course, yet only slightly higher than 1969's modest gain. The unemployment rate moved essentially sidewards through 1971, and averaged 5.9 percent for the year—the highest level in almost a decade. And price increases remained unchecked until the imposition of the wage-price freeze. For the year, the implicit price deflator for the private economy rose 4.3 percent—not strikingly better than the record of the two previous years, considering the impact of the freeze upon the index.

Crosscurrents of various kinds showed up in the GNP statistics. Defense spending continued down and Federal nondefense spending continued up. Residential construction boomed and so also did consumer durable-goods spending. Yet business outlays lagged in certain areas, especially for inventories, largely because of the pervasive air of uncertainty that dominated most of the year.

Industrial production fell behind even the slow pace recorded during the 1970 business slowdown, and the capacity-utilization rate in manufacturing remained below 75 percent throughout the year. At the same time, the nation's farmers posted a 12-percent gain in output of food and fiber—the sharpest increase of the past dozen years—yet that surfeit of riches tended to create downward pressures on farm prices and incomes.

Despite all the crosscurrents of 1971, the general pattern of business was not too far out of line with the consensus forecast for the year. The first quarter was especially strong, because of the rebound from the preceding quarter's auto strike and the beginning of a strike-hedge buildup in steel inventories. The second quarter followed through on that advance, although at a somewhat reduced pace. The third quarter was somewhat weak, at least in part because of the running down of steel stocks built up earlier; and the final quarter's pace strengthened as the economy began to respond to the stimulus of the New Economic Policy.

Sluggish GNP hurt by inventory slump . . . helped by housing, auto boom



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Cautious business spending

Cautious inventory-purchase attitudes, for the second year in a row, imparted a soft underpinning to the economy. Businesses added only about $2 billion to their stocks during 1971, or only about one-fourth as much as they did on average during the late 1960's. And in one quarter, the July-September period, stocks actually declined because of sharp cutbacks by steel consumers. The weakness in the inventory sector helps explain the sluggishness of the economic recovery in 1971.

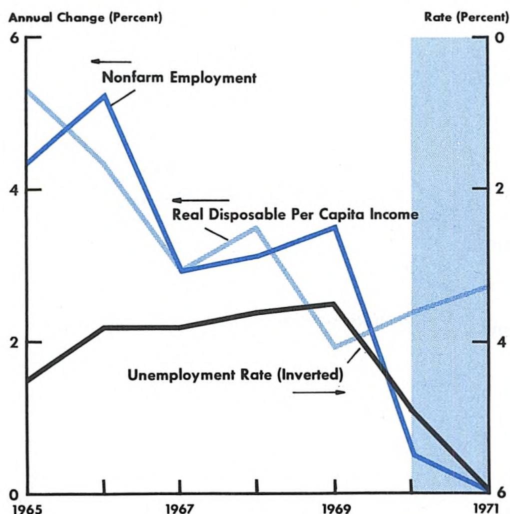
The generally cautious business atmosphere helped bring about tight inventory controls during both 1970 and 1971. Businesses had ample warning in 1969 of tightening policy pressures and were thus sensitive to weakening sales trends that year and next. At the same time, they had strong incentives to economize, because of high interest rates, falling profits, and tight liquidity conditions. The pressure of these constraints gradually abated, but cautious purchase attitudes persisted as business activity advanced only moderately during 1971.

Businessmen last year posted a modest 6-percent increase in fixed-investment spending, to $109 billion, largely on the basis of a strong early-year rise in auto-and-truck purchases following the auto strike. (In constant-dollar terms, capital-goods spending showed no gain whatsoever.) Electrical utilities substantially increased their capital outlays during the year, and petroleum producers, textile manufacturers, and commercial firms also upped their spending. But the airlines and aircraft manufacturers cut their spending drastically, and expenditures of auto, iron and steel, and nonelectrical-machinery manufacturers also declined.

The generally modest increase in capital outlays reflected businesses' modest evaluation of their capacity needs, which was associated with the low 74-percent rate of capacity utilization in manufacturing during the year. At the end of the third quarter, firms owning 31 percent of total fixed assets in manufacturing reported a need for more facilities—down from 41 percent a year before and 44 percent two years before.

Yet by year-end most determinants of capital spending had become more favorable. The improved pace of business activity, the rising trend of corporate cash flow, the falling trend of interest rates, the liberalization of depreciation procedures, and the reinstatement of the 7-percent tax credit on purchases of new machinery and equipment—all contributed to an expectation of rising capital spending. Still there remained some question over the speed with which the new tax incentives might take hold. In an earlier episode a decade ago, plant-equipment spending responded rather slowly to such incentives, although compared to today, the capacity-utilization rate was higher, the capital stock was older, and thus both considerations were more conducive to increased spending then than they are now.

Consumer sector hurt by jobless situation and small real-income gains



Other sectors: mixed record

In the government sector last year, defense spending dropped $4 billion to $71 billion, but other federal spending for goods and services rose by a like amount to $26 billion. Expenditures by state-and-local governments continued on their usual uptrend, rising more than 10 percent to $135 billion.

Federal budget data indicate that the post-Vietnam readjustment has been essentially completed, with a 27-percent decline in defense spending, in real terms, occurring over the past three years. (The spending attributable to the Vietnam

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conflict alone dropped from $20 billion to $7 billion between fiscal 1970 and fiscal 1972.) The decline has meant a reduction in military hardware purchases—and also in manpower, while military pay scales have risen sharply. Manpower needs have dropped off by one-third over the 1968-72 period, and are now close to the levels of a decade ago, while basic pay for recruits has quadrupled in less than a decade.

Consumer spending figures presented a mixed picture in 1971. Expenditures for durable goods rose by a strong 12 percent, to $100 billion. Spending for nondurable goods rose at a sluggish 5-percent pace, to $279 billion, while spending for services increased at a consistent 8-percent pace to $283 billion.

Sharp swings in auto buying dominated the sales picture, and overshadowed several other signs of expansion. Sales of other durable goods grew strongly throughout the year; for instance, color TV-set manufacturers, after a disastrous year in 1970, reported a 27-percent gain in set sales in 1971.

Boom in autos, housing

New-car sales rose to 10.3 million units last year—5 percent ahead of the earlier (1968) record —with imported cars showing their greatest strength prior to August 15 and domestic models booming thereafter. Price increases that had been posted by Detroit at the beginning of the 1972 model run were held up by the price freeze, but manufacturers later regained most of this when the Price Commission granted a 3.8-percent price hike towards the end of the year.

Unit sales of new cars (including imports) ran at a 9.9-million annual rate during the January-August period, partly on the strength of the early-year post-strike recovery. But in September-November, a dramatic upsurge occurred as sales rose to an 11.5-million rate under the spur of the price freeze—which permitted '72 models to be snapped up at '71 prices—along with the recommended excise-tax repeal. Sales weakened by year-end, however, in reaction to the borrowing of sales during the freeze period; at that time, too, the savings from the excise-tax repeal were partly offset by the Phase II price increase and by reduced allowances on late-model used cars.

Consumers helped sustain last year a 33-percent jump in new residential construction, to $41 billion, as the remarkable boom that began in early 1970 continued throughout all of 1971. Under the stimulus of strong basic demand and easy financing, homebuilders accounted for over 2.0 million housing starts—or for 2.5 million units if mobile homes are counted in the totals. The latter figure was 25 percent above the total posted during 1950, the previous peak year.

Lagging incomes, employment

The generally mixed consumer-spending picture reflected an 8-percent gain in disposable income but also a cautious spending attitude, evidenced by a very high rate of consumer saving. The saving rate, although falling in late 1971, averaged for the second straight year about 8.0 percent of disposable income. (In contrast, the rate averaged only about 6.5 percent during the preceding half-decade.) Moreover, consumers could report only modest improvement in one important measure of individual "welfare"—per capita disposable income, in constant dollars. This measure rose about 2.5 percent for the second straight year—in each case, a considerably smaller gain than the average gain of the 1960's.

Total (pre-tax) personal income increased by less than 7 percent in 1971, for the smallest gain in almost a decade. Besides, over one-fourth of the overall increase came from a sharp (19 percent) increase in transfer payments, primarily payments for old-age benefits, medicare, and unemployment compensation. Total wages and salaries paid in manufacturing rose by less than 3 percent, but stronger gains were recorded in other wage categories, such as the service industries. Total income was boosted in June by the payment of retroactive increases in social-security benefits, and again in December by the payment of wage-and-salary increases that had been held up by the wage freeze.

Nonfarm payroll employment, although strengthening late in 1971, increased for the second straight year at a very slow rate overall. Meanwhile, the jobless rate jumped from 4.9 percent in 1970 to 5.9 percent in 1971, the highest rate in a decade. The high and stable rate of unemployment throughout 1971 reflected substantial gains in the nation's labor force, which paralleled the large late-year increases in employment. Labor-force growth was most evident among women and teenagers, as a consequence not only

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of normal population growth but also of large increases in the labor-force participation rate for those categories.

With the jobless rate seemingly stuck at a high level, a decade-old debate on cyclical vs. structural unemployment came to be revived. The debate centered around the fact that a larger share of the labor force now falls into those groups with chronically high rates of joblessness. The major groups are women, teenagers, and minority workers, along with an increased number of skilled workers who have lost their jobs because of cutbacks in the defense and space programs. (In 1971, 2.9 percent of professional-technical workers were unemployed—the highest figure since statistics of this sort were first gathered 14 years ago). The problem, unsolved to date, is to find or create jobs for such workers without creating severe inflationary pressures.

As for wage rates, the first-year increases recorded in major labor-contract settlements in 1971 were roughly in line with the record increases posted during the preceding year. Indeed, for manufacturing the average increase was greater —10.8 percent as against 8.1 percent. In nonmanufacturing industries, however, the average first-year increase declined to 12.7 percent from 15.2 percent, largely because of the incomes policy imposed by the Construction Industry Stabilization Committee on that industry in early 1971.

At the Smithsonian

The prolonged international-payments crisis was resolved by the tentative agreement reached by the Group of Ten major industrial nations at the Smithsonian on December 17-18. The U.S. agreed to raise the official price of gold from $35 to $38 per ounce—an effective devaluation of the dollar of 8.57 percent against gold. The agreement also set new "central rates" for other major currencies, resulting in upward revaluations of 16.88 percent for the Japanese yen, 13.58 percent for the German mark, and 11.57 percent each for the Dutch guilder and the Belgian franc.

The U.K. and France, by leaving unchanged the gold parities for their currencies, thus revalued by 8.57 percent against the dollar, but Italy, by lowering slightly the gold parity of the lira, revalued by about 7.48 percent. Switzerland wound up with a 13.43-percent revaluation against the dollar, including its May revaluation, but Canada permitted its dollar to remain floating, as it had since early 1970. Finally, the Group of Ten widened the bands of allowable fluctuations in currency values to 2.25 percent above and below the new central rates.

The overall upward realignment of other principal currencies against the dollar—averaging 10 to 12 percent, depending on the method of calculation—was larger than many experts had expected, although it was less than the original U.S. bargaining target. At the same time, the Smithsonian agreement left many loose ends, including questions about the liberalization of trading practices by the major trading nations. In this area, Japan agreed to a number of trade concessions, including reduced quotas on four agricultural products and lower tariffs on 30 industrial items, and the Common Market countries agreed to concessions involving American wheat and citrus exports.

Despite the agreement about a new structure of parities, a number of major monetary questions remain unresolved. With the dollar still inconvertible, the task of stabilizing the dollar in foreign-exchange markets generally is left up to the foreign central banks. Other continuing problems include the future division of responsibilities for stabilizing currencies, the proper roles of gold, SDRs and other reserve assets, and the control over short-term capital movements. Yet no matter what comes out of future negotiations, the Smithsonian agreement suggests that the structure of international monetary arrangements for some time yet will not be substantially different from what it has been up to now.

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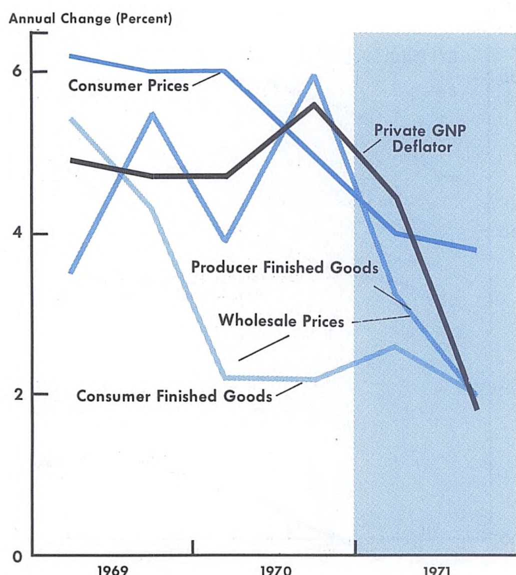
Price indexes show some improvement even before NEP



On the favorable side, private nonfarm labor productivity improved during 1971, exceeding the historical 3-percent average after several years of falling below trend. With this acceleration in per-unit output, unit labor costs decelerated to about a 3.5-percent increase, contrasting strongly with the increases of close to 7 percent in each of the two preceding years. Movements of this kind were warmly welcomed by the new pay and price agencies, for without rising productivity and decelerating unit labor costs, the arithmetic of pairing 5.5-percent wage increases and 2.5-percent price increases could become quite difficult.

Prices and the freeze

The price trend moderated during 1971, largely because of the freeze and Phase II controls, although some modest signs of price improvement surfaced earlier in the year. For 1971 as a whole, the implicit price deflator for the private economy rose 4.3 percent, as against 4.9 percent for 1970, and the consumer and wholesale price indexes showed similar movements.

Price indexes, like business activity generally, fluctuated unevenly throughout 1971. The wholesale index rose rapidly early in the year, reflecting sharp increases for farm products and the post-strike boost in auto prices. Food prices rose through the second quarter but then stabilized in the summer months. Prior to the freeze, however, a worrisome upsurge developed in wholesale industrial prices, in such key areas as steel, lumber, textiles, coal, and electricity.

After the conclusion of the price freeze in mid-November, sharp boosts occurred across the board, but especially for food and consumer durables. Nonetheless, the three-month freeze served a useful purpose in holding down the rate of price increases for the year as a whole.

Evolving an incomes policy

The imposition of wage and price controls was of course one of the most spectacular events of a quite spectacular year. Unexpected as it was in many respects, the need for a freeze became evident as the year progressed. Over time, both labor and management had come to expect the persistence of a pervasive inflationary atmosphere, and in this environment, labor typically demanded large wage increases and business typically met those demands in the belief that higher costs could be passed on in the form of higher prices. But the freeze and Phase II controls created a completely different atmosphere.

In mid-November, the three-month freeze on wages, prices and rents was replaced by a more flexible but more complex system of guidelines and controls, under the authority of the Pay Board and Price Commission. As noted already, the Pay Board adopted a general 5.5-percent annual ceiling on increases in wages and benefits, and the Price Commission set a 2.5-percent annual ceiling on average price increases.

The price agency permitted price increases only when necessary to cover cost increases, after allowing for productivity gains, and it disallowed price increases which would raise the profit-to-sales ratio above a specified base-period figure. Eventually, the agency adopted a simplified pricing approach, called "term limit pricing." Within the basic price guidelines, each firm using this system is permitted to boost its prices by a weighted average of up to 2 percent in any 12-month period, and is not required to obtain specific approval for individual price changes.

As 1971 came to a close, Phase II plus competitive pressures helped keep manufacturing

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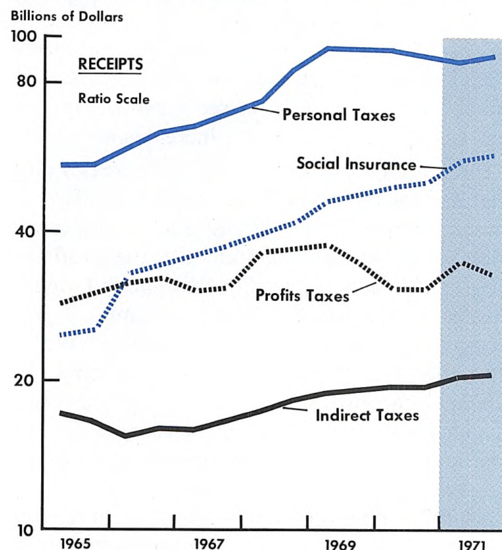
prices at least partially in check. In steel, manufacturers had raised some prices when they signed a new labor contract in August, and had also scheduled further price boosts. The freeze forestalled this action, but the Price Commission later awarded a 3.6-percent average rise which the industry translated into a 7.7-percent increase on almost half its product line. In early 1972, however, steelmakers rolled back about one-third to one-half of the scheduled increase, largely because of pressure from large customers, such as automakers, who were under official pressure to hold down their own price increases.

The Pay Board meanwhile encountered problems in obtaining adherence to official guidelines. Despite its 5.5-percent pay yardstick, the Board early in its existence approved contracts calling for first-year pay boosts of 14-to-15 percent for railway signalmen and coal miners. In its next major case, however, it disapproved a 12-percent settlement and instead forced through an 8-percent first-year increase in an aerospace-worker contract.

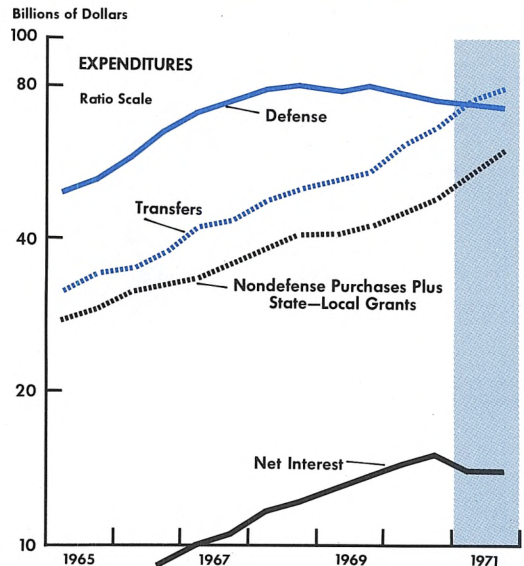
Stimulating the economy

While an incomes policy was evolving last summer and fall as a means of keeping cost-push inflationary pressures under control, fiscal operations were imparting a stimulus to the lagging economy. The Treasury had reported a substantial surplus in 1969, but the budget then slid rapidly into deficit; on a national-income basis, the deficit approached $20 billion in late 1970 and early 1971, and then exceeded a $26-billion annual rate in the second half of 1971.

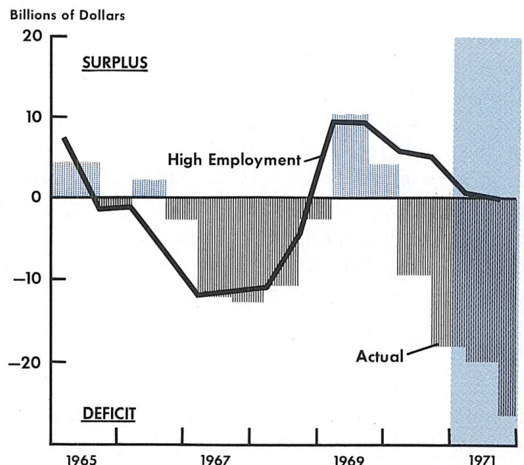
Receipts sag as economy slows, despite rise in social-security taxes



. . . but spending soars with rise in nondefense expenditures



. . . so budget shows more red ink than at any time in past generation



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Receipts rose slowly but expenditures soared during 1971. The business slowdown, along with scheduled tax reductions, led to an actual decline in personal income-tax receipts, although this was more than offset by a sharp rise in social-insurance contributions. The expenditures side was affected by a 5-percent reduction in defense spending, but was influenced even more by a 20-percent jump in nondefense spending, transfer payments, and state-local government grants.

The final fiscal-policy action of the year was the President's signing (December 10) of legislation designed to stimulate the economy further through a $15.8-billion tax cut over a three-year period. The bill reduced income taxes, repealed the auto-excise tax, and reinstituted the 7-percent tax credit for investment in new machinery and equipment. In addition, it wrote into law all but one feature of the liberalized depreciation rules introduced by the Treasury earlier in 1971.

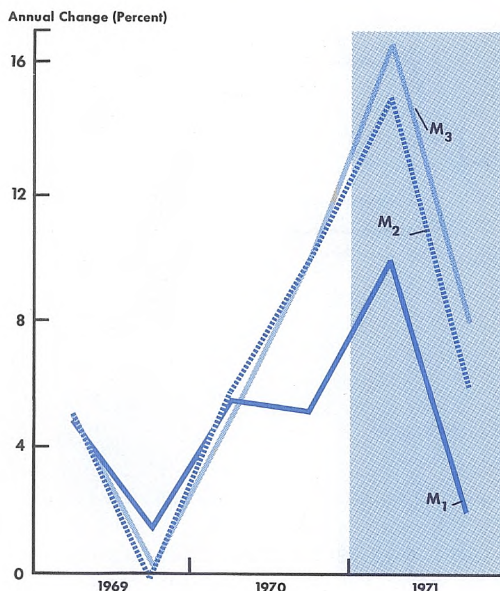
Money and policy

Monetary policy also became less inhibited as a result of the introduction of special measures to attack the inflationary and balance-of-payments problems more directly. The statistics showed a respectable 7-percent gain in total member-bank reserves over the year, as well as a shift from a significant net borrowed-reserve position at midyear to a small free-reserve position in December. Still, other indicators lagged.

The most closely watched monetary aggregates rose sharply during the first half of the year but sluggishly during the second half. The money supply (currency plus demand deposits) increased at almost a 10-percent annual rate during the January-June period but only at a 2-percent rate during July-December, with a 6-percent increase for the year as a whole. Broader monetary measures, which also include bank time deposits (except large CD's) and thrift-institution deposits, increased at more than a 15-percent annual rate during the first half but at less than half that pace during the second half.

The Federal Open Market Committee, the key policy-making body, sought to curb the over-rapid growth in the monetary aggregates last spring. After mid-August, however, the Committee moved toward a more expansive policy, in keeping with the announcement of the New Economic Policy. Thereafter, increased member-bank reserves allowed banks to add substantially to their holdings of loans and investments, while simultaneously reducing their indebtedness to the Federal Reserve. The FOMC in December moved to promote "somewhat greater growth" in the aggregates, especially in view of the slowdown recorded in several preceding months.

Monetary measures rise rapidly in first half but slowly in second half



On December 10, the same day the tax bill was signed, the Federal Reserve reduced its discount rate to 4 1/2 percent—the lowest level of the past three and a half years. This action was taken not only in recognition of falling market rates but also as a means of "assisting the progress of economic expansion." Also in December, the Reserve Board lowered, from 65 to 55 percent, the minimum downpayment required for stocks bought on credit, and thus gave a boost to a market which had perversely declined throughout most of the early stages of the New Economic Policy. This was the lowest margin requirement in almost a decade; indeed, the requirement had been as high as 80 percent during the speculative boom of the late 1960's.

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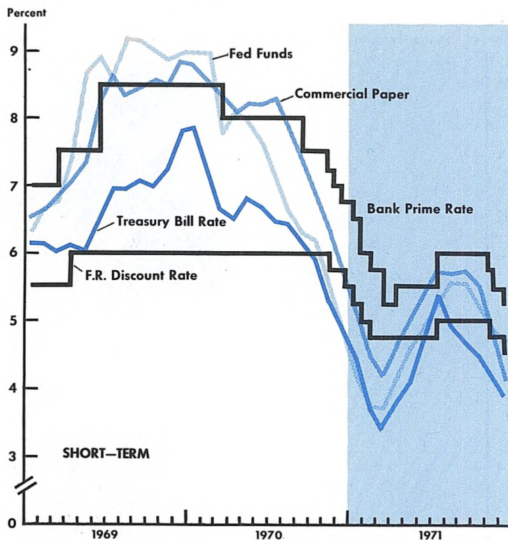
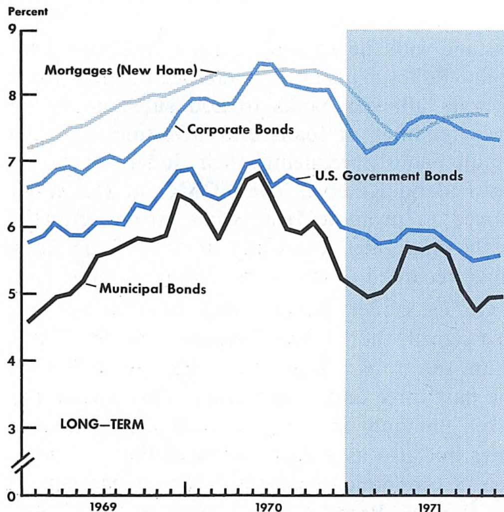
Short-term rates turn upward in spring but fall steeply after NEP



. . . and long-term rates move along same path, but with milder swings



Falling interest rates

Interest rates tobogganed during 1971. Rates fell sharply until the spring, extending the 1970 decline, and in most cases reached their lows for the year during March. But then rates turned upward, reflecting the international monetary crisis, the continuing problem of cost-push inflation, and the very heavy demands upon the capital markets. Then came the New Economic Policy, however, and a steep decline in rates which extended into 1972.

Short-term rates fell very sharply during the late summer and fall. Average rates on 90-day Treasury bills dropped from 5.41 percent in July to 3.90 percent in December, and fell even more in early 1972. A similar movement was traced by the Fed-funds rate—the rate banks charge each other for borrowings of excess reserves. The prime business-loan rate, a key "administered" rate, also followed the general pattern; this rate went from 5.5 percent to 6.0 percent during the spring upsurge, but it fell to 5.25 percent by year-end and even lower in early 1972. (The prime rate had reached 8.5 percent in tight-money 1969.) Long-term rates meanwhile moved along the same path, although they failed to match the steep late-year declines encountered at the short end of the spectrum.

Soaring financial markets

Throughout the year, the demand on U.S. credit markets was indeed spectacular. For 1971 as a whole, the total of funds raised jumped 50 percent over the previous year's record to an unprecedented $150-billion annual rate. All sectors of the economy participated in this explosive demand, ranging upward from a 29-percent increase by nonfinancial businesses to a doubling of demand by foreign borrowers.

As for sources of funds, commercial banks increased their credit flows by 47 percent, while

A strange perversity has apparently condemned this country to create the economic tools it needs only out of crisis and suffering. Financial panic gave the United States its Federal Reserve System, and made the use of monetary and credit policy an honorable pursuit for Government. Bitter depression produced the first use of fiscal policy, and made it respectable. And now, corrosive inflation is just as certainly making the use of an incomes policy inevitable. To be sure, once established, these pinions of public policy acquire a diversity of uses, and become essential through good times and bad. But their birth seems to require an ordeal.
Robert V. Roosa, *The New Leader* (February 22, 1971)

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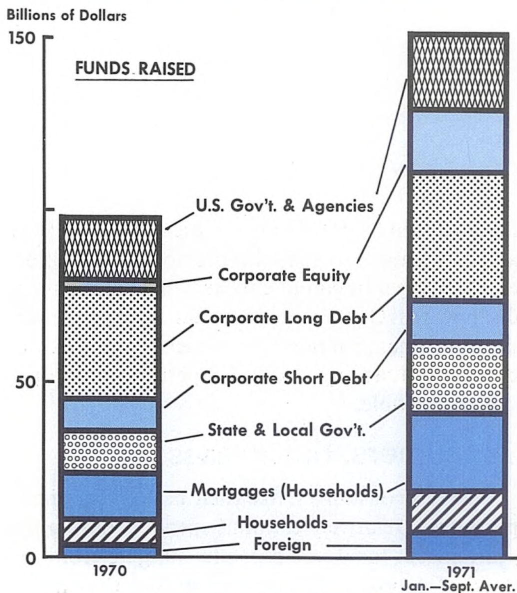
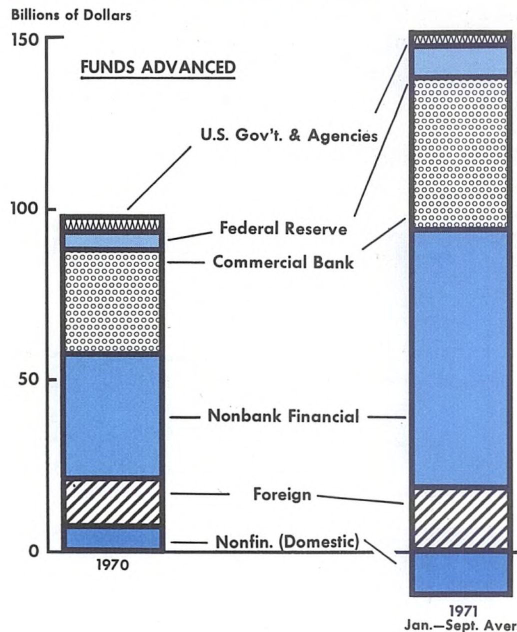
Total funds raised in 1971 jump 50 percent over 1970's record pace



. . . as increased funds come from higher assets of thrift institutions



nonbank financial institutions almost doubled theirs. But individuals sharply reduced their holdings of marketable financial assets, responding to the dull performance of the stock market and to the increased attractiveness of the rates offered by thrift institutions.

Perhaps the most spectacular of 1971's financial developments was the massive inflow of foreign funds, related to the international-payments crisis. The collapse of confidence in the dollar followed in the wake of a series of substantial balance-of-payments deficits, a reversal in the customary surplus on the merchandise-trade balance, an apparent failure to contain domestic inflation, and unsettling speculation about dollar convertibility. As holders of dollars dumped them in foreign-exchange markets to buy other currencies that were expected to rise in value, foreign central banks invested those dollars in short-term governments or special securities issued directly by the Treasury, thereby easing the Treasury's financing task by some $30 billion.

The massive hoards of American dollars that moved abroad last year have not yet shown much inclination to return. If and when the reflow of these funds takes place, the Treasury securities now held for the account of foreign central banks will tend to be liquidated, possibly leading to upward pressure on domestic short-term interest rates. However, as long as there is any lingering uncertainty over the health of the dollar and the stability of the new international monetary arrangements, or as long as the level of interest rates abroad exceeds the level of domestic rates, there will be an incentive for those funds to remain abroad.

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Uneven Year

The Western economy generated about $140 billion in personal income in 1971—a moderate 7-percent increase over 1970. A homebuilding boom contributed notably to the increase in business activity, and output expanded also in agriculture and a few other regional industries. On the other hand, activity remained weak in some basic production industries, including a key regional industry, aerospace manufacturing. Despite this weakness, however, the jobless rate dropped sharply in the latter part of the year.

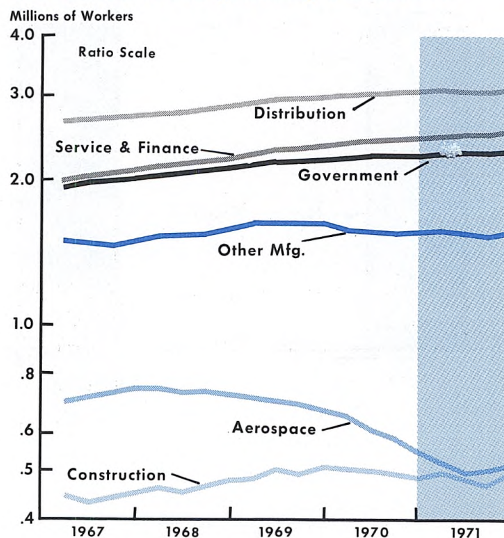
The regional economy was influenced by several random shocks during the year, including an earthquake and a major dock strike. The Los Angeles earthquake in February caused some loss of life and considerable property damage, and it reduced personal income by roughly $500 million because of uninsured property damage. The summer period's 100-day dock strike, which was extended for 35 days more in early 1972 after the expiration of a Taft-Hartley injunction, cost perhaps $60 million in lost longshoremen's wages as well as substantial wage losses in related industries. In addition, Pacific Coast farm exports during the crucial harvest season fell 75 percent ($215 million) below year-ago levels. At that, the longshore agreement finally reached in early 1972 faced the difficult hurdle of Pay Board approval.

Nonfarm employment in Twelfth District states patterned the experience elsewhere in the nation. Employment trended upward in the second half of the year, but on a year-to-year basis it expanded hardly at all. The Western economy employed more workers in the fields of distribution, services and government, but it employed fewer in manufacturing, especially in aerospace plants, and in construction. Even so, with the Western labor force lagging behind the growth of its national counterpart, the average unemployment rate declined here in late 1971 while remaining stable in the rest of the nation. The West's jobless rate dropped from 7.7 to 6.3 percent between May and December, so that the previous wide differential between regional and national rates almost disappeared. On an average annual basis, however, unemployment averaged 7.1 percent in the District during 1971, as opposed to 5.9 percent for the nation as a whole.

Consumers, businesses...

Western consumers, like their national counterparts, were relatively cautious spenders during the year, except for durable goods. Judging from the trend of deposits in thrift institutions, they maintained a high saving rate throughout the year. But with their interest in big-ticket items, they recorded a 12-percent increase in instalment debt with large District banks, in sharp contrast to 1970's very small gain. Most of the buying and borrowing activity was concentrated in the spring and fall

Employment remains sluggish in basic industries while growing elsewhere



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periods, however. Spring's splurge was based heavily on auto financing, plus some tax and other borrowing with credit cards. After a third-quarter slowdown, consumers sharply expanded their auto purchases and borrowing in the latter months of the year, in response to the tax and price inducements inherent in the NEP.

Western businessmen were cautious spenders and even more cautious borrowers during 1971. Business borrowing at District banks increased very sluggishly, by only $1.0 billion, but this 5-percent gain (after adjustment for loans sold to bank affiliates) was still considerably better than the 1970 increase. The heaviest borrowing activity was in the categories of bankers' acceptances and foreign loans, especially during the August financial crisis. Service firms and petroleum and natural-gas firms were substantial borrowers, but public utilities and most types of manufacturing firms reduced their bank debts.

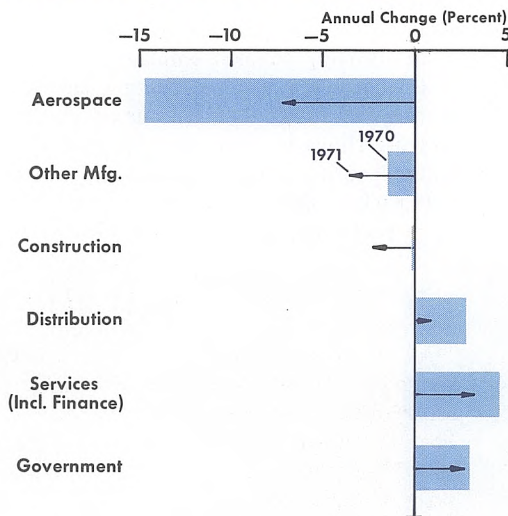
Business firms' modest credit demands reflected a low level of inventory buying and a low level of capital spending, as corporations delayed the implementation of forward investment plans because of uncertainties over the business climate. But in addition, large corporations in metropolitan areas tended to rely upon the capital market instead of the banks for their funds. With credit demands lagging in this fashion, the cost of bank credit dropped sharply, with the prime business-loan rate falling from 6 3/4 percent to 5 1/4 percent over the course of the year. By December, however, Western banks were reluctant to follow their Eastern counterparts in reducing rates further, partly because of strengthening loan demand but also because of their heavy reliance on high-cost savings deposits for their own funds.

. . . and governments

Western state and local governments continued to expand their spending, taxing, and borrowing during the past year. For example, bond sales of Western governmental units rose sharply in calendar 1971 to $3.7 billion—up more than one-fourth in a single year and double 1969's tight money pace—as agencies took advantage of last year's easier financial markets. The average interest rate on these sales dropped from 6.28 percent to 5.16 percent between 1970 and 1971.

The heavy financial requirements of state governments dominated this busy scene. Borrowing

Continued aerospace decline
helps offset gains in other sectors



by such units rose 70 percent during the year to $1.8 billion. Special districts were other major borrowers, with a modest increase in bond sales to $1.1 billion. Other categories—school districts, cities, and municipalities—maintained a fairly stable borrowing pace, but in any event were fairly minor participants in the market.

In a landmark court decision, the California Supreme Court ruled last August that a public-school financing system based largely on local property taxes was unconstitutional. The court said that local property taxes for schools, which raise about $3 billion a year in California alone, tend to discriminate against the poor because of inequities between rich and poor school districts in the size of tax base. Proposed solutions to this financing crisis include the imposition of a statewide property tax, a substantial gain in revenues from more general sources, or a sharp increase in Federal financing of elementary and secondary education. One possible model is Hawaii, the only state that does not rely on local property taxes for public education; all the costs of that state's educational system are met by the legislature from general funds.

Aerospace tailspin

Western aerospace employment dropped by 6 percent between 1970 and 1971, as against a 20-percent decline in the industry elsewhere. The

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worst decline regionally was in Washington, where the cancellation of the supersonic-transport project led to a 20-percent reduction in employment.

Although 32,000 jobs were lost over the course of the year—leaving 515,000 employed in December—this decline was considerably smaller than the drop of 120,000 that occurred in the previous year. (Indeed, some signs of recovery were evident during July-December 1971, as roughly 10,000 laid-off workers were recalled.) Altogether, cutbacks since the December 1967 peak amounted to about a quarter-million jobs.

Military prime-contract awards to District firms increased 2 percent to $7.3 billion during 1971, but this was almost 12 percent below the 1969 peak. The West still managed to get its share of Pentagon spending, since in the last fiscal year it accounted for almost one-fourth of the national total of contract awards. Although the Defense Department did not award any major new projects to Western firms last year, budget requests for fiscal 1971 included sizable increases in fund-

In the Regions

California's nonfarm employment declined slightly in 1971 to 7.7 million, and the state's unemployment rate rose somewhat to 7.0 percent, mirroring the shifts in the state's sluggish economy. However, these averages disguise a notable improvement in activity over the latter part of the year, represented particularly by a sharp decline in the jobless rate from 7.4 percent to 6.1 percent between May and December.

The average jobless rate was higher in Los Angeles-Long Beach than in other major areas, at 6.5 percent, but the San Diego and San Jose areas were not too far behind. The average jobless rate in San Francisco-Oakland was 5.9 percent, although joblessness increased more rapidly in that area than elsewhere.

Hawaii's situation was somewhat different, with a significant rise in nonfarm employment between 1970 and 1971, but also with a rising jobless trend during 1971. Nonfarm jobs increased 2 percent to an average 324,000 last year. Nonetheless, the jobless rate jumped sharply to 5.2 percent in 1971, as cutbacks in construction and trade activities resulted from the West Coast dock strike.

* * *

Pacific Northwest labor reports continued to be marred by the misfortunes of Washington's aerospace industry. Nonfarm employment dropped 2 percent in that state to 1.2 million, and the state's jobless rate averaged a whopping 11.0 percent in 1971. But just as in California, the jobless rate dropped very sharply between May and December, to its lowest level in over a year.

Alaska's nonfarm employment rose significantly to 106,000 on average for 1971, but the state continued to suffer from severe seasonal unemployment as well as from delays in the long-planned Arctic pipeline, and these factors boosted the average jobless rate to 12.0 percent for the year. Oregon was a brighter spot in the northern sky, with nonfarm employment holding stable at 839,000, and with only a small rise in joblessness to 6.3 percent.

* * *

The Mountain states provided a generally strong note for the labor news. In each of these states, nonfarm employment increased during 1971 at nearly 3 percent or better, and throughout the area jobless rates (although rising) were generally below the regional average for the year.

Arizona, with a rise in employment to 636,000, boasted a low unemployment rate of only 4.5 percent. Idaho, with a rise in employment to 247,000, saw its jobless rate rise to 5.6 percent. Utah and Nevada also recorded solid employment gains, to 407,000 and 230,000 respectively, but each suffered a rise in joblessness, with rates averaging about 6.5 percent for the year as a whole.

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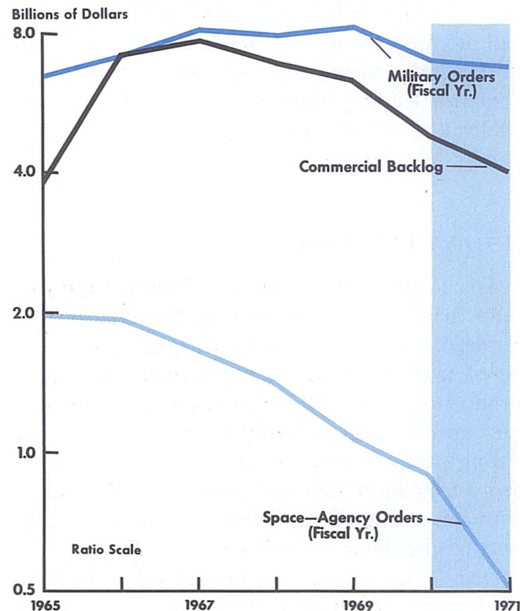
Aerospace beset by weakness in defense, space, commercial orders



ing for the B-1 bomber, the S3A anti-submarine aircraft, the P3C landbased patrol aircraft, and the Minuteman 3 missile system.

The industry received little help from the commercial-aircraft industry. Beset by their own problems, the air carriers cancelled a number of orders and options for wide-bodied jets despite significant price cutting by airframe manufacturers. The backlogs of the two major manufacturers amounted to only about $3.8 billion at the end of 1971—down 21 percent for the year and less than half of the 1967 peak.

The space agency, with its declining budget, also offered little assistance. NASA awarded $523 million in contracts to California firms in fiscal 1971—down 40 percent for the year and equal to only one-fourth of the 1965 peak level. However, NASA has one major project on its drawing board —a $5.5-billion space-shuttle system which was unveiled in early 1972. This project, a preliminary contract for which was awarded to a California firm in 1971, envisions a 50,000 employment boost by the latter part of the decade, with about one-half of these new jobs being centered in California.

With sales prospects still dismal, some aerospace firms attempted to diversify during the year, as they had done in earlier periods of recession. One firm is turning a 100,000-acre rocket site in Oregon into farm sites and home sites, and other firms are moving into petro-chemicals and other unrelated fields. Still, a full scale recovery awaits a substantial boost in orders from the Pentagon, from NASA or from commercial airlines—or from all three.

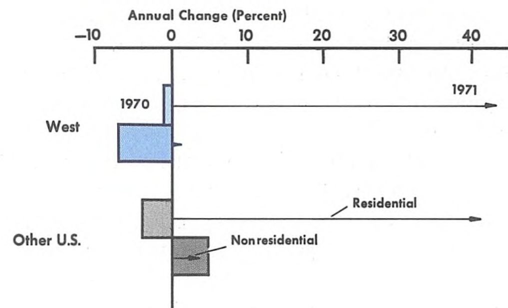
Housing in orbit

The construction picture was mixed in 1971, with declining activity in nonresidential and heavy construction partially offsetting the boom in residential construction. A slight 1-percent decline in contract awards in these other categories contrasted with a 40-percent jump in housing awards. Elsewhere in the nation, builders matched the Western pace in the volume of housing awards while reporting a moderate gain in other construction activity.

The $6.6 billion in contracts for nonresidential and heavy construction covered a wide variety of projects. There were moderate gains in construction of commercial buildings, hospitals and educational facilities, but there were also fairly substantial declines in construction of manufacturing plants, streets and highways and water-related projects.

Housing starts in the West rose 55 percent to a record 488,000 units, surpassing even the 40-percent increase in starts elsewhere. (These figures exclude mobile homes, which jumped 68 percent to 99,000 units.) Housing activity (including mobiles) increased fastest in Oregon and Arizona, with gains of 70 percent or higher, but California,

Drop in other construction partly offsets tremendous housing boom



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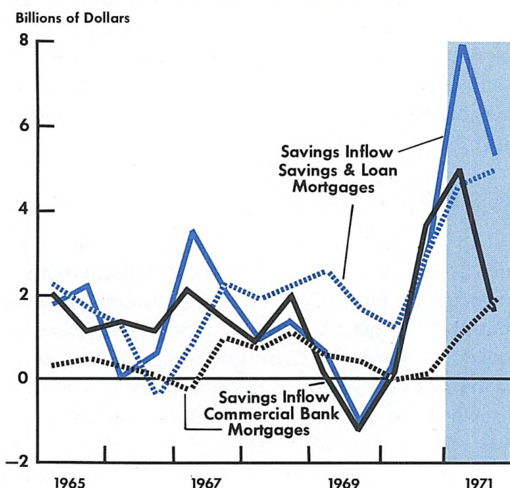
Mortgage market bolstered by large gains in deposit inflows



Nevada, and Utah also added new housing at a rapid pace. Even Washington posted a modest increase, despite another sharp drop in housing activity in the depressed Seattle area.

The housing boom was fueled by a massive supply of mortgage funds, supported by a record buildup of funds in savings institutions. The gain in savings and consumer deposits at large District banks reached $3.3 billion, and the deposit gain at savings-and-loan associations reached $6.6 billion—in each case, almost double earlier peak figures. This buildup developed because of the high rate of consumer savings and the increasing attractiveness of thrift-institution rates in relation to declining yields on competitive instruments.

The institutions funneled a substantial share of these massive inflows into mortgage markets. Banks registered a $1.4-billion increase in mortgage lending, about double the increase in the previous peak year (1963). S&L's expanded their mortgage portfolios by $5.0 billion, for a 10-percent gain over their earlier peak, even while reducing substantially their borrowing from regional Home Loan Banks.

The heavy savings inflow and the attendant expansion in mortgage lending was accompanied by a significant decline in mortgage rates throughout the West. The average rate on conventional new-home loans went from 8.40 percent in January to 7.85 percent at year-end. (In contrast, it reached 9.40 percent in early 1970.) Rates did not fall uniformly, but instead increased significantly in early summer before declining again during the fall months. Along with the decline in borrowing costs, some easing also appeared in non-price terms of lending, represented by increased loan maturities and loan-price ratios.

Varied fortunes

The fortunes of the major Western supplying industries varied with those of the sectors they serviced. Lumber, the most obvious case, prospered as the housing boom generated the highest production level of the past seven years. Producers encountered difficulty keeping up with the strong pace of orders, so prices rose steadily except during the 90-day freeze period. In December, with the easing of the freeze and seasonal production problems, a further upsurge in prices occurred. Thus at year end, lumber prices were up 35 percent and plywood prices 24 percent above the year-ago period.

Western steel production lagged for the second year, declining 10 percent to about 6.0 million tons, the lowest level of the past eight years. Steel output was sluggish during the first half (despite strike-hedge buying), because of the slowdown in nonresidential construction, and it slowed further in the second half, as steel users liquidated their excess inventories following August's steel labor settlement. Imports meanwhile surged to a new high, in the process taking almost one-third of the Western steel market. Yet despite falling demand and the pressure of imports, domestic producers raised prices 7.3 percent for the year.

Producers of copper and other nonferrous metals experienced a lengthy strike and some production shutdowns during the year. Copper mine production dropped 11 percent during the year, partly because of a strike which closed mines for several months during the summer period. Despite production problems here and in the nationalized Chilean mines, world market prices generally were down, ending the year 16 percent below the late-1970 peak of 60 cents a pound.

In the lead-and-zinc industry, cost pressures caused the closing of several important facilities, including the largest lead-and-zinc mine in Utah.

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The shutdowns occurred in the face of rising demand from the auto industry, which helped to boost prices of both metals significantly.

Pacific Northwest aluminum producers shut down a number of potlines in an effort to bring production more closely into balance with lagging demand, especially from the aerospace industry. With these cutbacks, primary aluminum production fell to 80 percent of capacity, but even this reduced-supply situation was not enough to prevent widespread discounting from list prices.

Petroleum demand expanded in 1971, causing a 5-percent rise in activity at Western refineries, which at year-end maintained a 2.1-million barrel-per-day capacity. Domestic sources were able to provide only 70 percent of the crude supply for refineries, with the remainder coming from Canadian and other foreign producers. In fact, crude-oil output declined both in California and Alaska, although California remained third (albeit a distant third) to Texas and Louisiana among producing states. And despite restrictions imposed on the development of offshore fields, California's offshore wells accounted for over one-quarter of that state's entire petroleum output.

The construction of a pipeline to bring oil and natural gas from Alaska's North Slope to market remained stalled, blocked by court suits filed by environmentalists and native land claimants. The President signed a bill granting 40 million acres and $962 million to settle these land claims, but some native groups objected that the grant excluded subsurface rights to oil-bearing land.

Rising farm output

Western farmers generally reported a prosperous year, with cash receipts rising 7 percent to a record $8.2 billion. The sharp advance in crop receipts, partly due to a bumper wheat crop and expanded fruit output, contributed most to this record gain, but returns from livestock marketings also increased moderately. Western farmers scored larger gains, both in crops and livestock, than did their counterparts elsewhere.

Even so, the net income of District farmers increased only slightly, since most of the gains in marketing receipts were offset by rising production expenditures and falling government payments. With expenditures rising, farmers in the West increased their credit requirements, but most turned to Production Credit Associations rather than to commercial banks for their funds.

Dairymen and cattlemen apparently did quite well last year, at least by comparison with earlier years. Grapes and tree nuts also fared well, as did field crops—except for cotton, where the market

INDEXES OF INDUSTRIAL PRODUCTION—TWELFTH DISTRICT

(1967=100)

INDUSTRIAL PRODUCTION	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971
Copper	130	131	132	143	150	100	128	166	180	161
Lead	109	106	99	95	121	100	88	88	84	88
Zinc	117	113	107	103	111	100	88	87	69	64
Silver	104	102	102	114	128	100	101	119	123	115
Gold	78	78	77	105	120	100	89	115	118	100
Steel Ingots	75	86	97	101	103	100	104	106	101	91
Aluminum	55	61	69	77	85	100	105	129	128	114
Crude Petroleum	78	79	79	84	92	100	113	115	117	114P
Refined Petroleum	87	88	90	94	96	100	108	114	115	120P
Natural Gas	86	98	100	99	107	100	104	104	107	104P
Lumber	106	105	111	109	106	100	107	104	101	110
Douglas Fir Plywood	89	99	107	111	106	100	108	97	99	113
Canned Fruit	118	104	137	106	131	100	129	138	102	103P
Canned Vegetables	93	85	87	85	99	100	110	86	83	93P
Red Meat	87	89	98	98	100	100	102	104	102	103P
Sugar	98	104	119	118	113	100	117	124	112	124
Creamery Butter	114	98	99	92	81	100	112	114	144	164

P=Preliminary

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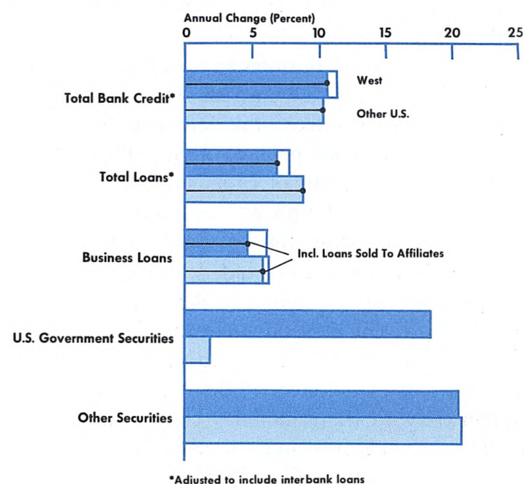
improved but yields continued to decline. Deciduous fruit growers, at least in California, generally had a difficult year because of poor weather and lowered demand. Citrus production went up slightly over the previous year. In contrast, California's canning tomato crop jumped 16 percent over the 1970 level, as the industry bounced back after completing a cycle of overproduction and reduced output over the past several years.

The prolonged Pacific Coast dock strike created major transportation problems for farm products, especially the bumper 243-million-bushel wheat crop. In the Northwest states, wheat piled up on the ground at harvest time, and U.S. outshipments dropped sharply from the previous year. Canadian producers reaped the benefit from this situation, recording a very strong increase in wheat exports.

Strong gains in bank credit in line with gains recorded elsewhere



Sources and Uses

The uneven performance of large District banks as they adjusted to changing economic signals is evident from the quarterly swings in their sources and uses of funds. (Data unadjusted for seasonal variation.) In the first quarter of 1971, the expansion in funds exceeded $2.1 billion, as an expansive monetary policy and declining money rates stimulated an inflow of deposits. Time deposits completely dominated the expanded source of funds, providing 93 percent of the total. About three-fourths of these funds were invested in U.S. Government and other securities, mainly the latter, and nearly one-fourth was channeled into loans. The remainder was used to reduce Eurodollar and Federal-funds borrowings, to meet increased required reserves, and to pay out demand deposits.

In the second quarter, the expansion in funds fell slightly under $2.0 billion, as the downward movement in rates was reversed and signs of inflation once more became evident. The inflow of time deposits diminished sharply, providing only 37 percent of the total. Demand deposits, borrowings under corporate and other repurchase agreements, and an increase in capital accounts filled the "gap" in sources of funds, together with a net reduction in holdings of U.S. Government securities. About one-half of these funds went to increase loan portfolios—double the first-quarter allocation—mainly to meet the large demand for mortgages. Other uses were for "other" securities and for further repayments of Eurodollar and Federal-funds borrowings.

The effects of more stringent monetary conditions were evident in the third quarter, and the expansion in funds fell below $1.5 billion. Time deposits contributed only a small part (16 percent) of this amount, but demand deposits rose sharply. An increase in capital accounts and further net sales of U.S. Governments made up the remainder. Eighty percent of these funds were used to expand loan portfolios, which were heavily weighted by mortgage loans and by loans related to the international financial crisis. Larger required reserves and reductions in various types of borrowings absorbed the remaining funds.

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Rising credit and deposits

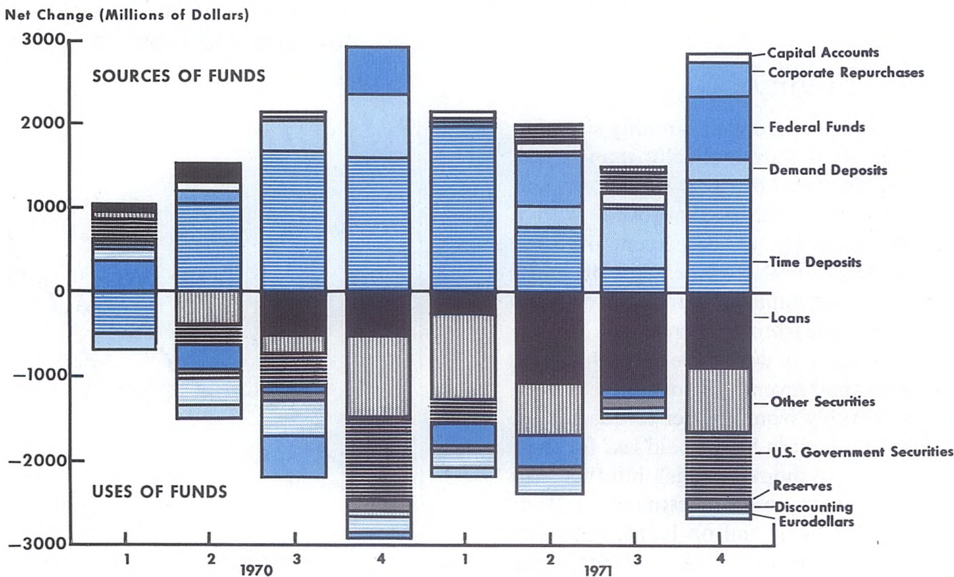
Western banks were buffeted in 1971 by the sharp swings in the regional economic climate described above, as well as by the gyrations of the national and international economies. Even so, with the aid of a generally easing monetary policy, Twelfth District commercial banks recorded gains of 13 percent in deposits and 11 percent in total credit during the year. These gains were about even with the rates of increase reported by commercial banks elsewhere.

The year was highlighted by a deluge of personal savings deposits in the first quarter, record increases in mortgage lending in the second and third quarters, and heavy business loan demand stemming from August's international financial crisis. Banks made frequent adjustments, up and down, in loan and deposit rates throughout 1971.

The $8.6-billion deposit expansion exceeded the previous year's gain, largely because of a strong 7-percent increase in private demand deposits. An even larger 16-percent increase in time deposits was smaller than the previous year's increase, despite the early-year upsurge in savings. These new funds were used primarily for investment in securities and for loan expansion, but also for the repayment of Eurodollar borrowings and bank-related commercial-paper borrowings.

The $7.1-billion increase in total credit was distributed evenly between the banks' loan and security portfolios. Banks made heavy purchases of municipal securities in both short- and longer-term maturities, whereas their investment in U.S. Treasuries was mostly concentrated in the intermediate and long end of the maturity spectrum. As already noted, the $3.5-billion expansion in loan portfolios was heavily weighted by the $1.7-

In the fourth quarter, as the effectiveness of the wage-price freeze brought some easing in monetary conditions, the expansion in funds rose steeply to $2.8 billion. A resurgence in the inflow of time deposits contributed nearly half of the total, and demand deposits another tenth. The remaining sources were from borrowings in Federal funds, from corporate and other repurchase agreements, and from a further small increase in capital accounts. Loans absorbed about one-third of these expanded funds. The rest, except for small amounts for reserves and repayments of Eurodollar borrowings, was divided about equally between investment in U.S. Governments and other securities.



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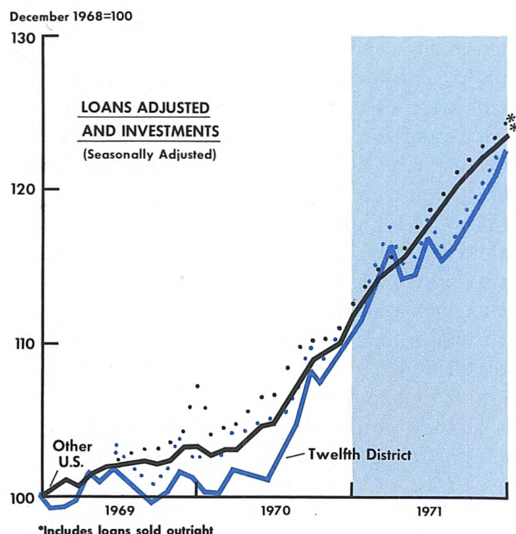
Bank credit advances strongly throughout most of year



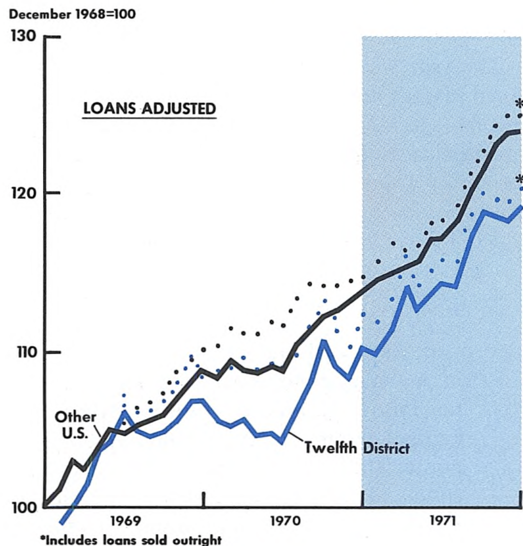
billion increase in mortgages, plus a sharp $400-million increase in loans to mortgage companies and a strong $670-million expansion in consumer instalment credit. While business loans rose by $1.0 billion, this represented only a modest increase in borrowing by most types of business, reflecting as it did the slow business pace and the reduced corporate reliance on banks as a source of funds.

Improved liquidity

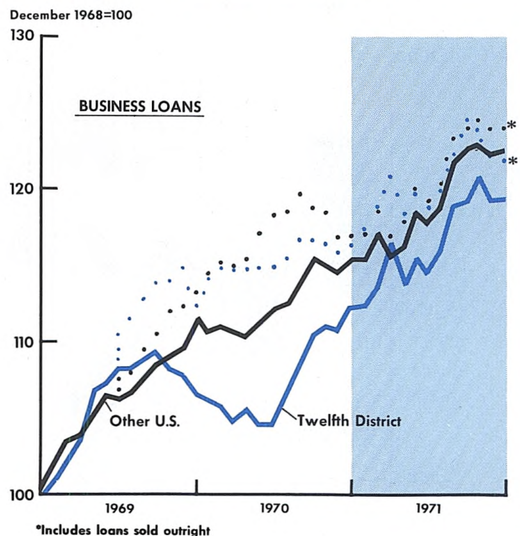
District banks improved their liquidity situation in 1971, although less dramatically than in the previous year. The ratio of loans to deposits (including Eurodollar liabilities) improved, with a decline from 74 percent to 70 percent over the course of the year. Similarly, the ratio of short-term Treasuries and municipals to total deposits rose over the period, from 6.1 percent to 6.9 percent, at which point it was twice the 1969 low.

Changing cost and revenue factors altered profit margins considerably from quarter to quarter. In the first quarter, Western banks paid less for their funds (except for passbook savings), but they also had lower rates of return on investments, reflecting falling security rates, and on loans, reflecting five reductions in the prime rate; at the same time, however, they reported large capital gains from security sales. In the second quarter, as loan rates began to edge up again, many banks benefitted on the cost side from the one-half percent reduction in rates paid on passbook savings, but after mid-year this cost advantage disappeared with the return of rates to the 4 1/2-percent ceil-

...but loan growth reflects mortgage buying and summer crisis lending



...as business loans remain sluggish except during world financial crisis



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ing. Then in the fourth quarter, profit margins again were squeezed as security yields declined and banks made rate reductions on loans, even while maintaining the high level of rates paid on savings and consumer type deposits. In 1971 as in other recent years, net income varied widely among District banks, but in general smaller banks turned in a better profit performance than their larger counterparts.

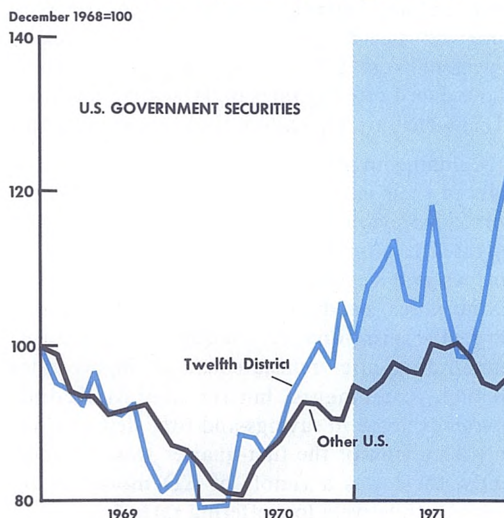
Easier reserve pressure

District banks were under relatively little reserve pressure except during the third quarter. Required reserves increased $363 million above the 1970 level (daily-average basis), but this increase was less than might otherwise have been expected, since the banks' deposit inflow was heavily weighted toward time deposits, which carry a smaller reserve requirement than demand deposits. Reserves declined against Eurodollar borrowings and bank-related commercial-paper borrowings, because of reduced bank reliance on such sources of funds.

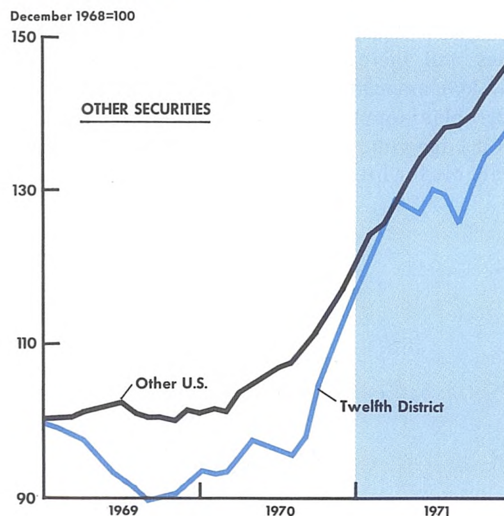
District-bank borrowings from the Federal Reserve Bank amounted only to $27 million in 1971, as against $72 million in the preceding year (daily average basis). Similarly, banks recorded net borrowed reserves of $8 million—well below the 1970 average of $54 million—despite wide fluctuations during the year. In the first and second quarters, banks reported a small net *free* reserve position, reflecting the accommodative monetary policy at that time. In the third quarter, as reserve pressures increased because of the world financial crisis, banks increased their borrowings, so that their reserve position shifted to net *borrowed* reserves of $45 million. Finally, amidst the fourth quarter's easing of monetary policy, banks shifted again to a net *free* reserve position.

Large District banks made relatively little use of the Federal Reserve discount window, but they continued to borrow fairly heavily through interbank purchases of Federal funds. Net interbank purchases (borrowings) amounted to $678 million on a daily average basis, as against $883 million in 1970. At the same time, net sales (loans) to dealers fell, so that on total transactions, banks were net purchasers of $380 million, as against $450 million in 1970. Still, some major District banks on average were net sellers of funds for the year.

...while banks make heavy purchases of Treasuries, especially longer term



...and also increase their purchases of municipal bonds



Erratic deposit flows

Deposit flows were erratic during the year, partly reflecting changes in rates offered on time and savings deposits. District banks were inundated by consumer savings in the first quarter, as the spread widened between stable bank rates and declining market rates. In this period, passbook savings at large banks rose by $1.7 billion. Con-

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sequently, in an effort to reduce interest expenses and slow down the pace of inflow, a number of banks reduced offering rates on longer-term consumer certificates, generally rolling them back to 5 percent from 5 1/2 or 5 3/4 percent. Banks also reduced offering rates on large-denomination CD's, which are typically issued to corporations.

Beginning in April, many West Coast banks reduced their passbook-savings rate to 4 percent from the previously prevailing 4 1/2-percent ceiling rate. Because of this less attractive interest return, as well as seasonal withdrawals for income-tax purposes, passbook savings actually declined during the spring quarter. Consumer-type deposits rose in June after reinstatement of higher rates on such instruments, but the overall second-quarter increase in savings-and-time deposits was only a fraction of the first-quarter gain. Concurrently, there was a runoff of CD money in response to relatively low offering rates.

The deposit experience was completely different in the third quarter. The outflow of passbook savings was stemmed as banks reinstituted a 4 1/2-percent rate, reacting to rising money-market rates and increased competition from savings-and-loan associations. Banks also attracted a considerable amount of CD money by actively bidding for a large volume of short-term corporate funds available for investment.

In the fourth quarter, there was a further increase in passbook-savings flows but a further reduction in inflows of consumer-type deposits. The uncertainties regarding Phase II may have induced individuals to put their savings in passbook accounts, where they were not committed to any particular maturity. But overall the fourth quarter witnessed a substantial increase in total time deposits, due to unseasonably large increases (especially in December) in the deposits of governmental units.

Private demand deposits increased steadily through July, moved irregularly through November, and then rose rapidly again in December. U.S. Government deposits fluctuated widely, and declined slightly over the year. Treasury balances dropped sharply in January, March and again in October, but in contrast they skyrocketed during August's foreign-exchange crisis.

Western banks faced a profit dilemma as the old year ended and the new year began. On the revenue side, they found it necessary to meet the rate reductions initiated by Eastern banks on business loans, and meanwhile reduced their rates on consumer and mortgage loans. On the cost side, they hesitated to lower the rates on savings and other time deposits, because of the fear of a substantial loss of funds to the S&L's. But eventually, in February, they lowered deposit rates so as to avoid a severe profits pinch.

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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
	Dec. 29, 1971	Dec. 30, 1970 to Dec. 29, 1971		Dec. 31, 1969 to Dec. 30, 1970	Dec. 30, 1970 to Dec. 29, 1971
		Dollars	Percent	Percent	Percent
Loans gross adjusted[1] and investments	61,768	+6,201	+ 11.16	+ 10.26	+ 6.65
Loans gross adjusted[1]	43,170	+3,260	+ 8.17	+ 4.55	+ 5.44
Commercial and industrial loans	16,119	+ 817	+ 5.34	+ 4.17	+ 1.67
Real estate loans	12,601	+1,355	+ 12.05	+ .71	+11.71
Agricultural loans	1,463	+ 132	+ 9.92	− 1.82	+16.90
Loans to nonbank financial institutions	2,329	+ 324	+ 16.16	+ 6.86	+ 4.79
Loans for purchasing or carrying securities:					
To brokers and dealers	839	− 814	− 49.24	+236.66	− 5.51
To others	324	+ 105	+ 47.95	− 24.64	+ 3.43
Loans to foreign banks	425	+ 267	+168.99	− 41.04	+77.60
Consumer instalment loans	6,356	+ 668	+ 11.74	+ .32	+ 9.47
All other loans	2,714	+ 406	+ 17.59	− 2.98	+ 6.33
Total investments	18,598	+2,941	+ 18.78	+ 28.12	+ 9.67
U.S. Government securities	7,308	+ 975	+ 15.40	+ 36.23	− 1.35
Obligations of states and political subdivisions	9,255	+1,516	+ 19.59	+ 17.76	+15.76
Other securities	2,035	+ 450	+ 28.39	+ 58.67	+22.17
Total deposits (less cash items)	60,939	+7,166	+ 13.33	+ 12.81	+10.68
Demand deposits adjusted	19,160	+1,214	+ 6.76	+ .91	+ 3.13
Time and savings deposits	39,390	+5,488	+ 16.19	+ 20.87	+17.65
Savings deposits	17,316	+1,886	+ 12.22	+ 2.60	+12.63
Other time IPC	14,377	+1,948	+ 15.67	+ 35.28	+18.87
Deposits of states and political subdivisions	6,024	+1,398	+ 30.22	+ 74.35	+31.74
(Neg. CD's $100,000 and over)	5,300	+ 931	+ 21.31	+ 83.45	+31.99
Capital accounts	4,667	+ 446	+ 10.57	+ 3.48	+ 8.32
Total assets/liabilities and capital accounts	78,852	+9,683	+ 14.00	+ 8.12	+ 7.06

[1]Total loans minus loans to domestic commercial banks

This annual-review issue was edited by William Burke and Karen Rusk. Principal contributors to this issue included: William Burke (domestic business conditions); Ruth Wilson (District banking); Verle Johnston (District construction and mortgage markets); Yvonne Levy, Karen Rusk, Donald Snodgrass, and Joan Walsh (District business); Janis Wilson (artwork). The *Monthly Review* is published by the Bank's Research Department: J. Howard Craven, Senior Vice President.

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Federal Reserve Bank of St. Louis

Western Central Bank

The Federal Reserve Bank of San Francisco, the West's central bank, expanded its operations during 1971. The San Francisco office and its branches at Los Angeles, Portland, Seattle, and Salt Lake City serve nine Western states—Alaska, California, Hawaii, Idaho, Nevada, Oregon, Utah, Washington, and most of Arizona.

As a result of changing monetary conditions, the Federal Reserve Bank's discount rate changed frequently during 1971. It started the year at 5 1/2 percent, then was lowered in three steps to 4 3/4 percent by mid-February. Monetary policy stiffened somewhat by mid-year, and the rate was boosted to 5 percent on July 16—the only increase made in 1971. Short-term rates later dropped following the wage-price freeze, and the discount rate was lowered in November to 4 3/4 percent and in December to 4 1/2 percent.

The "moderately easy" position of the monetary authorities during the year was plainly evident at the discount window. Borrowings by District member banks, on a daily average basis, were only $27 million in 1971, as against $72 million the preceding year.

Telegraphic transfers of funds continued to increase in 1971, although at a slower rate than in the past three years. Transfers for all five offices totalled nearly $2 *trillion*—an 18-percent gain in dollar volume, which went along with a 10-percent gain in number over the year. The five offices also processed 897 million checks—a gain of more than 33 million over the previous year. The total value of these checks was more than $210 billion.

The addition of two "new" coins during 1971 highlighted coin and currency operations. The Kennedy half, while not a new design, was issued for the first time as a silverless coin, and the Eisenhower dollar—also a clad coin—was distributed late in the year. The number of pieces of coin handled at the Reserve Bank, and the dollar value, declined slightly from a year ago. Total value dropped by $1 million to $199 million. The amount of currency handled increased moderately to 896 million pieces and $7.5 billion.

The San Francisco Bank's activity as fiscal agent for the Federal Government remained at a high level during 1971. The Treasury conducted its regular quarterly refinancing operations and also raised additional funds in 1971 through several special offerings. For the first time under new legislation, the Treasury issued bonds with interest rates exceeding the 4 1/4- percent legislative ceiling. These $1,000 and $10,000 bonds featured attractive yields of 6 1/8 percent on 15-year issues and 7 percent on 10-year issues.

Treasury bill yields were weak during most of the year and reached a two-year low after 1972 began. Nevertheless, the dollar volume of marketable securities processed by the Reserve Bank in 1971 showed an increase of $31 billion over 1970 to $115 billion. The redemption of savings bonds in the District continued to exceed new sales, although the margin was much smaller than in earlier years because of their increasingly attractive rates.

The Bank's Government-security holdings increased, but total earnings for the year fell for the first time since 1961. This drop, from $535 million to $524 million, was largely due to the lower level of short-term interest rates during most of the year. The average yield on Bank holdings was 5.66 percent in 1971, as compared with 6.48 percent in 1970. The Bank's share of securities in the System's Open Market Account totalled $9.6 billion —13.8 percent of total System holdings.

Net expenses for the Bank rose by more than $4 million in 1971, to $35 million, partly because of higher salaries, increased benefit costs, and an increase in assessment for expenses by the Board of Governors. Dividends of over $5 million were paid to member banks, and $7 million was transferred to surplus to bring that account to the level of paid-in capital stock. The remaining net earnings of $477 million were paid to the U.S. Treasury as interest on Federal Reserve Notes.

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