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Monthly Review
OF THE FEDERAL RESERVE BANK OF MINNEAPOLIS

Slowing shown in recovery

The steel strike which closed iron ore mining operations in this district has not significantly curtailed economic activity in other lines. Most metal fabricators apparently have sufficient stocks of steel to continue operations through the greater part of September. Consequently, state employment departments anticipate no major layoffs in steel fabricating or related fields during this period.

The economic recovery in this district has begun to show a few signs of slowing down a bit. However, this cannot be directly traced to the steel strike. The aggregate volume of business transacted during July as measured by the seasonally adjusted index of bank debits, was down slightly from June. Employment in nonagricultural establishments from mid-June to mid-July, before the strike was called, expanded at a slower rate than in former months and also slower than in the comparable period of a year earlier.

In July, evidence appeared that farmers in this district had begun to cut back on their expenditures. The sale of farm equipment dropped sharply. In fact, some regional distributors reported the sharpest drop experienced in the post World War II period. In communities principally serving farmers, some evidence exists that the decline in sales has begun to spread to other merchandise lines.

Although larger marketings of livestock and livestock products have maintained cash farm income in this district in the face of lower prices,

First half bank profits 6

Losses on securities drop bank profits for first half 1959 below year-ago levels.

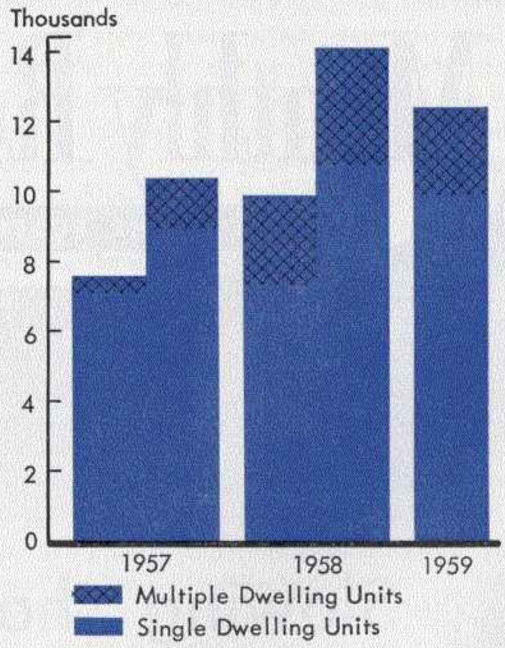
farmers have cut back expenditures in anticipation of lower incomes during the remainder of this year. Small grain yields in South Dakota were generally well below the ten-year average. In other districts states yields were, on the whole, equal to their long-term averages but extremely spotty. Small grain acreage abandonment was quite heavy in central South Dakota, in southern and western North Dakota and in eastern Montana.

The lack of moisture, which remains a critical problem throughout the district, is causing crop prospects to deteriorate further. In west central and southwestern Minnesota and in eastern parts of North and South Dakota, corn yield prospects declined further during August.

In the iron ore mining regions retail and service establishments such as department and apparel stores, drycleaning establishments, and gasoline service stations, experienced a lower volume of sales for some months prior to the steel strike than was true in other areas of the district. Workers apparently restrained their spending in anticipation of a possible need for savings during a strike. During the first two weeks of the steel strike, sales were maintained as workers on strike bought materials for home repair work. However, during the first part of August, an increasing number of outlets in the iron ore mining regions experienced a falling off in the volume of sales. Incomes, of course, were gradually being cut off; many workers received vacation pay at the end of July. For instance, in Minnesota weekly earnings in metal mining averaged $53.61 for July compared to $114.05 for June. This is forcing workers to tighten up on expenditures.

In the credit field, the demand for bank loans in large cities of this district remained strong through July but tapered off in smaller cities and towns. Twin Cities and Helena banks (designated as reserve city banks) lost deposits while the total for other banks increased. As a result of these diverse trends, the loan-deposit ratio at reserve city banks rose further during July to 56 percent and at country banks it declined to 46 percent.

Dwelling units authorized by building permits in the Ninth district, 6-month totals



CONSTRUCTION

Construction has been an expansionary force in the current economic recovery. In the nation the value of new construction put in place during July continued at a seasonally adjusted annual rate of nearly $55 billion. This was below the recent peak of $55.8 billion reached last March but still well above the year-ago total of $48.4 billion.

In past months the amount of contracts awarded for industrial plants and for commercial building—especially shopping centers—has risen noticeably. The awards made for highway construction have been particularly high. The expansion in commercial, industrial and highway construction as a whole has slightly exceeded the smaller increase in public utility and residential awards.

In the Ninth district the total amount of contracts awarded during the first half of this year exceeded $600 million as it did in the same period last year. Compared with the first six months last year, there was a decrease in the awards made for industrial plants and commercial buildings of 13 percent and for public works and utilities of 27 percent. On the other hand, the amount of awards made for residential building was up 33 percent in the like period. This more than offset the decrease in other fields.

Residential building has been an important part of the high level of construction activity in this district. In the first half of this year, the amount of awards for home construction totaled $260 million or 41 percent of all awards made. Construction employment has increased but it is still down as compared with the total number of workers employed in several years prior to 1958.

In residential building there has been a substantial pick-up in the construction of multiple dwelling units. In this district, out of a total of 23,580 new dwelling units authorized by building permits in 1958, 6,152 or one-fourth were duplexes, triplexes or apartment houses. In the first half of this year the number of multiple units authorized (2,513) has fallen off somewhat but still constitutes one-fifth of the total. This represents a markedly larger number planned for construction than in 1957.

Multiple-unit building is concentrated in the larger district cities. In the Twin Cities metropolitan area, 3,954 multiple dwelling units were authorized by permit in 1958. About 736 of those units were included in a single project—the Glenwood redevelopment project. However, even with this project excluded, there were better than 2 1/3 times more of such units authorized by permit in 1958 than a year earlier. During the first six months of this year, a total of 1,953 multiple units were authorized by permit which was about 50 percent as many as in all of 1958, indicating that the boom in the building of apartments is still going strong.

Although residential building continued at a high level through July, a peak in the number of dwelling units authorized by permit in this district occurred in April. In that month, 3,619 units were authorized. In both May and June, the number of authorizations were down 25 percent from the peak established in April.

RETAIL SALES

Despite the closing down of the steel industry on July 14, retail sales in the nation during the month continued at the record seasonally adjusted rate reached in May. At department stores, sales during July and the first part of August declined less than the usual seasonal amount. The advanced rate of sales of new cars and of a number of other durable goods achieved in earlier months has substantially held up.

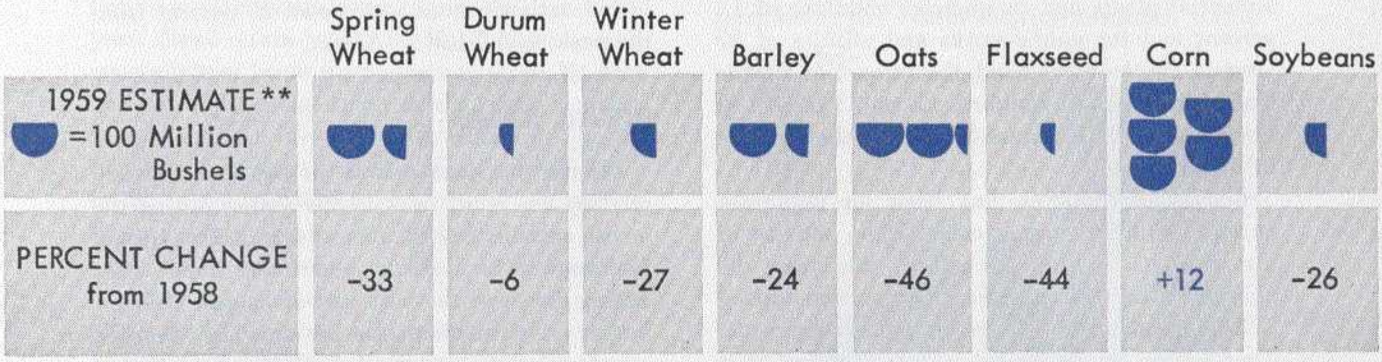
In the Ninth district, retail sales during July have held up well in most lines. The seasonally adjusted department store sales index stood at 133 percent of the 1947-49 base period which indicates a level of sales quite comparable to that recorded earlier in the year. The index dropped a few points in June but was higher than it had been in April and May. Sales this summer in Minneapolis, St. Paul, Duluth and Superior have held up better in general than in the smaller cities and towns, which apparently reflects the economic recovery in the more industrialized larger centers.

Based on June registration figures, new passenger car sales in this district were 34 percent higher than last year. Registration rose in all district states. The smallest increase was reported in South Dakota. In the Twin Cities area, registrations during July and the first part of August continued to exceed those of a year earlier.

Sales figures reflect some pessimism, too. For example, sales of farm machinery dropped sharply when it became evident that the yield of small grain in many areas would fall below expectations. In many trade centers principally serving farmers, a more general decline in sales has reportedly begun to develop.

During the first two weeks of the steel strike, retail sales in iron mining regions of the district held up well. Perhaps this was the result of miners

Prospective Ninth district* crop production, 1959 compared with 1958



*Data based on four states wholly within district.
**1959 based on U.S.D.A.'s August 1 crop forecast.

turning to home-repair work, and consequently buying hardware, building materials and paint. However, during the first part of August, an increasing number of retail and service establishments in those areas experienced a falling off in their volume of sales. Some evidence exists of scattered layoffs in affected retail establishments.

CROP PRODUCTION ESTIMATES DECLINE

A lack of moisture remains the critical problem throughout the district as crop prospects continue to deteriorate. The U. S. Department of Agriculture made downward revisions in most district crop production estimates between July 1 and August 1, though national estimates are close to 1958 levels. Continued unfavorable weather in August has undoubtedly cut further into district crop production since the last estimate.

Throughout South Dakota small grain yields are reported as well below average. Yields in other district states as a whole are about equal to 10-year averages. However, the crop is extremely spotty throughout the district. In Minnesota below average small grain yields were realized in the west central and southwestern portions of the state. In North Dakota the southern central and western portions have the poorest crop. And in Montana the eastern portion of the state reports below average yields. The southeastern portion of Minnesota and the Red River Valley areas have been the most favored district areas weatherwise this year. Yields there are well above average. Also the winter seeded grains in Montana have fared better than the spring grains which have a critical moisture period later in the season.

Corn yield prospects have declined during the past six weeks throughout west central and southwestern Minnesota and the corn areas of the Dakotas. Heavy plantings, plantings on lighter soil, and plantings on alfalfa ground are showing the most serious signs of drouth. Because of the drouth many corn stocks are barren and will not produce corn even with additional moisture. District corn production estimates were revised downward by 14 percent between July 1 and August 1. However, the August 1 estimates indicate an expected corn crop 12 percent above 1958; district corn acreage is 13 percent above last year.

Soybeans have also suffered from the recent drouth conditions. However, reports indicate that in many of the drouth areas soybeans bear unfilled pods which could fill if additional moisture is received. The first USDA soybean production estimate of the season made as of August 1 indicates that this year's crop is expected to be 26 percent below 1958. However, soybean acreage is 29 percent below the 1958 acreage.

RECENT DISTRICT BANKING DEVELOPMENTS

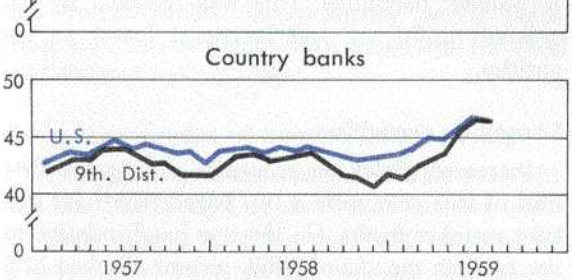
The liquidity of Ninth district city banks was further reduced in the four week period ended August 12 as the banks added new loans, liquidated short term government securities, and lost deposits. The ratio of loans to deposits at the city banks rose to the highest level in recent years —56 percent—as indicated by the chart.

In the four weeks ended August 12, loans rose by $17 million reflecting added consumer type loans and loans to nonbank financial institutions of $22 million and $12 million respectively. These gains were offset in part by a reduction of $19 million in the commercial and industrial loans and small changes in other loans. Previously this year commercial loans had been rising.

Another indication of reduced liquidity was a $38 million decline in city bank holdings of U. S. Treasury securities maturing within a year. This development reflects in part the purchase and subsequent liquidation of special treasury bill issues on July 7th and 15th. Holdings of under-one-year governments on August 12th were only $3 million less than on July 1. Demand deposits of the city banks fell $68 million in the four weeks ended August 12. The changes in both deposits and securities were in large part produced by the withdrawal of U. S. Treasury deposits—previously swelled by the special bill purchases.

According to preliminary estimates, district country member banks reduced loans slightly and added deposits during July. Loans, which rose or remained unchanged in ten of the past twelve years during July, fell $2 million during the month. Total deposits rose seasonally by $39 million. This compares with an increase of $27 million in July last year. The ratio of loans to deposits at country banks fell to 46.1 percent in July. Every other month this year except January it had increased, rising from 41.6 percent in January to 46.4 percent in June.

Ratios of loans to deposits at member banks, by months



DISTRICT CALF CROP SHOWS SLIGHT INCREASE

The 1959 calf crop in the Ninth district is expected to total 5,081,000 head according to U. S. Department of Agriculture estimates. A crop of this size would amount to an increase of 1 percent over 1958 and 14 percent over the 10-year average. The expected increase in the 1959 calf crop will be the first increase since 1955, when the crop peaked at 5,230,000 head.

The district calf crop increase in 1959 is about equally accounted for by a slight increase in the inventory of cows on farms and a slight increase in the calving rate.

The Montana and South Dakota calf crops are expected to exceed the 1958 crops by 3 and 4 percent, respectively, while in North Dakota and Minnesota the crops are expected to be down 1 and 2 percent, respectively.

Compared with the 10-year averages the 1959 calf crop is up in the Dakotas and Montana; the increases amount to 11 percent in North Dakota, 20 percent in South Dakota and 18 percent in Montana. In Minnesota the 1959 calf crop is about 1 percent below the average.

A downward trend in dairy cattle numbers exists. This reflects more heavily in the Minnesota calf crop because of the relatively greater importance of dairying in Minnesota. Dairy females of breeding age in Minnesota numbered 1,451,000 on January 1, 1959 while beef breeding females numbered 298,000. Compared with 10-year averages the Minnesota female dairy breeding herd as of January 1, 1959 was down 4 percent, while the female beef breeding herd increased 23 percent.

Treasury-Federal Reserve Study of the Government Securities Market

Early last spring the United States Treasury and the Federal Reserve System initiated a joint inquiry into the functioning of the Government securities market. The first of three parts of the study is now available in printed form.

Part I of the Study consists of two papers. The first is based on informal consultations with many individuals who are closely associated with the workings of the market or in other ways well-informed about the market. The second paper is a special technical study concerned with the question whether an organized exchange might better serve the public in effecting purchases and sales of Government securities.

Part II of the study will be a factual and analytical report on the performance of the Government securities market in 1958. Part III will deal with specialized and technical subjects suggested by the earlier two parts.

All may be ordered from the Board of Governors of the Federal Reserve System, Washington 25, D. C. The price of each part is $1.00, or $2.50 for the set of three pamphlets if ordered at one time. The individual parts will be forwarded as they become available.

Losses on securities cut into bank profits

During the first six months of 1959, profits of Ninth district member banks fell below the record level reported during the like period a year earlier. A look at the first half profits in other years shows that there were only three cases since 1948 when profits before taxes failed to better the comparable year earlier figure. In 1955 and 1957 district member banks experienced declines of six percent and two percent, respectively. But the most impressive case is that of the first half of this year when profits before taxes declined 35 percent relative to the like period a year earlier. Despite this, 1959 first half profits bettered the showing of every other year save 1958.

In the first half of 1959, earnings on loans at district member banks increased 10 percent relative to the analogous period a year ago. This as well as increased earnings on securities pushed up gross revenue for district member banks in the first six months of 1959. But in spite of added gross revenues net profits declined—in large part the result of a decline in the market value of investment portfolios. This was reflected by decreased profits on and increased losses on securities.

Losses on securities

Increased yields on securities during the first half of this year were a two edged sword for district member banks. On the one hand, relative to the first six months of 1958, income climbed 12.3

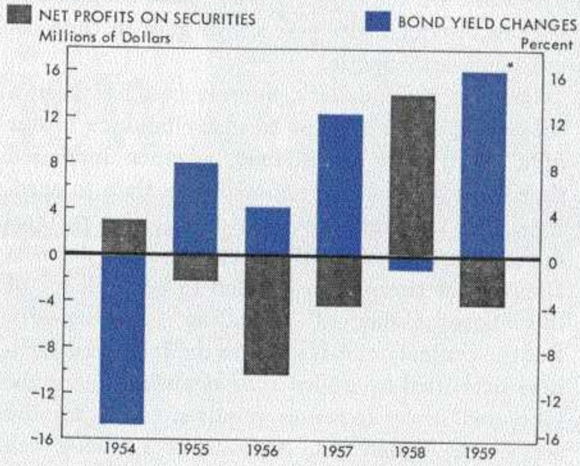
percent on government securities and 5.4 percent on other securities. In absolute terms, this amounted to a $2.6 million greater income on securities than district banks earned during the corresponding 1958 period. But on the other hand, the net of losses and profits on securities cut $17.3 million from profits relative to the first half of 1958. This canceled the gain in income from securities seven times over and was largely responsible for the fact that district member banks recorded less income before taxes than in 1958.

In Chart I the effect of changes in the market yield of bonds is compared with changes in net security profits of district member banks. The chart shows that security profits tend to decline or become losses when yields go up. This inverse relationship results because the market value of already existing securities tends to decline when currently issued securities must carry higher rates of return in order to be marketed.

Often when security yields are rising banks experience increased demand for loans. Since in such circumstances the Federal Reserve may not permit total bank credit to rise as fast as loan demand is rising, banks may have to meet part of their rising loan demand by selling securities. And because of the general increase in yields, the market value of those securities may be below their cost. Thus banks may experience losses or reduced profits on securities when security yields and loans are rising simultaneously. But at least part of these losses will likely be offset by higher yields on loans and on newly acquired securities.

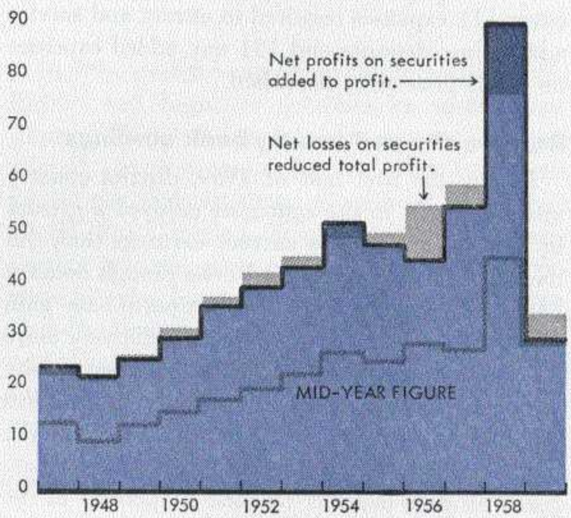
Chart II demonstrates that profits or losses on securities have been important factors in explaining overall profits earned during recent years. Note that this is particularly important for 1958 and the first half of 1959.

Net profits on securities and changes in bond yields, by years



*First half 1959.

Profits before taxes at Ninth district member banks, by years



Increased profits at South Dakota banks

A comparison of the first half of this year with the like 1958 period discloses that member banks in each district state or part state experienced greater increases in current earnings than in current expenses. But greater losses, especially losses on securities, more than offset increases in net current earnings in each state save South Dakota. There, member banks enjoyed greater relative gains in each major source of earnings—government securities, other securities, and loans—than did member banks in any other district state or part state. On the expense side, South Dakota also led the district in its percentage gain in time deposit interest expense.

Growing time deposit interest cost has been a subject of much interest to many bankers in our area. They have questioned whether increased time deposits add more to expenses than to earnings. The fact that the ratio of expenses to total deposits rises as the ratio of time to total deposits rises has at times been pointed to as evidence of the unprofitability of expanding time deposits. But the critical point is whether the increased earnings permitted by added time deposits exceed the increased direct expenses required to attract and service the added time deposits. If a banker can make more profits by adding time deposits he may very well be indifferent to the fact that his expenses have risen. A bank, of course, profits from accepting more time deposits so long as increased earnings which the new funds support more than cover (1) expenses required to attract and service added time deposits and (2) any added expenses on funds previously deposited.

Reserve city and country bank earnings

During the first half of 1959, district country member banks in the aggregate enjoyed a greater increase in their gross current earnings than did their city counterparts. And even though country banks experienced a greater proportionate gain in current expenses, they salvaged relatively more net current earnings than did the reserve city banks in the district. Country banks, which have relatively greater amounts of time deposits than do reserve city banks, reported that interest expense on time deposits climbed 15 percent in the first half of 1959 relative to a year earlier. Reserve city banks reported a 9 percent increase in time deposit interest. On the other hand, interest expense on borrowed funds from the Federal Reserve and from other lenders grew considerably more at the reserve city banks than at the country banks from the first half of 1958 to the like period of this year. In the first half of 1959, Ninth district member banks paid the Federal Reserve Bank of Minneapolis about $300 thousand for loans of reserve balances. The ten reserve city banks in the district accounted for over half of this amount. Their total borrowings expense from the Federal Reserve as well as from other lenders amounted to almost $600 thousand during the first six months of 1959.

Country banks reported about three-fourths of the total losses on securities in the first half of 1959. The net of recoveries and losses reduced the net current earnings of the country banks from $23 million to $19 million. It cut net earnings of the reserve city banks from $12 million to $10 million. Taxes captured about 50 percent of these profits at banks in each class, and in turn each class of bank paid out about half the remaining net profits to stockholders.

In summary, the first half of 1959 saw district member banks profiting from a growing volume of loans and substantially more securities than were held during the like period a year earlier. But current expenses continued their upward trend, and, most important, the seeming windfall profits on securities that occurred during the first half of 1958 were sharply reversed. Substantial cuts in profits or increased losses on securities dominated the first half earnings picture for district member banks. Nevertheless, a profit was earned and an addition to surplus was made during the first half unmatched in any like period save the record first half of 1958.