MONTHLY REVIEW

Contents:

FEDERAL RESERVE BANK OF MINNEAPOLIS
JUNE 1965

Current conditions . . .

Business activity in the Ninth district has been expanding at approximately the same rate as nationally. Improvement from year-earlier levels in nonagricultural employment in recent weeks was the same in the Ninth district as in the nation. The decline in the number of persons drawing unemployment compensation was also about the same, at around 15 per cent. The district unemployment rate—at 3.6 per cent in March, seasonally adjusted—was at the lowest monthly level for which data are available; in the nation, the rate was 4.7 per cent, the lowest level since 1957. New or initial claims in the district for unemployment compensation declined 10 to 11 per cent in the early spring period from year-earlier levels, about the same as nationally.

The labor market in the district is relatively tight, especially for skilled workers. This is particularly true in the Twin Cities area for construction workers following disastrous spring floods and tornadoes. The Minnesota Department of Civil Defense estimated tornado losses at $51.5 million; flood losses, estimated by the Army Corps of Engineers, $116 million.

According to estimates, the output of district manufactured products expanded about 8 per cent in the early spring from year-ago levels. This, too, was about the same pattern as nationally.

Total district construction activity, judged from contracts awarded and permits issued, was relatively low during the first quarter because of especially generally severe weather around the district. Although statistical data are not yet available for recent weeks, preliminary survey reports suggest a sharp pick-up in activity.

The dollar volume of district retail sales was also curtailed by the severe weather early in the year, but department store sales data in the 4-week period ended May 15 were about 10 per cent ahead of the same period of 1964.

Total district bank debits during April expanded about 8 per cent from April 1964. Since the first of the year, the expansion of the district debits index series has lagged that of the nation by only a small margin. This has been true also of the personal income series.

Our survey of bankers' opinion about current business conditions as of May 25 indicated a generally optimistic feeling. Only about 10 per cent of those reporting on this survey anticipated a decline in business prospects for the latter part of May or early June. A good part of the pessimism that does exist is from agricultural areas hard hit by last summer's drouth or by late spring planting conditions.

Credit expansion at district banks, after proceeding at an unusually vigorous pace during early 1965, gave way to a more subdued growth rate in the latter part of April—a rate which closely followed the seasonal pattern. Both city and country banks recorded substantial increases in loans during the first half of April; due in part, perhaps, to the need for funds to meet unusually heavy personal income tax liabilities which were created by the underwithholding of taxes during 1964. Subsequent to April 15, however, there has been little change in loans at city banks. At country banks, loans did spurt during the first two weeks of May, perhaps because of the delayed warm weather; but there was essentially no corresponding increase in total credit as country bank holdings of U. S. Government securities were drawn down to accommodate the increased loan demand.

The following selected topics describe particular aspects of the district's current economic scene:

More moderate pace marks district credit

The unusually vigorous rate of credit growth at district banks evident earlier in the year gave way in late April to a more moderate pace—a pace closely in line with the seasonal pattern. Although the increase in total credit during April amounted to $44 million—more than double the average rise for the month—all but $2 million of this advance had been recorded by the end of the second week. During the first two weeks of May district credit increased $12 million: the total advance for the four weeks ended May 12 amounted to only $14 million compared to a $19 million average increment during the comparable periods of the last five years.

Bank loans rose $45 million in April, substantially above the average for the month, but again, the entire increase was compressed into the first two weeks. After undergoing a slight contraction during the last half of April, outstanding loans increased $30 million during the initial two weeks of May. The level of bank investment holdings remained essentially unchanged during April, but fell $18 million during the same two weeks.

Weekly reporting banks increased total loans by $14 million during April—a month when ordinarily there is little or no change in the level of city bank loans. The aggregate increase was more than accounted for during the second week as business loans rose $15 million while "all other loans" expanded by $10 million. Higher personal income tax liabilities resulting in part from the underwithholding of 1964 income taxes may have been a significant factor in the expansion. Offsetting the rise, however, was an $11 million reduction in loans to nonbank financial institutions, the major part of which occurred during the last two weeks of April. City bank loans during the first two weeks of May increased $8 million—about average for the period. Small increases in business and real estate loans were noted while loans to nonbank financial institutions continued to decline.

Country banks followed the same pattern as did city banks during April. Of the $31 million increase in loans during the month, $26 million was recorded in the first half of April. This strong expansion was 50 per cent above the usual advance for the period; and again the need for loans to meet income tax liabilities may have been an indicative factor in the expansion. Unlike city banks, loan expansion was quite pronounced at country banks in the early part of May. The increase amounted to twice that of the average for the same period in recent years. To provide the needed loanable funds, $16 million of investments, principally U. S. Government securities, were liquidated thereby preventing any significant increase in total credit.

Floods, windstorms sweep parts of district

Floods and windstorms swept through portions of the Ninth district during April and May causing extensive damage. In southern Minnesota the Mississippi river, the Minnesota river, and many smaller streams left their banks as the spring thaw released heavy accumulations of frozen moisture. Homes, commercial and industrial establishments, fields, and highways were flooded along low-lying

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Operating ratios report:

1964 banking scorecard

In April of each year the Federal Reserve Bank of Minneapolis prepares as a summary report 41 operating ratios of member banks in the Ninth Federal Reserve district. The average ratios to be found in this report allow individual banks to compare their experience with representative district experience for similar size banks; the source of the ratios is the basic operating data submitted on regular reports by individual Ninth district member banks during the preceding operating year.

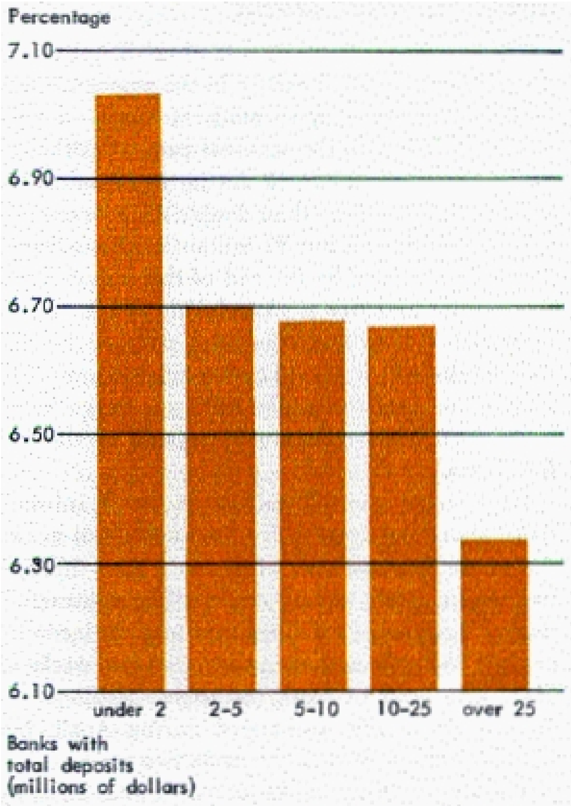
In addition to being of interest to bankers the operating ratios report contains information of general interest both to the financial specialist and to the casual observer of the financial picture. The ratios provide a number of useful details about the performances of banking in the district.

Size of bank

Most member banks in the Ninth district are somewhat smaller than typical member banks in the nation as a whole. About 74 per cent had less than $10 million in total deposits in 1964 in contrast to about 64 per cent for the nation. And only 25 per cent of all member banks in the district had deposits totaling over $10 million in contrast to 36 per cent in the entire Federal Reserve System. Since each bank is given a weight of one in computing the over-all average operating ratios, district averages more heavily reflect the influence of the smaller banks.

An examination of ratios for different size classes reveals that interest earnings on securities provided a relatively greater source of earnings at the smaller banks than at the larger ones. Interest earned on government securities averaged a little under 24 per cent of total earnings at the 360 district member banks with less than $10 million in deposits and 18 per cent at the 125 banks with over $10 million in deposits. Earnings on other securities accounted for about 8 per cent of total earnings

Chart 1—Revenue from loans, effective rate charged, 1964



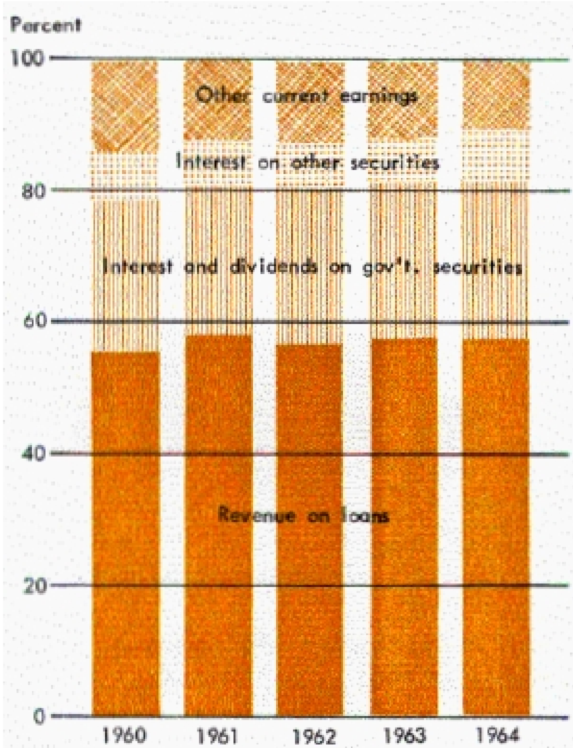
Note: Based on the average amount of loans outstanding during the year net of valuation reserves. Excludes losses or recoveries on loans.

at the smaller banks and approximately 7 per cent at the larger ones. In part, higher relative securities earnings by the smaller banks resulted from higher average yields on securities held by smaller banks. But to a major degree the proportionately higher securities earnings at the smaller banks stemmed from their relatively greater holdings of securities: U.S. government and other securities averaged 29.6 per cent and 11.7 per cent, respectively, of total assets at member banks with less than $10 million in deposits in contrast to 24.1 per cent and 10.8 per cent at banks with more than $10 million in deposits.

Earnings on loans showed an obverse relationship to that on securities in spite of the fact that the average rate of earnings at larger banks trailed that of the smaller ones (Chart 1). Loans made up a relatively greater percentage of total earning assets at larger banks than at smaller member banks in the district. Interest on loans averaged 57.9 per cent of total operating revenue at banks with less than $10 million in deposits, 62.8 per cent at banks with over $10 million in deposits.

The relative contribution of these various sources of earnings (government and other securities, and loans) has remained virtually unchanged the past five years (Chart 2).

Chart 2—Sources of operating revenue, 1960-64



Expenses

On the expense side of the ledger the average bank in the smaller deposit classes tended to have proportionately greater salary and wage expenses: they averaged 27 per cent of operating revenue at banks with less than $10 million in deposits; 22.5 per cent at banks in the more-than-$10 million class. This fact may be the result of economies of scale in banking. Or it may simply show that smaller banks have compensated manager-owners more by way of salaries than by way of dividends.

Taxes took a relatively larger bite out of the profits at the larger banks; being 8.6 per cent of net income on the average at banks in the largest size class in contrast to 5.4 per cent at the smallest banks. But despite higher taxes, dividends of the large banks on the average were relatively larger than those at the smaller banks. Cash dividends as a fraction of capital amounted to 4.4 per cent at the largest banks and 3.1 per cent at the smallest banks.

Time deposit interest

An examination of the interest-to-time-deposits ratio reveals a steady progression from the smallest size bank to the largest size in effective rate paid (Chart 3). The ratio was computed only for those banks with time deposit or trust departments. The over-all average was 3.32 per cent, up from 2.51 per cent in 1960. This fact no doubt reflects the increased competition of commercial banks among themselves and with other financial institutions for savings throughout the Ninth district.

Chart 3—Interest-to-time deposits, effective rate paid, 1964

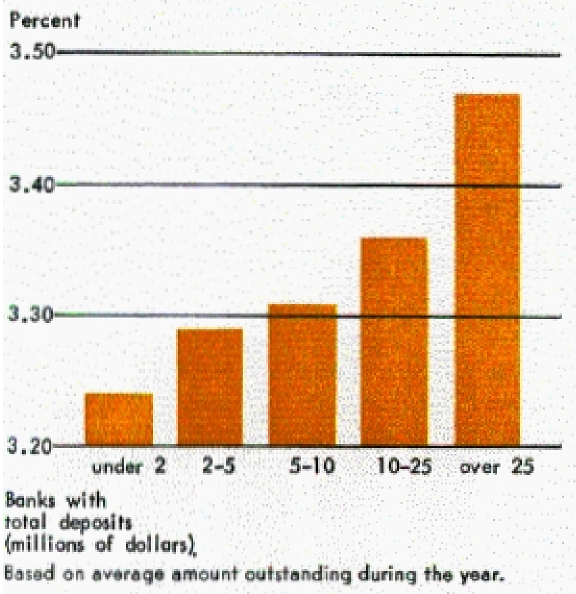
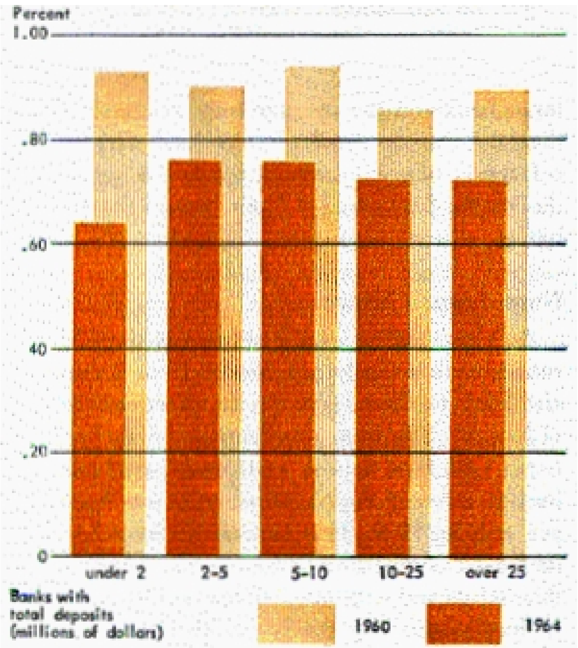


Chart 4—Net income after taxes as a percentage of total assets, 1960-64



The ratio of net profits to total assets, when compared with that of 1960, reveals a decline for all classes of banks (Chart 4). The largest drop was in the smallest bank category (banks with total deposits of under 2 million), .93 per cent in 1960 to .64 per cent in 1964.

Current conditions . . .

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areas. Col. Leslie Harding, St. Paul district engineer of the Army Corps of Engineers, told a congressional subcommittee that damage totaled $116 million: $47 million along the Mississippi, $44 million along the Minnesota, $17 million along the Red River of the North, $5 million along the St. Croix, and $3 million along the Crow and the Rum. In mid-May, flash floods in the Black Hills of South Dakota caused more than $3 million damage to highways, bridges, and residences.

A disaster of a different sort struck a 10-county area of Minnesota in May when a series of tornadoes skipped through. Particularly hard hit were portions of Minneapolis suburbs. More than 1,000 homes were destroyed or suffered major damage; 500 farm buildings; and 60 small businesses. Total property damage was estimated at over $51 million by the Minnesota Department of Civil Defense.

Some of the funds for clean-up and rebuilding to state and local governments is coming via federal assistance under the Federal Disaster Act of 1950; and to individuals and businesses via programs of the Small Business Administration, the Farmers Home Administration, the Federal Housing Administration, and the Veterans Administration.

An economic consequence of the floods and storms showed up in the construction industry as residents set about the task of rebuilding. In Minnesota, for example, the Department of Employment Security estimated that employment in the construction industry increased 8,600 between mid-April and mid-May, 1,000 of the increase attributed to workers for flood repair.

Cattle feeding operations undergo sharp cutback

Cattle feeding operations in the district evidenced a sharp cutback from year-earlier activity during the spring months. The total number of cattle and calves on feed on April 1 amounted to 970,000 head, down 8 per cent from April 1, 1964, a figure that compares with a 2 per cent cutback throughout the 32 major cattle feeding states. In Minnesota and South Dakota, the district's major feeding states, the cutback in cattle and calves on feed amounted to 10 per cent and 3 per cent respectively. Cattle on feed on April 1 were down 18 per cent in North Dakota and 3 per cent in Montana from year-earlier levels.

Much of the cutback was caused by a marked reduction in the number of cattle placed on feed during the first quarter of 1965. In all, just 275,000 head were added to district feedlots during that period, a drop of 27 per cent from placements during the same period in 1964. The largest relative drop in placements occurred in North Dakota where just over one-half as many cattle were put into feedlots as compared with last year. In Minnesota placements were down 38 per cent; South Dakota, 12 per cent; and Montana, 9 per cent. These district declines contrast sharply with the 1 per cent decline in feedlot placement in the 32 major cattle feeding states.

Adding to the decrease in feedlot numbers was a fairly heavy movement of cattle to market during the January-March period. Over-all, 411,000 head were sold off district feedlots, a 6 per cent increase over the number marketed during the first quarter of 1964. The first quarter marketings from Minnesota and South Dakota exceeded those of a year earlier by 1 per cent and 9 per cent respectively. Marketings out of Montana feedlots were up 20 per cent; in North Dakota, 5 per cent. Marketings from the 32-state area were up 5 per cent.

As a result of the drop in numbers of cattle on feed on April 1, district fed cattle marketings are expected to be off 15 per cent during the period April through June as compared with the same period in 1964. That decline compares with an expected 4 per cent drop in fed cattle marketings from the 32-state area. Among the district states, fed cattle marketings during the second quarter are expected to be off 12 per cent in Minnesota, 15 per cent in South Dakota, 14 per cent in North Dakota, and 5 per cent in Montana.

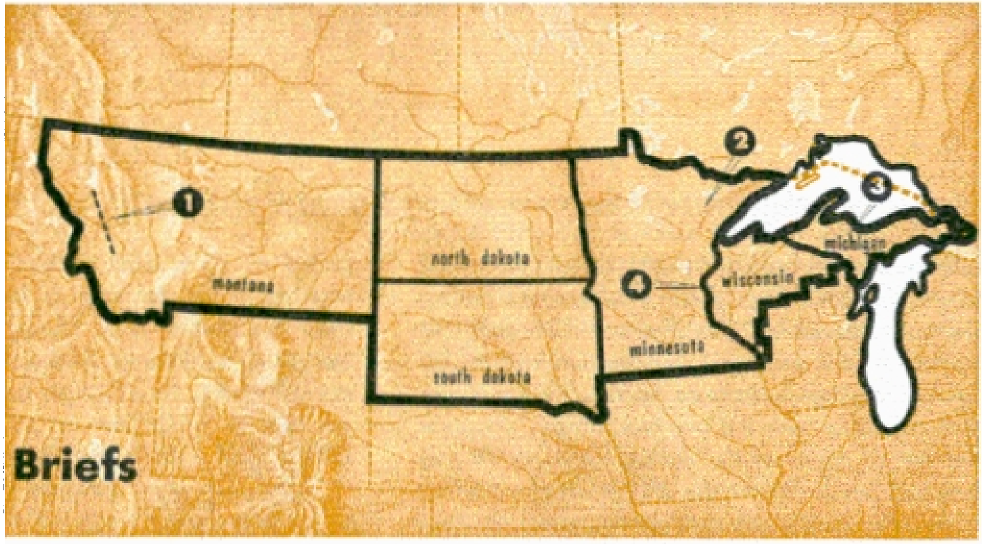
Marketings after mid-year will continue to be under year-earlier levels. Of the number on feed on April 1, 583,000 head are expected to be marketed after June 30, a decline of more than 3 per cent from the comparable figure in 1964. For the 32-state area a near 1 per cent increase is expected.

CATTLE AND CALVES ON FEED, BY QUARTERS
(thousands of head)

	April 1 1964	Jan. 1 1965	April 1 1965
Minnesota	501	506	451
North Dakota	141	158	116
South Dakota	342	349	332
Montana	73	92	71
Total	1,057	1,105	970
32 States	8,612	9,357	8,450

In spite of heavy total marketings during the first quarter of 1965, fed cattle prices have shown considerable improvement since the first of the year. Choice 900-1,100 lb. steer prices at Chicago averaged $25 per cwt. the last week of April, about $2.50 higher than mid-January 1963 and more than $3.00 higher than in 1964. The main reason for this price improvement was a decline in the output of choice and prime cattle and a concurrent drop in average market weight of the higher quality animals. Liveweight of choice steers declined about 13 pounds per head between January and May and were 50 pounds below the year-earlier average. Thus, high quality beef production has fallen off more than the number marketed would indicate. Over-all, choice and prime cattle accounted for 52 per cent of total output in the major markets during the first quarter as compared with 61 per cent a year earlier.

Economic Briefs



1. $4 million power link

A major project in a $22 million expansion program by Montana Power Co. is a 230,000 volt line extending from Hot Springs to Anaconda, Montana. The 150-mile line will connect with facilities being constructed from the Washington Water Power Co. plant at Noxon. Work on the $4 million project began in February.

2. Chemical company announces plant

Dow Chemical Co. has announced plans to build a new plant to manufacture blasting agents for the taconite industry. To be constructed on a site between Biwabik and Aurora, Minnesota, the plant will replace an older facility near Virginia. Construction is scheduled for completion in late 1965.

3. Fourth unit for Presque Isle station

Construction is scheduled to begin soon on the No. 4 unit of the Upper Peninsula Power Company's Presque Isle generating station at Marquette, Michigan. Energy from the unit will be used primarily to produce power for the Empire Mine of the Cleveland-Cliffs Iron Co. and its partners located near Palmer. Cost of the new addition will be $8 million; its capacity, 58,400 kilowatts.

4. Work slated on Eau Galle dam

A project to harness the Eau Galle river at Spring Valley, Wisconsin with a 122-foot-high earth and rock-fill dam will be started this summer by the St. Paul district of the U. S. Corps of Engineers. The over $10 million project also includes construction of a spillway, levee, channel enlargement, and straightening of a tributary, Mines creek.