annual statement for...

1966

FEDERAL RESERVE BANK OF DALLAS

FEDERAL RESERVE BANK OF DALLAS

To the Member Banks in the
Eleventh Federal Reserve District:

The Statement of Condition and the earnings and expenses of the Federal Reserve Bank of Dallas for the year 1966, with comparative figures for 1965, are shown herein. Lists of the directors and officers of the Bank and its branches as of January 1, 1967, are also included.

A review of economic and financial developments in the Nation and the District during 1966 is being presented in the January 1967 Annual Report Issue of the *Business Review* of this Bank.

Additional copies of these publications may be obtained upon request to the Research Department, Federal Reserve Bank of Dallas, 400 South Akard Street (mailing address: Station K, Dallas, Texas 75222).

Sincerely yours,

Watrous H. Irons

WATROUS H. IRONS
President

statement of condition

	Dec. 31, 1966	Dec. 31, 1965
ASSETS		
Gold certificate account	$ 655,337,464	$ 367,907,289
Redemption fund for Federal Reserve notes	61,919,809	56,691,801
Total gold certificate reserves	717,257,273	424,599,090
Federal Reserve notes of other Banks	40,500,700	47,262,200
Other cash	18,429,704	6,546,798
Discounts and advances	400,000	22,024,000
U.S. Government securities:		
Bills	430,479,000	374,626,000
Certificates	158,682,000	—
Notes	776,882,000	1,022,083,000
Bonds	226,069,000	269,636,000
Total U.S. Government securities	1,592,112,000	1,666,345,000
Total loans and securities	1,592,512,000	1,688,369,000
Cash items in process of collection	540,487,954	464,980,479
Bank premises	9,840,781	10,513,931
Other assets	62,751,442	49,104,064
TOTAL ASSETS	$2,981,779,854	$2,691,375,562
LIABILITIES		
Federal Reserve notes in actual circulation	$1,278,172,767	$1,193,940,804
Deposits:		
Member bank — reserve accounts	1,064,648,587	1,034,443,622
U.S. Treasurer — general account	137,218,136	21,204,504
Foreign	9,280,000	8,700,000
Other	7,047,303	5,970,581
Total deposits	1,218,194,026	1,070,318,707
Deferred availability cash items	410,832,102	355,703,182
Other liabilities	8,152,959	7,476,769
TOTAL LIABILITIES	2,915,351,854	2,627,439,462
CAPITAL ACCOUNTS		
Capital paid in	33,214,000	31,968,050
Surplus	33,214,000	31,968,050
TOTAL CAPITAL ACCOUNTS	66,428,000	63,936,100
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	$2,981,779,854	$2,691,375,562

earnings and expenses

	1966	1965
CURRENT EARNINGS		
Discounts and advances	$ 2,184,633	$ 1,062,969
U.S. Government securities	71,722,638	62,144,870
Foreign currencies	1,275,220	809,956
All other	35,484	31,407
TOTAL CURRENT EARNINGS	75,217,975	64,049,202
CURRENT EXPENSES		
Current operating expenses	10,437,270	9,991,494
Assessment for expenses of Board of Governors	524,400	501,096
Federal Reserve currency:		
Original cost, including shipping charges	863,240	1,153,992
Cost of redemption, including shipping charges	66,555	48,538
Total	11,891,465	11,695,120
Less reimbursement for certain fiscal agency and other expenses	848,953	840,387
NET EXPENSES	11,042,512	10,854,733
PROFIT AND LOSS		
Current net earnings	64,175,463	53,194,469
Additions to current net earnings	76,588	71,537
Deductions from current net earnings:		
Loss on sales of U.S. Government securities (net)	95,832	329
All other	7,241	49,113
Total deductions	103,073	49,442
Net additions or deductions (–)	–26,485	22,095
Net earnings before dividends and payments to U.S. Treasury	64,148,978	53,216,564
Dividends paid	1,965,116	1,891,621
Payments to U.S. Treasury (interest on F.R. notes)	60,937,912	49,942,543
Transferred to surplus	1,245,950	1,382,400
Surplus, January 1	31,968,050	30,585,650
Surplus, December 31	$33,214,000	$31,968,050

directors

FEDERAL RESERVE BANK OF DALLAS

CARL J. THOMSEN	*(Chairman and Federal Reserve Agent),* Senior Vice President, Texas Instruments Incorporated, Dallas, Texas
MAX LEVINE	*(Deputy Chairman),* Retired Chairman of the Board, Foley's, Houston, Texas
MURRAY KYGER	Chairman of the Board, The First National Bank of Fort Worth, Fort Worth, Texas
J. EDD MCLAUGHLIN	President, Security State Bank & Trust Company, Ralls, Texas
J. B. PERRY, JR.	Real Estate Investments and Development, Lufkin, Texas
KENNETH S. PITZER	President and Professor of Chemistry, Rice University, Houston, Texas
RALPH A. PORTER	President, The State National Bank of Denison, Denison, Texas
C. A. TATUM, JR.	President and General Manager, Dallas Power & Light Company, Dallas, Texas
H. B. ZACHRY	Chairman of the Board, H. B. Zachry Company, San Antonio, Texas

EL PASO BRANCH

GORDON W. FOSTER	Vice President and Director, Farah Manufacturing Company, El Paso, Texas
ROBERT W. HEYER	President, Southern Arizona Bank & Trust Company, Tucson, Arizona
ROBERT F. LOCKHART	Vice President, The State National Bank of El Paso, El Paso, Texas
C. ROBERT MCNALLY, JR.	Rancher, Roswell, New Mexico
JOSEPH M. RAY	President, The University of Texas at El Paso — Texas Western College, El Paso, Texas
ARCHIE B. SCOTT	President, The Security State Bank of Pecos, Texas
JOE B. SISLER	President, The Clovis National Bank, Clovis, New Mexico

HOUSTON BRANCH

DONALD B. CAMPBELL	Retired, Orange, Texas
HENRY B. CLAY	President, First Bank & Trust, Bryan, Texas
EDGAR H. HUDGINS	Ranching — Partner in Hudgins Division of J. D. Hudgins, Hungerford, Texas
A. G. MCNEESE, JR.	President, Bank of the Southwest National Association, Houston, Houston, Texas
GEO. T. MORSE, JR.	President and General Manager, Peden Iron & Steel Company, Houston, Texas
W. G. THORNELL	President, The First National Bank of Port Arthur, Port Arthur, Texas
JOHN E. WHITMORE	President, Texas National Bank of Commerce of Houston, Houston, Texas

SAN ANTONIO BRANCH

W. A. BELCHER	Veterinarian and Rancher, Brackettville, Texas
JAMES T. DENTON, JR.	President, Corpus Christi Bank and Trust, Corpus Christi, Texas
TOM C. FROST, JR.	President, The Frost National Bank of San Antonio, San Antonio, Texas
HAROLD D. HERNDON	Independent Oil Operator, San Antonio, Texas
MAX A. MANDEL	President, The Laredo National Bank, Laredo, Texas
FRANCIS B. MAY	Chairman of Department of General Business and Professor of Business Statistics, The University of Texas, Austin, Texas
J. R. THORNTON	Chairman of the Board and President, State Bank and Trust Company, San Marcos, Texas

FEDERAL ADVISORY COUNCIL MEMBER

ROBERT H. STEWART, III	Chairman of the Board, First National Bank in Dallas, Dallas, Texas

officers

FEDERAL RESERVE BANK OF DALLAS

WATROUS H. IRONS, *President*

P. E. COLDWELL, *First Vice President*

ROY E. BOHNE, *Vice President*

JAMES L. CAUTHEN, *Vice President*

J. L. COOK, *Vice President*

RALPH T. GREEN, *Vice President*

CARL H. MOORE, *Vice President*

*G. R. MURFF, *Vice President*

JAMES A. PARKER, *Vice President*

T. W. PLANT, *Vice President and Cashier*

W. M. PRITCHETT, *Vice President*

FREDRIC W. REED, *Vice President*

THOMAS R. SULLIVAN, *Vice President*

ARTHUR H. LANG, *General Auditor*

GEORGE F. RUDY, *General Counsel*

ROBERT H. BOYKIN, *Assistant Vice President and Secretary of the Board*

LEON W. COWAN, *Assistant Vice President*

TONY J. SALVAGGIO, *Assistant Vice President*

E. A. THAXTON, JR., *Assistant Vice President*

E. W. VORLOP, JR., *Assistant Vice President*

J. Z. ROWE, *Director of Research*

JAMES O. RUSSELL, *Chief Examiner*

SIDNEY J. ALEXANDER, JR., *Assistant Cashier*

ROBERT A. BROWN, *Assistant Cashier*

RICHARD D. INGRAM, *Assistant Cashier*

HARRY E. ROBINSON, JR., *Assistant Cashier*

JESSE D. SANDERS, *Assistant Cashier*

GEORGE C. COCHRAN, III, *Assistant Counsel and Assistant Secretary of the Board*

HERMAN B. HUDSON, *Assistant General Auditor*

EL PASO BRANCH

FREDRIC W. REED, *Vice President in Charge*

T. C. ARNOLD, *Cashier*

FORREST E. COLEMAN, *Assistant Cashier*

HOUSTON BRANCH

J. L. COOK, *Vice President in Charge*

RASCO R. STORY, *Cashier*

ROY E. MALEY, *Assistant Cashier*

R. J. SCHOENHOFF, *Assistant Cashier*

SAN ANTONIO BRANCH

CARL H. MOORE, *Vice President in Charge*

A. E. MUNDT, *Cashier*

ALVIN E. RUSSELL, *Assistant Cashier*

FREDERICK J. SCHMID, *Assistant Cashier*

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*Will retire on February 1, 1967.

FEDERAL RESERVE BANK OF DALLAS

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business review

january 1967

FEDERAL RESERVE
BANK OF DALLAS

Annual Report Issue

contents

1966 — another boom year

1966—another boom year

Regardless of which broad measure is used, 1966 can be characterized as another year of booming economic activity. It was a year highlighted by severe strains on the Nation's productive resources and a continuation of the accelerated price increases that began in 1965, following several years of relative price stability. The value of goods and services produced in the Nation last year, at about $739 billion, was well above the 1965 total; but the year-to-year gain registered, if adjusted for price changes, was slightly lower than the advance of nearly 6 percent achieved in 1965.

The total output of goods and services increased to successive highs in every quarter of 1966, but the pattern of the economic expansion was uneven. After its exceptional first-quarter gain, gross national product showed more temperate advances. Further, all sectors — residential construction and net exports of goods and services in particular — did not fare equally well last year in the competition for available resources, nor maintain their contribution to the economic upswing.

economic developments

After rising almost $18 billion (annual-rate basis) in the final quarter of 1965, GROSS NATIONAL PRODUCT — the value of all goods and services produced — increased nearly $17 billion in the first quarter of 1966. These large gains reflected the convergence of the sharply higher demands of both consumers and businessmen and the substantial acceleration in defense expenditures stemming from the Nation's enlarged commitment to the Viet-Nam war. Although the rate of expansion in GNP subsided markedly from the exceptional first-quarter pace, the quarter-to-quarter rise averaged close to $12 billion during the rest of the year.

Three broad sectors contributed to the rise in GNP last year — consumer spending, business investment, and government purchases of goods and services; and of these, spending by Federal, state, and local governments showed the most vigorous relative gain. Defense spending rose almost one-fifth in 1966; in contrast, such expenditures in 1965 were virtually unchanged from the previous year. On the other hand, the advance in nondefense expenditures of the Federal Government was held to less than 3 percent in an effort to reduce pressures upon resources. State and local government spending continued apace last year, with the percentage increase in such expenditures slightly exceeding both the gain recorded for 1965 and the rise in total GNP during 1966.

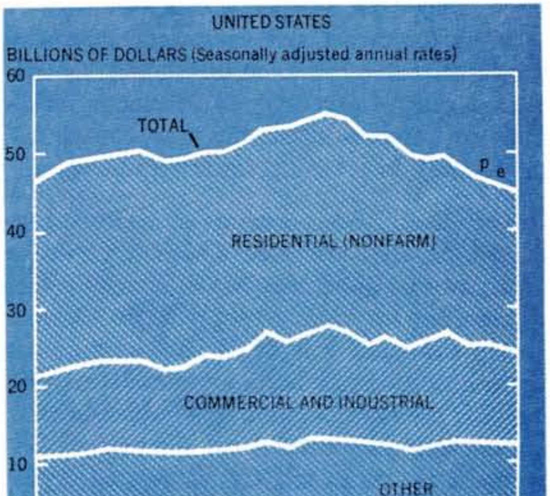
Personal consumption expenditures and private domestic investment registered somewhat similar increases last year, averaging in the neighborhood of 8 percent each. Outlays by business for plants and equipment accounted for all of the rise in fixed investment, as residential construction sagged. Substantial additions to business inventories also contributed importantly to total investment spending.

The efforts of businessmen to increase productive capacity remained a vital force in the economy throughout the year, although the rate of spending for such purposes began to taper during the latter half of 1966. The vigorous uptrend in business fixed investment early in the year prompted legislation — which became law in early November — to suspend the investment tax credit and the accelerated depreciation allowances on new projects undertaken between October 10, 1966, and the end of 1967. Plant and equipment spending in 1966 is expected to total about $60.6 billion, or 16.5 percent above the previous record set in 1965.

Despite the sizable outlays for fixed investment that have been made since 1963, the growth in demand has reduced much of the excess capacity; and by 1965, manufacturers' capacity utilization rates averaged about 89 percent. During 1966, utilization rates moved up to around 91 percent, the highest since the final quarter of 1955 and only slightly below the operating rate which has been indicated, in some private surveys, to be preferred by manufacturers. A further stimulus was given to investment by the high and rising level of corporate profits in 1965 and early 1966 and the expectations of businessmen that further strong sales gains could be anticipated.

As might be expected in an economic environment as buoyant as that in 1966, businessmen accumulated inventories throughout the year. Inventory accumulation for the year averaged around \$10.0 billion, up from \$9.1 billion in 1965. Inventories usually are increased in order to accommodate a rise in final demand, but a slight gain in inventory-sales ratios for both manufacturers and distributors during 1966 suggests that some involuntary inventory accumulation may have occurred. A part of the dip in the rate of inventory accumulation reflected the rather substantial adjustment made in inventories of new cars when it became apparent that the exceptionally high level of sales achieved early in the year could not be maintained.

NEW PRIVATE CONSTRUCTION



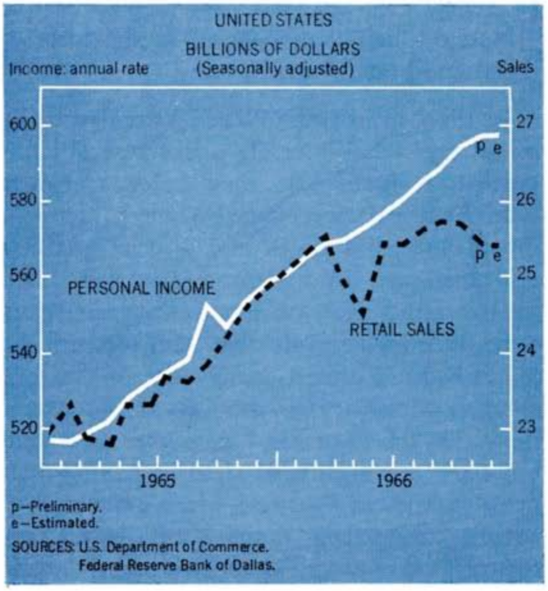
p—Preliminary.
e—Estimated.
SOURCES: U.S. Department of Commerce.
Federal Reserve Bank of Dallas.

A significant portion of the stocks of manufacturers represented work in process, particularly in the case of machinery, equipment, and defense products. The accumulation of inventories by manufacturers was mirrored in a gain in stock-sales ratios; late in 1966, the ratio equaled 1.70 months of shipments, compared with an average of 1.61 months for 1965. The continuation of efforts of businessmen to keep stocks well balanced with sales was one of the favorable aspects of economic developments last year.

The residential construction industry met with disappointment in 1966. After remaining virtually on a plateau during the previous year, spending on residential building rose slightly in the early months of 1966 and then moved downward rather abruptly; for the year, such spending totaled about 7 percent below the 1965 figure. New private housing starts dipped more abruptly than did total dollar outlays; starts were about 20 percent below their 1965 total.

Much of the disappointing performance of housing activity last year undoubtedly was due to a drying up of traditional sources of mortgage funds as these suppliers sought more profitable outlets. Another possible influence in the housing market may have been the fact that, since residential building had remained at high levels for several years and vacancy rates were uncomfortably high in some areas, a period of digestion was needed. The somewhat slower rate of family formation may also have been a moderating influence.

PERSONAL INCOME AND RETAIL SALES



Because of its size in relation to other markets in the economy, consumer spending importantly shaped economic developments during the course of the year. Personal consumption expenditures, at about $465 billion, accounted for around 63 percent of total GNP in 1966 — little different from the proportion a year earlier. Unlike in 1965, when consumer buying of durable goods (especially automobiles) provided a pacesetting lift, spending on all durable goods in the final months of 1966 was slightly below that in the early months of the year, and purchases of automobiles were significantly lower. Sales of new automobiles dipped from an annual rate of 9.4 million units in January to only a little over 8.0 million units in the closing weeks of last year. Further, some softening in purchases of various major household durables emerged toward the year-end, probably reflecting, in part, the reduced rate of home building. It is the durable goods sector that is often the "swing" element in consumer buying.

The major source of strength in consumer spending last year was nondurable goods and services, with the gains in outlays for both exceeding their respective gains in 1965. The upward lilt in food prices during much of 1966 and the higher costs for apparel and a wide range of professional, business, and personal services contributed to the rise in outlays for soft goods and services.

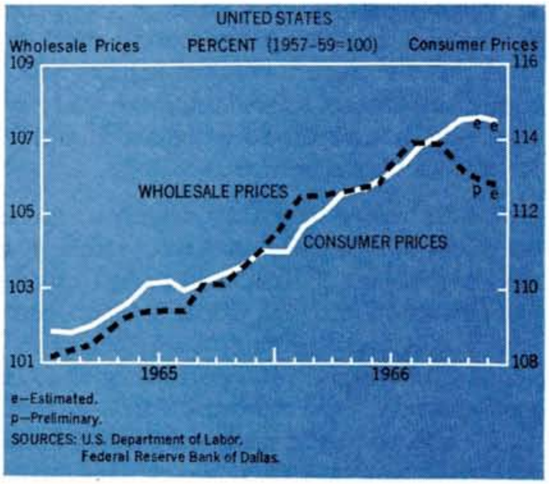
For the second year in a row, net exports of goods and services declined, reaching a level of less than $5 billion. Although exports of both agricultural and nonagricultural commodities expanded during 1966, the proportionally greater rise in imports narrowed the trade balance. Imports of machinery, aircraft, trucks, scientific equipment, and industrial raw materials rose significantly; and consumers also bought increasing quantities of foreign goods.

INDUSTRIAL PRODUCTION reached a new high last year and was nearly 9 percent more than in 1965. The most rapid advance in physical output occurred in the first part of 1966, when the month-to-month increase was averaging well over 1 index point a month. After midyear, however, the rate of gain in industrial output slackened, with production showing decreases in some months. Automobiles, iron and steel, and building materials were the major categories contributing to the easing in production.

The production of business equipment and defense goods remained on an upswing throughout 1966, reflecting the demands of the Viet-Nam war and the trend in business investment. The output of aircraft and parts, in particular, rose sharply last year as defense requirements accelerated. Nondurable manufacturing exhibited strength during most of the year, with output of most broad categories of soft goods rising above their 1965 levels. Defense ordering was an important factor in boosting production of apparel and textiles and petroleum and related products.

In large measure, some of the greatest pressures last year developed in connection with

WHOLESALE AND CONSUMER PRICES



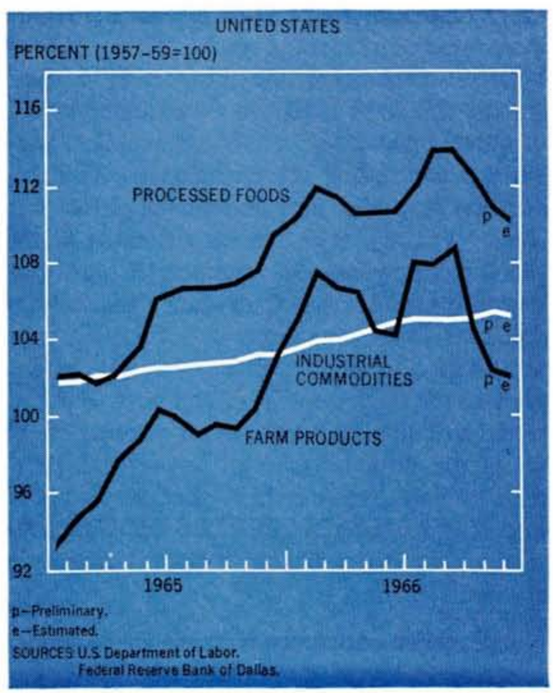
manpower requirements to service the burgeoning economy. Some of the largest gains were centered in EMPLOYMENT in defense-related industries — namely, ordnance and accessories, aircraft and parts, and electrical equipment. Employers had a particularly difficult time finding trained and experienced workers and often had to resort to hiring less-qualified personnel, increasing the amount of overtime work, or both. Manufacturing employment maintained a general uptrend during 1966, but average hours worked shortened slightly after midyear.

Job opportunities last year rose more rapidly than did the civilian labor force, and unemployment shrank from an average rate of 4.6 percent of the labor force in 1965 to 3.8 percent in 1966. In several months last year, the unemployment rate declined to as low as 3.7 percent. The rate for married men was considerably smaller, averaging less than 2 percent.

The growth in personal income in 1966 exceeded the rise of nearly 8 percent in the previous year, with wages and salaries showing especially vigorous growth. Hourly earnings of production workers continued upward, and several union contracts which were renegotiated provided significant wage increases. In addition to wages and salaries, other broad types of income rose last year, including income of proprietors and that received in the form of rents, dividends, and interest.

In 1966, as in 1965, PRICES were generally on an uptrend. Wholesale prices rose about 3 percent, a faster rate than in the previous year. Food prices remained a major factor in the advance, but prices of industrial products also increased over their year-earlier level. In the latter part of last year, there were some heartening signs that the pressure on prices had moderated, mainly due to the softening in prices for farm products and processed foods. On the other hand, consumer prices did not show any significant signs of halting their upswing and, at year-end, were more than 3 percent above their January 1966 level. Although food contributed importantly to the rise in consumer prices, nonfood items — particularly services — were significantly more costly than a year earlier.

TRENDS IN WHOLESALE PRICES



Of particular concern to the Nation's competitive position has been the rise in unit labor costs in manufacturing. After holding relatively steady for several years, unit labor costs in manufacturing began to increase in 1965 and continued their upward movement during 1966. If this trend continues, it could deal a heavy blow to the Nation's efforts to expand its volume of exports.

financial developments

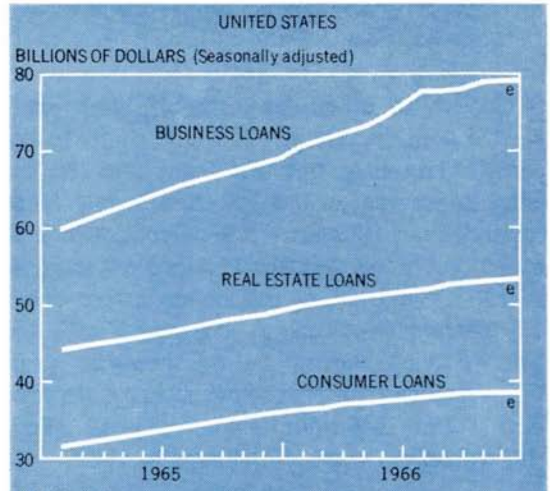
Developments in the financial sector of the U.S. economy in 1966 reflected strongly expanding credit demands during most of the year and official anti-inflationary measures which relied heavily upon the instruments of general monetary policy. In this atmosphere, interest rates in money and capital markets rose to 40-year highs, and competition among financial institutions for savings and other funds became intense. In the international area, the U.S. balance-of-payments position continued to be of major concern, especially the declining surplus of merchandise exports.

Continuing to grow rapidly but at a somewhat slower pace than in 1965, loans at all COMMERCIAL BANKS in the United States increased about 8 percent during 1966 and, based upon preliminary estimates, reached a level of $207 billion at the year-end. Because of the sharp curtailment in the rate of advance of business loans after July, loan expansion was heavily concentrated in the first 7 months of the year. Through July, loans expanded at a seasonally adjusted annual rate of 12 percent, or at a somewhat slower pace than in the comparable period of 1965. After July, loans increased at only a 1-percent rate. The strong pressure of loan demand during 1966, however, is evident from the fact that substantial loan expansion occurred despite the dampening impact of declining reserve availability.

The major impetus for the continued rise of loans at all commercial banks in the United States during 1966 came from the heavy demands of businesses for borrowing. Rising outlays for plants and equipment and other increased spending requirements greatly exceeded corporate internal cash flows. Thus, businesses continued to seek external sources of financing. Moreover, as market rates of interest rose during the year, short-term financing through commercial banks became relatively more attractive than the alternative of borrowing through long-term debt. Commercial bank loans to business rose an estimated $9.9 billion during 1966, or 14.0 percent; the expansion in 1965 was $10.8 billion, or 18.5 percent. In the first 7 months of 1966, business loans increased at a seasonally adjusted annual rate of 21 percent, as compared with 20 percent in the corresponding period of 1965. From July through December, however, business loans rose at a much slower pace — at an estimated annual rate of 5 percent.

The strong rise in business loans in the first 7 months of 1966 was of special concern to Federal Reserve officials. In a September 1 letter to member banks, the Reserve bank presi-

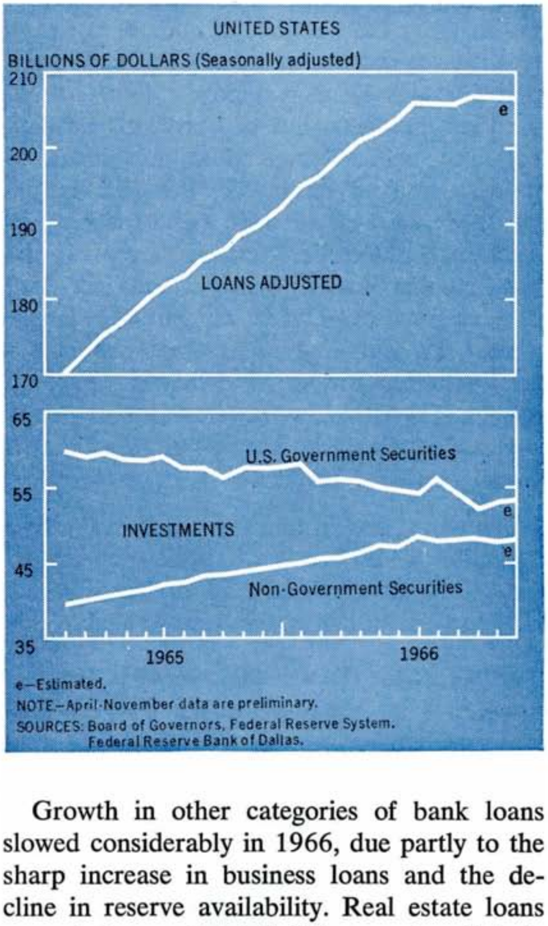
SELECTED COMMERCIAL BANK LOANS



e—Estimated.
NOTE.—April-November data are preliminary.
SOURCES: Board of Governors, Federal Reserve System.
Federal Reserve Bank of Dallas.

dents called for moderation in the growth of such loans. After achieving its purposes, the letter was rescinded in late December.

COMMERCIAL BANK LOANS AND INVESTMENTS



e—Estimated.
NOTE.—April-November data are preliminary.
SOURCES: Board of Governors, Federal Reserve System.
Federal Reserve Bank of Dallas.

Growth in other categories of bank loans slowed considerably in 1966, due partly to the sharp increase in business loans and the decline in reserve availability. Real estate loans expanded an estimated 8.9 percent, which is considerably less than the 13.1-percent increase in 1965. Similarly, consumer loans rose about 7.8 percent in 1966, as compared with the gain of 15.1 percent in the previous year. Finally, loans for financing security transactions, after increasing 1.4 percent in 1965, showed only a negligible change in 1966.

With monetary policy and rising loan demands placing pressure upon reserve positions, commercial banks sold or redeemed a large volume of U.S. Government securities last year. The net reduction in holdings of Treasury issues amounted to an estimated \$4.7 billion, or 8 percent. In 1965, holdings of these issues had declined \$3.4 billion, or 5.6 percent. Although banks continued to add to their portfolios of Federal agency and state and local government issues, the rate at which these investments were acquired slowed sharply from that prevailing in other recent years. Holdings of these issues are estimated to have increased \$3.1 billion, or 7 percent, in 1966, as compared with the rise of \$6.1 billion, or 15.8 percent, in 1965.

Commercial bank liquidity, as measured by the loan-deposit ratio, continued to decline in 1966. After increasing from 60.5 percent in December 1964 to 63.7 percent in December 1965, the loan-deposit ratio rose another 3.1 percentage points to reach 66.8 percent in September 1966. At the year-end, the ratio remained near this higher level.

While time and savings deposits at commercial banks continued to expand during most of 1966, the rate of growth slowed considerably from the 16-percent advance in 1965. For the year, time deposits expanded about \$10.7 billion, or 7 percent. The overall change during 1966, however, conceals important shifts which resulted from bank and public responses to changes in regulation Q, on the one hand, and to the increases in market rates of interest, on the other.

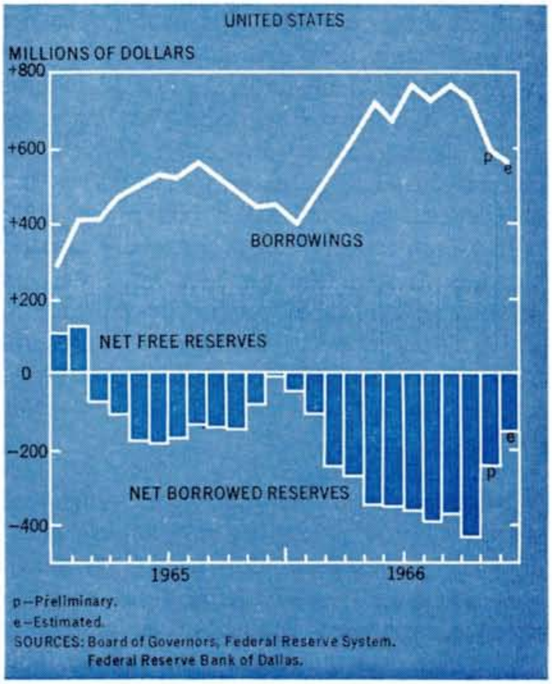
Beginning in December 1965, banks were permitted to pay up to 5½ percent on time deposits (other than savings) maturing after 30 days. This change in regulation Q contributed to a sharp expansion in the volume of time deposits obtained through the issuance of both investor- and consumer-type certificates of deposit. With the rapid rise of interest rates in the summer of 1966, however, CD's issued at the maximum rate of 5½ percent became less attractive in relation to competing instruments yielding the prevailing market rates of return, and funds were shifted out of CD's into other money market instruments.

This shift was especially marked in the case of the more interest-sensitive CD's — that is, negotiable time certificates of deposit issued in denominations of $100,000 or more. Thus, after reaching a peak of $18.6 billion in August, the volume of these large CD's declined more than $3 billion through November and, in late December, reached an estimated level of $15.4 billion. Despite the reduction from 5½ percent to 5 percent in the maximum rate payable on time deposits — other than savings — in denominations of less than $100,000 (a change in the regulation Q ceiling which became effective in September), these instruments continued to attract funds, although their rate of growth was small.

The reserve positions of member banks came under increasing pressures during the first 10 months of 1966, reflecting not only the expanded credit demands but also the more restrictive Federal Reserve monetary policy. As a result, average net borrowed reserves of member banks deepened from $44 million in January to $428 million in October. As pressures upon reserve positions became more intense, member banks increased their borrowings at the discount windows of the Reserve banks. Member bank borrowings in January averaged $402 million but rose to $766 million in July and remained near this level until November. Moderate easing of reserve strains occurred in November and December, however, with the result that borrowings declined and net borrowed reserves became less deep.

Following several years of rapid growth, the Nation's MONEY SUPPLY (conventionally defined as demand deposits adjusted and coin and currency in the hands of the public) rose only moderately in 1966. In 1965 the money supply had expanded nearly 5 percent, and this rate was maintained in the early months

MEMBER BANK BORROWINGS AND RESERVES



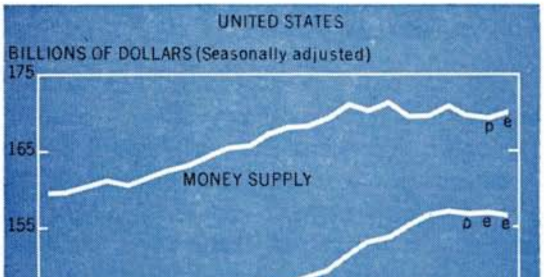
of 1966. From April through December, however, the money stock declined slightly; as a result, for the year as a whole, the money supply rose only about 1.8 percent. The slowdown in money growth was centered in demand deposits, since coin and currency continued to rise at about the same rate as in the previous year. With the reduced rate of growth in the money supply in 1966, the public tended to utilize its deposit balances more intensively, as indicated by a further increase in the rate of turnover of demand deposits at commercial banks.

Liquid assets held by the public rose only moderately in 1966, with the growth in most major categories showing a marked slowing from the 1965 pace. During the first 11 months of the year, liquid asset holdings advanced only 4.6 percent, as compared with the 7.1-percent increase during the corresponding period in 1965. Shares in savings and loan associations and time deposits at commercial and mutual savings banks were especially hard hit by the public's portfolio adjustments. The net inflow of funds to savings and loan associations totaled only $2.9 billion in the first 11 months of 1966, as compared with the $7.9 billion increase during January-November 1965; commercial banks and mutual savings banks realized net deposit gains of $10.9 billion and $2.2 billion, respectively, or substantially smaller amounts than in the previous year. On the other hand, the public stepped up the pace at which it added to its holdings of short-term Government securities — a development which reflected, in part, the relatively attractive yields on these issues.

New long-term corporate borrowing rose sharply in 1966, principally reflecting expanded outlays by businesses for fixed investment. New SECURITY OFFERINGS for cash totaled an estimated $18.0 billion, up nearly $3.2 billion over the record 1965 volume. This increase, coupled with the new cash needs of state, local, and Federal governments, exerted considerable pressure on capital markets during the year. Corporate debt financing expanded about 15 percent, primarily on the strength of public offerings since the volume of private placements was virtually unchanged. Stock issues reaching the market increased during 1966 but remained below the high level registered in 1964.

State and local governments borrowed an estimated $11.2 billion of new funds in the capital market during 1966, or $700 million more than the previous high established in 1965. It should be noted that the tax revenues of some state and local governments showed unexpectedly large increases during the year, mainly as a result of the general expansion in business activity, and some potential borrowing units postponed financing plans because of the advanced level of market borrowing costs or locally imposed rate limitations. Without

MONEY SUPPLY AND TIME DEPOSITS



these constraints, the total of actual borrowings probably would have been substantially larger. As in past years, commercial banks were heavy purchasers of municipal obligations, but the rate of bank acquisition of these issues slowed markedly after the third quarter of the year.

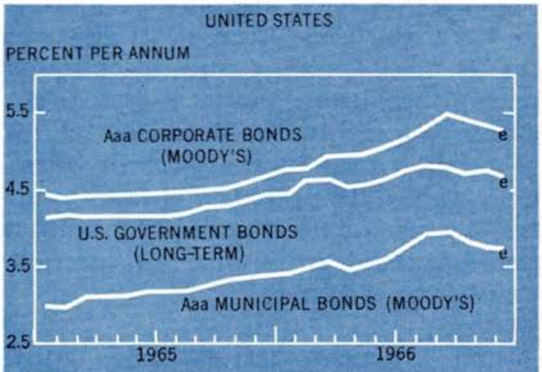
Despite unusually large increases in tax receipts during calendar year 1966 arising from expanded social security payments and accelerated tax collections, the U.S. Treasury made heavy demands upon money and capital markets. During the year, the Treasury raised approximately $14.5 billion of gross new cash, primarily to meet rising expenditures associated with the hostilities in Viet-Nam. Most of the new cash — about $10.5 billion — was raised in the second half of the year, when payments were rising rather sharply and cash revenues were seasonally low. In order to raise this substantial amount of new cash in the second half, the Treasury sold $7.3 billion of Tax Anticipation bills, added $1.6 billion of bills to its regular monthly auction, raised $1.2 billion by a "strip" offering of outstanding bills, made a special borrowing of $169 million from the Federal Reserve banks, and permitted a $245 million oversubscription to its November refunding. At the year-end, the public debt was at or near the statutory ceiling of $330 billion, or $9 billion above the end-of-1965 level.

In addition to its cash borrowing operations, the Treasury refunded $34.1 billion of Government securities maturing in February, April, May, August, and November with notes and certificates of indebtedness due from 12 months to 5 years. The Treasury also employed the prerefunding technique in order to lengthen the average maturity of the marketable debt and to achieve a more balanced maturity distribution. In February, $5.4 billion of notes and bonds maturing between April 1 and August 15 was exchanged for two notes maturing in August 1967 and November 1970; and in August, $1.7 billion of notes, bonds, and certificates due November 15, 1966, was exchanged for notes maturing in August 1970.

On September 10, the Secretary of the Treasury announced that public offerings of various Federal agency securities and participation certificates in pools of federally owned financial assets would be substantially reduced and held to a minimum for the remainder of the calendar year. The flow of these offerings into the private market had accelerated earlier in the year and contributed to the pressures in money and capital markets.

INTEREST RATES in money and capital markets rose steeply in the first 9 months of 1966, thus showing an extension of the in-

CAPITAL MARKET RATES

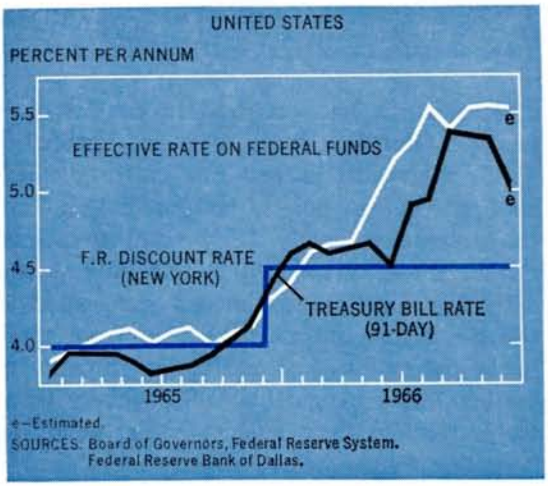


e—Estimated.
SOURCES: Board of Governors, Federal Reserve System.
Federal Reserve Bank of Dallas.

creases which had occurred in the last half of 1965. Between June 1965 and September 1966, short-term interest rates rose as much as 2 percentage points, and some long-term rates increased nearly 1.5 percentage points. At the levels established in late August and early September, many interest rates stood at 40-year highs; but rates receded from these peaks during most of the closing months of 1966. During August and September, when yields reached their highest levels, new Aaa corporate bonds yielded slightly more than 6 percent, conventional mortgages were made for more than 7½ percent in certain regions of the country, and market rates on some new U.S. Government issues exceeded 6 percent.

The upward movement in interest rates resulted from a combination of supply and demand pressures. On the demand side, the large amount of new borrowings by corporations, Federal agencies, the Treasury, and state and local governments attained record levels. Concurrently, monetary policy exerted increasing pressures upon the supply of funds by moderating the growth of member bank reserves. While a growing shortage of funds developed relative to rising demands, market participants' expectations of the future course of interest rates were buffeted by recurring discussions of tax increases, rumors of peace in Viet-Nam, and large buildups in the forward calendar of security issues. Under these prevailing market conditions, most interest rates moved upward sharply, but certain depository-type institutions were unable to adjust their rates sufficiently to attract their "normal" deposit inflows. Consequently, the availability of funds to certain key markets, most notably the mortgage market, declined; and interest rate movements were further accelerated.

SHORT-TERM RATES



In the first 2 months of 1966, market rates on 3-month Treasury bills rose 28 basis points above their December 1965 level, primarily in response to the forces noted above and to the December 6, 1965, discount rate increase. Throughout most of the spring and early summer, rates on the 3-month bills fluctuated in a trading range of 4.70 to 4.40 percent. In July, however, the market rate broke through this trading range and rose steadily to reach a peak of 5.59 percent on September 21. Most other money market rates followed a similar course through September.

In late September, the market rate on 3-month Treasury bills eased from its high for the year and, from mid-November to mid-December, declined sharply to a level of 4.92 percent. Rates on most other money market instruments—such as prime commercial paper, bankers' acceptances, and bank loans to Government securities dealers — also declined; however, these rates displayed somewhat greater resistance to downward adjustment than did rates on Treasury bills and other short-term Government issues. At the end of the year, the market yield on 3-month Treasury bills was 4.81 percent.

The prime rate charged by commercial banks to customers with the highest credit rating was raised on four separate occasions between December 1965 and August 1966. In December 1965, the rate was advanced from 4½ percent to 5 percent; by August, the rate had reached 6 percent — its highest level since the prime rate convention was established during the 1930's.

In the capital markets, rates on corporate and municipal bonds increased steadily through September, when Moody's Aaa corporate and municipal indices were 75 and 53 basis points, respectively, above their January levels. Yields on long-term U.S. Governments were up 36 basis points, and those on the more volatile 3- to 5-year Government issues were up 73 basis points. After September, however, yields receded about one-third from their peaks but remained substantially above the rates that had prevailed in the early months of 1966.

MONETARY POLICY during 1966, as reflected by Federal Reserve operations, assumed a markedly less expansive stance than in other recent years of economic advance. Open market operations during most of the year were conducted so as to exert continuing pressure upon the reserve positions of member banks and thereby moderate the rapid expansion of bank credit. As a result, net borrowed reserves deepened throughout most of the year, and the rates of growth of total and nonborrowed reserves slowed markedly.

The tightening of monetary policy and the development of greater demand pressures in the economy were reflected in rising interest rates and a marked lessening of liquidity. After midyear, rates of growth in the money supply, bank credit, business loans, and time and savings deposits contracted noticeably. Although monetary policy firmed during most of 1966, the Federal Reserve System added substantially, on balance, to its holdings of Government securities. Actually, net purchases in the open market were made in each quarter of the year except the first.

Effective July 20, the Board of Governors of the Federal Reserve System lowered the maximum interest rate that member banks may pay on time deposits having multiple maturities; and on September 26, the Board reduced from 5½ percent to 5 percent the maximum rate of interest that member banks may pay on any time deposit (other than savings) of less than $100,000. Concurrently with these actions of the Board, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board placed restrictions on interest payments by insured banks and Federal savings and loan associations, respectively. The purpose of both of these actions was to forestall excessive interest rate competition among financial institutions and to moderate the growth of bank credit.

On June 27, the Board of Governors announced that, effective September 1, 1966, short-term promissory notes and similar instruments issued by member banks would come under the regulations governing reserve requirements and payment of interest on deposits. The purpose of the Board's action was to prevent future use of these instruments as a means of circumventing statutory and regulatory requirements applicable to bank deposits.

The Board of Governors raised reserve requirements against time deposits on two occasions during 1966. The first increase, announced on June 27 and effective in July, raised reserve requirements against member bank holdings of time deposits (except savings deposits) in excess of $5 million per bank from 4 percent to 5 percent. On August 17, the Board announced a further increase to 6 percent. Both of these actions were designed to exert a tempering influence on bank issuance of time certificates of deposit and to apply some additional restraint upon the expansion of bank credit to businesses and other borrowers.

balance of payments

The balance-of-payments position of the United States continued in deficit during 1966; and, as in other recent years, the persistence of this imbalance was an important factor influencing the Nation's economic policy decisions. Although data are not available for all of the year, the deficit, on the liquidity basis, may not exceed the $1.3 billion total for 1965.

A sharp slowing occurred last year in the rate of capital outflow from the United States, but the slowdown in this drain of funds was accompanied by a further narrowing in the trade surplus. Improvement in the capital account included inflows of foreign funds into nonliquid forms and of credits reported by U.S. banks, both of which aided the balance of payments as measured on a liquidity basis, and (also stimulated by the high and rising level of interest rates) heavy purchases by domestic commercial banks of Euro-dollars, which benefited our payments position as measured on the official reserve transactions basis. Deterioration in the trade surplus stemmed mainly from a further rise in U.S. imports. Between the third quarter of 1965 and the third quarter of last year, imports expanded one-fifth, but exports advanced less than one-tenth.

In financing the deficit in its balance of payments in 1966, the United States sold gold to foreigners and increased its liquid liabilities to foreign monetary authorities and official institutions. The decline in the monetary gold stock amounted to $575 million, reflecting a sharp reduction from the drain of almost $1.7 billion in 1965. At the end of last year, the gold stock of the United States totaled $13.2 billion.

In both 1965 and 1966, commercial banks and nonbank financial institutions cooperated with the System under a voluntary program to reduce the net outflow of U.S. private capital from the extraordinarily high rates prevailing in 1964 and, in this way, bring about an improvement in the Nation's payments problem. Nonfinancial firms cooperated with the U.S. Department of Commerce. Because this cooperative program had produced highly encouraging results, the President of the United States asked that it be continued in the light of a persisting need to improve the payments position. Therefore, on December 13, the Department of Commerce and the Board of Governors issued revised guidelines for U.S. firms to follow during 1967 in continuing to cooperate with the President's program.

Under the 1967 program, nonfinancial corporations are requested to limit their foreign capital outflows in 1966 and 1967 to an average annual rate that is no more than 20 percent above the average annual rate of the base period, 1962-64. In December 1965, these firms were asked to limit such outflows in 1965 and 1966 to no more than 35 percent of the same base.

Commercial banks are asked to limit their foreign credits in 1967 to 109 percent of the base total of credits outstanding on December 31, 1964. This is the same percentage and base applied in 1966. Since banks were $1.2 billion under their ceilings in 1966, the Board of Governors has requested that each bank use only 40 percent of its "leeway" under the ceiling until March 1967 and an additional 20 percent per quarter thereafter. Moreover, banks are requested to use no more than 10 percent of their leeway to expand nonexport loans to developed countries between October 1, 1966, and December 31, 1967. Nonbank financial institutions are permitted an increase of 5 percent in foreign credits and investments during the 15 months ending December 31, 1967.

Cooperation among the central banks and treasuries of major industrial countries continued at a high level during 1966. In the early fall, the swap network between the Federal Reserve System and the central banks of 11 other countries and the Bank for International Settlements was expanded from $2.8 billion to $4.5 billion. The objective of this action was to increase the reciprocal credit facilities available, both to the Federal Reserve System and to its central bank partners, to levels well above the size of any routine borrowings that might reasonably be expected and, thus, to provide a broad margin of safety against any unforeseeable threats to international currency stability. In addition to its use of the swap lines during 1966, the United States also made a number of drawings on the International Monetary Fund. Drawings were made both to fund earlier short-term credits and to aid other countries which held dollars to make repayments to the Fund.

The international financial system underwent considerable strain in 1966 — especially in the early weeks of July, when speculation against the British pound reached major proportions. However, the speculative pressures were met by a vigorous stabilization program put into effect by British authorities, supplemented by large-scale assistance to the United Kingdom by major central banks. These credit arrangements provided time for the British Government to plan and implement the austerity program which has protected the pound. By September, there was evidence that the British program was beginning to take effect on the economy; in addition, the demonstrated intent of British authorities to defend sterling was beginning to have favorable effects on confidence. At the year-end, sterling was stronger and the British balance-of-payments position showed improvement.

regional situation

Participating in the buoyancy evident in the Nation's economic expansion in 1966, the southwestern states of Arizona, Louisiana, New Mexico, Oklahoma, and Texas attained new highs in the production of goods and services, in employment, in income, and in sales. Residential construction and, to a lesser extent, nonresidential building were among the more important sectors failing to share in the broad economic advance. Somewhat paralleling developments in the Nation, the rapid pace of the southwestern economy began to show signs of moderating in the final months of the year.

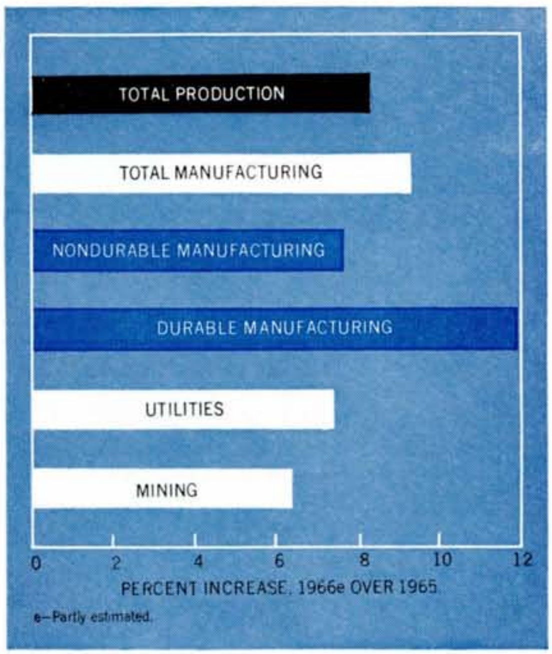
INDUSTRIAL PRODUCTION in the Southwest increased significantly during 1966. Data for Texas indicate that the overall physical volume of production last year showed a gain of more than 8 percent over 1965, well above the rise for any other year since the current expansion began in 1961. Output in each of the major components — durable manufacturing, nondurable manufacturing, mining, and utilities — advanced moderately to strongly above the previous year. The broadly based character of the industrial activity is evident in the fact that, in 1966, the output of only 2 of the 24 subgroups — namely, leather and leather products and stone, clay, and glass products — failed to exceed their 1965 levels.

The gain in the production of durable manufactures, about the same in 1966 as in 1965, again gave the major thrust to overall output. The strong demands stemming from business plant and equipment expenditures and rising defense outlays were especially reflected in the output of durable goods. Production of transportation equipment in 1966 rose about one-fifth above the previous year, as the output of aircraft and parts expanded sharply to fulfill defense contracts. Other durables industries performing vigorously were those manufacturing furniture and fixtures, primary metal products, and electrical machinery—types of items which are importantly affected by plant and equipment spending and trends in defense orders.

Nondurable manufactures rose more than 7 percent above their 1965 level. Industries producing textiles, apparel, paper, and chemicals and allied products contributed forcefully to the increase in nondurable goods output. Some of the industries, notably textile and apparel concerns and chemical manufacturers, were called upon to step up production for defense needs.

Petroleum refining did not constitute a major source of strength for nondurable manufacturing during 1966, as output of refined products rose less than 4 percent in Texas. While overall refinery output was virtually unchanged between 1964 and mid-1966, refining activity showed a gain during the latter half of last year, which,

CHANGES IN INDUSTRIAL PRODUCTION IN TEXAS

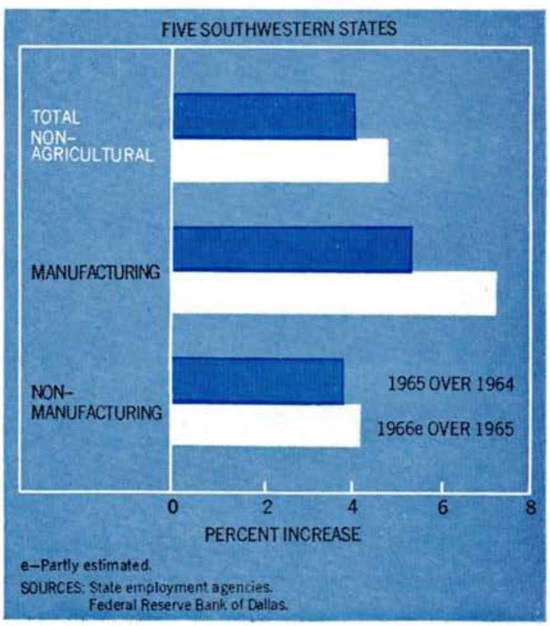


in turn, was reflected in a stronger production picture for crude petroleum mining.

Crude petroleum mining displayed considerably more strength than in 1965 and provided a hefty lift to total mining activity. The production of natural gas liquids and metal, stone, and earth minerals also buoyed mining activity. Stimulated by the requirements of the Viet-Nam war, accelerated industrial activity, and the public's increased motoring needs, crude oil production rose in 1966 to a level which is about 7 percent over the previous year. Regulatory authorities in Texas increased maximum permissible allowables on several occasions; and by the end of 1966, allowables were well above a year earlier. Despite the increased pace of crude oil production, drilling activity continued weak, and the number of well completions was about 16 percent below that in 1965.

After showing substantial growth in 1965, EMPLOYMENT in the five southwestern states last year grew at an even faster rate. The 4.7-percent advance in total nonagricultural employment in 1966 was spearheaded by a 7.0-percent rise in manufacturing employment. Nonmanufacturing employment increased 4.2 percent. Although there was a gain in each of the broad nonmanufacturing employment categories except mining (the work force for which remained relatively stable over the last 3 years), government employment showed a pronounced 5.7-percent gain over 1965.

WAGE AND SALARY EMPLOYMENT



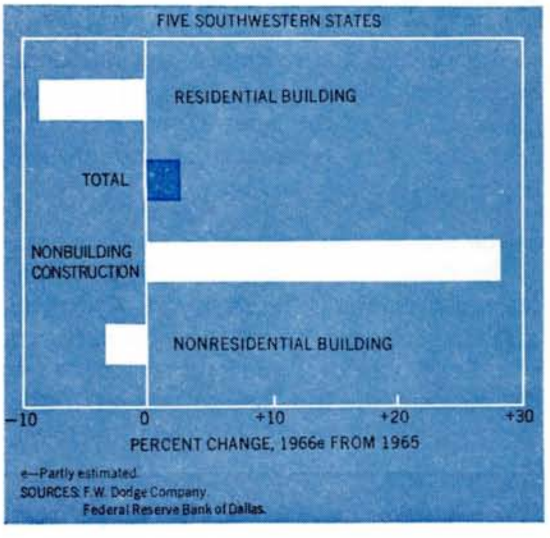
Since the civilian labor force last year, as in 1965, rose at a slightly slower rate than did employment in the region, the unemployment rate decreased significantly. The year-to-year decline in the unemployment rate in nearly every successive month during 1966 reflected a tightening labor market. The unemployment rate in the five southwestern states averaged 3.7 percent in 1966, compared with 4.5 percent in 1965. Shortages of skilled, experienced, and professionally trained workers became acute in several of the major southwestern labor markets.

The tightness of the labor market contributed to a lengthening of the workweek, and the average hourly earnings for manufacturing production workers in the five states rose 4 percent. In addition to the labor market pressures perceived through increases in wages and the number of hours worked, labor turnover rates indicated tight labor market conditions. Quit rates and new-hire rates remained quite high last year, although some moderation in these rates began to emerge in September.

CONSTRUCTION activity in the five southwestern states attained another record in 1966, as the value of construction contracts advanced nearly 3 percent to total about \$5.4 billion. The gain in the total value of contracts was achieved despite year-to-year declines in both residential construction (nearly 10 percent) and nonresidential building (about 3 percent). The sustaining strength in total construction activity was the increase of nearly one-third which occurred in nonbuilding construction contracts.

The decrease in residential construction that developed during 1966 was largely due to substantial reductions in contracts for single-family units and for hotels and motels, a weakness which began to become increasingly evident by mid-1966. The number of units declined more than the dollar volume because of the higher value per unit. The downtrend in residential construction is primarily attributed to the increasing stringency in the availability of mortgage credit during 1966. The slackening in the rate of new household formations, not fully offset by the net gain of persons through in-migration, and the existence of some overbuilding were also factors (although of secondary importance) depressing residential construction.

VALUE OF CONSTRUCTION CONTRACTS



Although nonresidential building activity last year was slightly lower than in 1965, the paramount pattern of the building activity was directed toward meeting the educational and administrative needs of the public. Substantial increases occurred in contracts let for government administration and service buildings and for educational and science buildings. Significant gains also were shown by contracts for commercial and industrial structures.

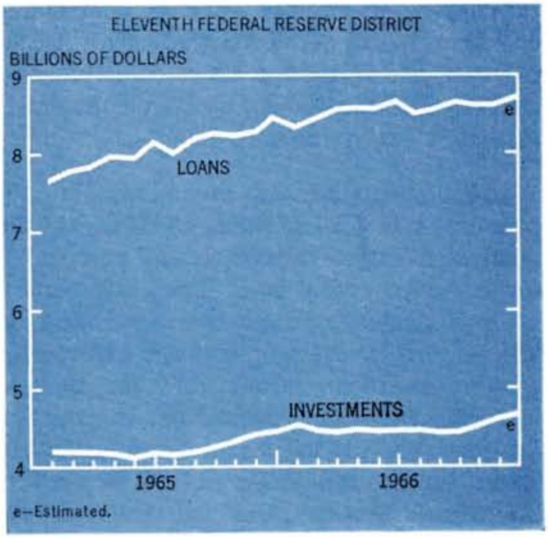
Efforts to fulfill expanding transportation and power needs helped propel nonbuilding construction in the five states to a record high in 1966. Expansion of electrical power and gas systems and further construction on the Interstate Highway System and urban streets, along with the requisite highway bridges, contributed substantially to the total value of nonbuilding construction. The Southwest, particularly Texas, has been among those sections of the country leading in construction progress on the Interstate Highway System.

In contrast to the sharp rise in industrial production, AGRICULTURAL OUTPUT in the Southwest last year dipped about 7 percent below the 1965 record total. The lower outturn of crops, stemming from increased participation in acreage diversion programs and unfavorable growing conditions, accounted for the decrease in overall agricultural production, as output of livestock and livestock products was moderately larger. Despite the smaller volume of marketings, higher average prices for farm products and larger Government payments boosted the income of southwestern farmers and ranchers in 1966 above the 1965 level.

Personal income continued to rise in the Southwest last year, since employment expanded and the average pay advanced. Income arising from interest, dividends, and rents increased, as did the incomes of farm and business proprietors. The gain in personal income, however, was not as completely mirrored in augmented RETAIL SALES as was the case in 1965. Retail sales rose only about 6 percent above their 1965 level, or less than one-half of the advance that occurred between 1964 and 1965. Practically all of the increase in retail sales in the Southwest was accounted for by nondurable goods stores.

Although reaching another registration high in 1966, new automobile sales in four major markets in Texas — Dallas, Fort Worth, Houston, and San Antonio — exhibited a less vigorous performance during the latter part of the year. Registrations for the full year were only fractionally above 1965, in contrast to an increment of more than 15 percent between 1964 and 1965.

MEMBER BANK LOANS AND INVESTMENTS



While BANKING DEVELOPMENTS in the Southwest in 1966 reflected many of the same elements as those in the Nation, there were a number of important differences. In the Eleventh District, both total loans and business loans expanded at slower rates than in the Nation; demand deposits were virtually unchanged for the year; time deposits increased at a slower rate than in the Nation; and large certificates of deposit showed greater stability.

Total loans at all member banks in the District expanded about 3 percent during the year, or at a somewhat slower pace than in 1965. Commercial and industrial loans and consumer-type loans accounted for most of the overall gain. Real estate loans rose moderately through midyear but showed little change thereafter.

Demand deposits of District member banks showed almost no change, on balance, during 1966. Thus, as in other recent years, member banks relied heavily upon time and savings deposits to expand their earning assets. Although the net inflow for the year reflected a gain of about 7 percent, growth in time and savings deposits had slowed sharply after April. With respect to the more volatile component of time deposits — negotiable certificates of deposit issued in denominations of $100,000 or more — the District's banks were more successful last year than those in the Nation in retaining these funds under conditions of rising interest rates in the open market. The volume of large CD's issued by banks in the Nation showed a contraction of 16 percent from its August peak to the mid-November level; in the District, the decline was only 7 percent.

The member banks continued to add to their portfolios of non-Government securities and to reduce their holdings of Treasury issues. Actually, net sales and redemptions of the former increased slightly throughout most of 1966, but net purchases of the latter slowed somewhat. On balance, total investment holdings of member banks rose only modestly.

The loan-deposit ratio of all member banks in the District rose further during 1966 and reached a level of 58 percent at the year-end; at the larger banks, the ratio was about 63 percent. Despite the declining liquidity reflected by this measure, the loan-deposit ratio of District banks remained favorable in comparison to that for all banks in the Nation.

Purchases of Federal funds by District banks expanded sharply in 1966. For example, in September and October, gross purchases were nearly double the monthly average volume for 1965. With gross sales increasing only slightly, net purchases of Federal funds advanced rapidly, reaching an average level of $962 million in October. Member bank borrowings from the Federal Reserve Bank also increased sharply in 1966. In October, daily average borrowings reached $96.5 million, or more than three times the amount in October 1965.

FEDERAL RESERVE BANK OF DALLAS

11-K

DALLAS, TEXAS