

Research Department
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Emerging Titan

In recent years, the West Coast has grown into a major international financial center, second in the United States only to New York. Many are aware of the growth, but few know how rapid the growth has actually been, and how high a stature the West Coast has already attained in world banking.

Record of growth

Foreign banking activities of West Coast banks were quite modest a half-decade ago. At the end of 1969, only five West Coast banks had more than \$100 million in foreign assets, for a total of \$7 billion in all; five years later, by the end of 1974, there were eleven such banks with aggregate foreign assets of \$32 billion. Claims on foreigners booked at West Coast banks' head offices were only about \$1.5 billion in the mid-1960's, and remained fairly flat until the early 1970's, as a result of U.S. controls over capital outflows. Since then, such claims have grown by leaps and bounds to reach a total of \$8.5 billion, accounting for 19 percent of the national total, while banking liabilities to foreigners totaled \$7.2 billion, accounting for 7 percent of the national total, at the end of 1974.

In addition to international-banking activities at head offices, rapid growth is evident in the expansion on the West Coast of Edge Act corporations—bank affiliates designed specifically for the financing of foreign trade and investment. In number, Edge corporations have increased from

3 a decade ago to 22 today; in volume of assets, they have expanded 15-fold just since 1968 to reach \$1 billion today. Of the total, 13 are banking corporations and 9 are investment corporations, with the banking Edges accounting for the vast bulk of the \$1 billion in assets. All except one of the banking Edges are subsidiaries of banks outside the region—8 from New York, 3 from Chicago, and one from Boston.

Even more striking is the vastly increased presence abroad of 18 West Coast banks, with 130 foreign branches and about 60 foreign representative offices. Their \$33 billion in foreign-branch assets represents a 7-fold increase in just 6 years' time. (Bank of America alone has 104 branches and 12 rep offices, and these account for 38 percent of its total deposits.) West Coast banks also have invested substantial sums in partly- or wholly-owned foreign affiliates, which are engaged in such activities as merchant banking, investment banking, leasing, factoring, mortgages and trusts.

This expansion of West Coast banks in foreign markets has been paralleled by the growth of foreign banks on the West Coast. California alone now has 15 state-chartered foreign banks with total assets of \$4.5 billion, plus 43 agencies with total assets of \$8.3 billion, compared to 6 state-chartered foreign banks with only about \$450 million in total assets and 7 agencies with only \$300

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million in total assets just ten years ago. Represented in one form or another are major banks from 15 foreign countries in practically every continent—with Japanese banks heading the list in terms of total assets, followed by British banks and Canadian banks.

Recent problems

Despite the phenomenal growth of the past decade, West Coast banks have been hard pressed to adjust to the extraordinary turbulence of the past two years. Banks at the beginning of 1974 faced the petrodollar-recycling problem and, in addition, the lifting of U.S. capital controls as well as the simultaneous liberalization of controls by other major industrial nations. Then, in May and June, came the Franklin National and Herstatt debacles, which led to concern by the world's central bankers about the headlong pace of banks' overseas-expansion programs. Throughout all of this period, inflation reigned rampant, with soaring interest rates and the shriveling of the international bond market. Finally, the worldwide boom ended in the most severe recession of the past generation, resulting in a widespread fear of a collapse of the international financial system.

These conflicting developments were amply reflected in the West Coast banking scene. Total claims on foreigners rose at a hectic pace during the first half of 1974, dropped sharply during the crisis-laden third quarter, but then

resumed growth, so that claims at the end of this September stood at 35 percent above a year ago.

In contrast, overseas-branch activity of West Coast banks has failed to expand at all this year, after steady growth during most of 1974. For somewhat unclear reasons, West Coast banks in 1975 have chosen to expand foreign loans in their head offices' portfolios, while other U.S. banks have done so through their foreign branches.

Engine of growth

The phenomenal growth of international banking on the West Coast during the past ten years is an integral part of the internationalization of banking the world over. Confronted with the rapid expansion of international trade, the spread of multinational corporations, and the breakdown of national barriers to international capital movements, institutions in the wholesale-banking business have had little choice but to lift their eyes beyond their national borders with regard to both the placement and the gathering of funds. In just a few years, banking operations on the West Coast have been fundamentally and irrevocably transformed.

The rewards for success have been substantial. At the national level, international earnings of a selected group of U.S. banks have increased roughly ten times as fast as their domestic earnings in recent

years. Moreover, foreign loan-loss ratios of U.S. banks over a period of thirteen years have been found to be generally smaller than their domestic loan-loss ratios. Thus, the profit instinct, rather than the herd instinct, has been behind banks' overseas-expansion drive.

Moreover, West Coast banks have their own strong reasons for expansion: Aside from the underlying strength of the regional economy, international banking has benefited from the rapid growth of West Coast trade, especially trade with the booming Orient. Between 1967 and 1974, the total value of West Coast foreign trade (exports plus imports) rose 3½ times to \$37 billion—at a compounded growth rate of 24 percent per year, which must have made foreign trade the fastest growing industry in the West. Two-thirds of this trade was conducted with Pacific Basin countries; indeed, Japan alone accounted for almost one-half of all West Coast foreign trade during this period. As this expansion continued, financiers could see no reason why such business should be financed in New York, London or elsewhere, and not right here where trade was being conducted.

Nothing attracts like success. Despite several recessions, the West Coast grew significantly over the past decade. From 1967 to 1974, manufacturing production

in the Western states grew at 5.6 percent per year, and personal income at 9.3 percent a year. Financial resources and expertise from all over the world poured in, to assist in the financing of that growth and in the strengthening and broadening of the base for a rising international financial center. International finance fed on domestic finance and in turn contributed to the growth of domestic finance—in a sort of symbiotic growth process analogous to orchards and apiaries prospering together. Besides financial resources, a host of human resources have also been attracted to the region. Bankers, lawyers, accountants, foreign-exchange dealers, investment counselors, data-processing specialists, business analysts have brought with them uncounted years of training and experience—a major capital investment in human resources. The growth of their services plus the great expansion of financial resources add up to the rise of the West Coast as a major international financial center.

Undoubtedly, the recent worldwide business recession with a ten-percent decline in the volume of world trade has temporarily chilled the environment for growth. But the bulbs of further expansion are in place. As trade and finance revive from the severe wintry climate that has beset the world economy in the last two years, the West Coast can look forward to renewed growth in its international financial activities.