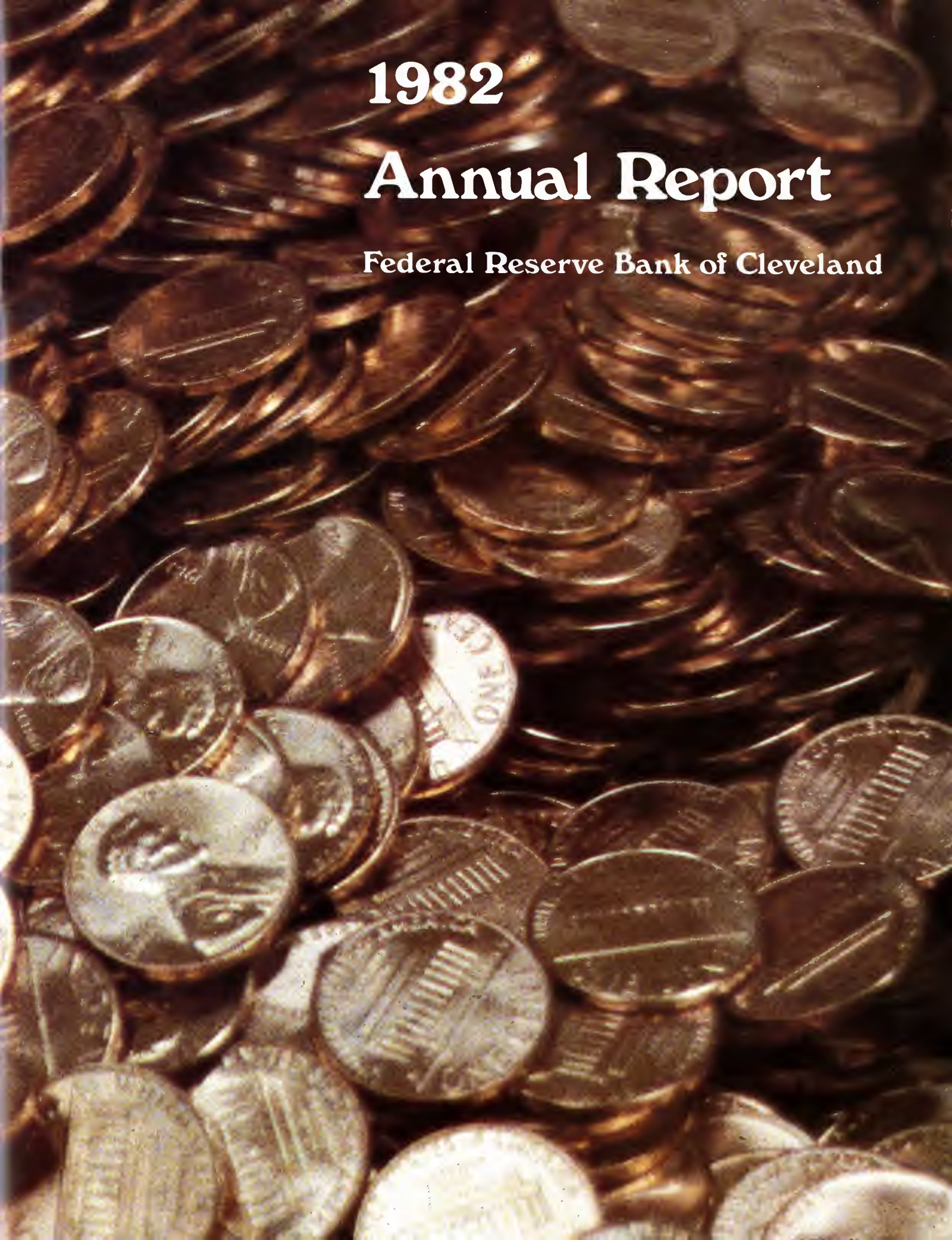

1982 Annual Report

Federal Reserve Bank of Cleveland

Contents

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The Federal Reserve Bank of Cleveland's *1982 Annual Report* was prepared by the Research Department, Federal Reserve Bank of Cleveland, P.O. Box 6387, Cleveland, OH 44101.

On the cover: A binful of new pennies awaits processing before distribution to depository institutions that we service. The Federal Reserve Fourth District handles about 1,500,000,000 coins annually.

Facing page: This bronze eagle dominates the lobby of the bank's Cincinnati Branch. Created by Marshall M. Fredericks, the sculpture has a wing span of four feet and weighs 400 pounds.

The President's Foreword

This past year has been a very exciting and eventful year at the Federal Reserve Bank of Cleveland. One very noteworthy event was the retirement of Willis J. Winn, who so ably served as this bank's president for nearly eleven years. His contributions to a variety of Federal Reserve activities established pathways for many System programs, both during his presidency and afterward.

There is much for me to accomplish as the new president of the Federal Reserve Bank of Cleveland. Being president of a Federal Reserve Bank is indeed an honor—and a tremendous challenge. Perhaps most challenging to me has been my service on the Federal Open Market Committee. From the beginning of my presidency in May 1982 through February 1983, I was a voting member of FOMC. (The president of the Federal Reserve Bank of Cleveland serves on the FOMC for a one-year term in rotation with the president of the Federal Reserve Bank of Chicago.) To participate so closely in the monetary policy-making process of this nation brought home the responsibility that we all must shoulder in our continued battle with inflation.

This past year brought substantial progress in reducing inflation and expectations of future inflation. Prices rose less than in any year in the past decade. Current economic indicators—the housing sector, retail sales, and industrial production—suggest a gradual recovery from a recession that began in 1981, a recovery that was anticipated in the second half of 1982. While certainly there is "a strong opportunity" for a noninflationary business expansion, we know that continued disinflation depends on a concerted effort by the Federal Reserve, the Congress, the administration, and the people of this nation to quell inflationary forces.

The people of the Federal Reserve Fourth District were especially hard hit by the 1981-82 recession. The competitive positions of our automotive, steel, and rubber industries have been eroded by inflation, international competition, and shifting economic activity. The result is a declining industrial base that in turn has depressed economic growth and curtailed employment. Unemployment in this district reached peak levels of 14 percent and higher in 1982; indeed, several counties in Ohio registered unemployment rates of over 20 percent for the year. In the long run, the capital-intensive industries that predominate in the Fourth District should benefit most by the disinflationary policies of the Federal Reserve.

Implementing a disinflationary policy has been greatly complicated by the ongoing deregulation of financial markets. The Garn-St Germain Depository Institutions Act of 1982 further accelerated the pace of financial market deregulation. Because of various new deposit accounts—specifically the MMDAs and the Super-NOWs—there have been massive shifts of funds among financial institutions. These shifts produced sharp changes in the measured monetary aggregates—and led to a significant reorientation of monetary policy in the third quarter of 1982.

Because of earlier deregulation legislation, we at the Federal Reserve Bank of Cleveland undertook a major operational reorganization this year. Our ultimate goal was to add a new dimension to the role of the Federal Reserve, as mandated by the Depository Institutions Deregulation and Monetary Control Act of 1980. In addition to continuing our roles of regulating and supervising depository institutions, setting monetary policy for the nation, and providing payments services such as check clearing, the Federal Reserve has been presented with the challenge of marketing its services. To move from a primarily service orientation to a marketing orientation, we are focusing our efforts on *proactive marketing of products and services.* We are instilling a sense of marketing values throughout our organization, knowing that day-to-day functions in our operations departments are integral to a successful marketing program. The marketing efforts of this bank are being spearheaded by a newly formed department called *Services Management.* This department is divided into three units—market research, product development, and sales. Services Management has the overall responsibility for managing the delivery of services from the bank and for selling our products and services in the marketplace.

The development of a marketing dimension for this bank was achieved, in large measure, through the assistance and insight of our directors. The bank is served by 23 directors who represent a variety of banking, business, and educational interests. Three of our directors completed their terms of service in 1982: after serving six years on the Cleveland board, John W. Alford (Chairman of the Board and Chief Executive Officer, The Park National Bank); after serving three years on the Pittsburgh board, William D. McKain (President, Wheeling National Bank); and after serving three years on the Cincinnati board, Oliver W. Birckhead (Chairman of the Board and Chief Executive Officer, The Central Trust Company, N.A.). Our thanks to these directors in particular and to all of our directors for their dedicated service.

The many changes at this bank in the past year were made possible only through the diligence of our capable officers and staff. Without their dedication, the accomplishments of this institution, the widespread changes that we have implemented, and our unmistakable growth would never have occurred.

Karen N. Horn became president of the Federal Reserve Bank of Cleveland on May 1, 1982. Before joining the bank, Mrs. Horn was treasurer of the Bell Telephone Company of Pennsylvania, located in Philadelphia.

Mrs. Horn received her doctorate in economics from Johns Hopkins University in 1971. Having served as a senior economist at the Board of Governors of the Federal Reserve System from 1969 to 1971, she then joined the First National Bank of Boston as an economist and later became a vice president there.

Karen N. Horn
President

March 18, 1983

Opposite page: The main entrance to the Pittsburgh Branch features an untitled sculpture by Pittsburgh artist Sylvester Damianos. The original eight-story building (on the left) was completed in 1931, and the ten-story addition was completed in 1955. In 1973-74 an underground two-story structure was constructed adjacent to the building to provide coin handling and equipment facilities.

Top: High-speed check sorters can process 100,000 checks per hour. Within a few hours of receipt of a check, the check sorters read the magnetic ink coding printed on each check, transmit the dollar amount and routing number to a central computer, and sort checks for delivery to appropriate depository institutions. The Fourth District offices receive, sort, and dispatch 4.2 million checks daily.

Lower left: U.S. savings bonds are issued through payroll deductions for participating corporations. Bonds are printed via advanced computer technology at a rate of 10,000 per hour. The bond operation for the Federal Reserve Fourth District is centralized at the Pittsburgh Branch, which is responsible for one-fourth of the total bond issuance in the Federal Reserve System.

Lower right: Computers are used to control the heating, cooling, and ventilating systems of the Pittsburgh Branch.

The Year of Disinflation

This past year brought substantial progress in reducing both inflation and expectations of future inflation. Prices rose less than in any year in the past decade. Even more significant, the disinflation process has broadened to encompass a steadily widening range of economic activities and decisions, suggesting that last year's progress against inflation may be a precursor of more to come.

Progress in reducing inflation was achieved, however, as the recession that began in 1981 continued. Utilization of labor and plant capacity fell to the lowest levels of the postwar period. The economic recovery that had been expected in the second half of the year failed to materialize. Product demand, instead of strengthening, continued to be weak. Uncertainty about future inflation held interest rates at high levels atypical for a recession, despite a substantial quickening in the pace of money-supply growth. Economic distress, uncertainty about the future, and the legacy of past inflation overwhelmed the stimulative effects of the second phase of tax reductions that began at mid-year.

The past year also witnessed several very significant regulatory developments. Most notably, the Garn-St Germain Depository Institutions Act of 1982 greatly accelerated the pace of financial market deregulation. Swept away by year-end was a large part of the regulatory framework constructed since the 1930s to constrain interest rates paid by depository institutions. Massive shifts of funds among depository institutions and their various accounts produced sharp changes in the measured monetary aggregates. These changes, together with the unusual behavior of velocity last year, greatly complicated the problems confronted by economic policymakers, leading to a significant reorientation of monetary policy by 1982:IIIQ.

Both the sharp slowdown in the rate of inflation and the wide margins of excess capacity that prevail throughout the economy suggest that further progress toward disinflation is possible. What is uncertain is the attainment of monetary growth rates and a federal budget structure that would be consistent with both economic recovery and continued disinflation. The historically large federal budget deficits now projected to accompany economic recovery will collide with the investment needs of a growing economy. The inevitable demand that the Federal Reserve absorb the force of that collision by monetizing deficits suggests that both sustained recovery and disinflation are not yet assured. There

are limits to the share of national savings that can be drained into federal finance. These limits must be respected if economic growth is to be sustained. Similarly, there are limits to money and credit growth that must be respected if recovery from the 1981-82 recession is to be consistent with continued disinflation. The experience of monetary policymaking in 1982 demonstrates that it can be difficult to discern those limits.

I. Monetary Policy in 1982

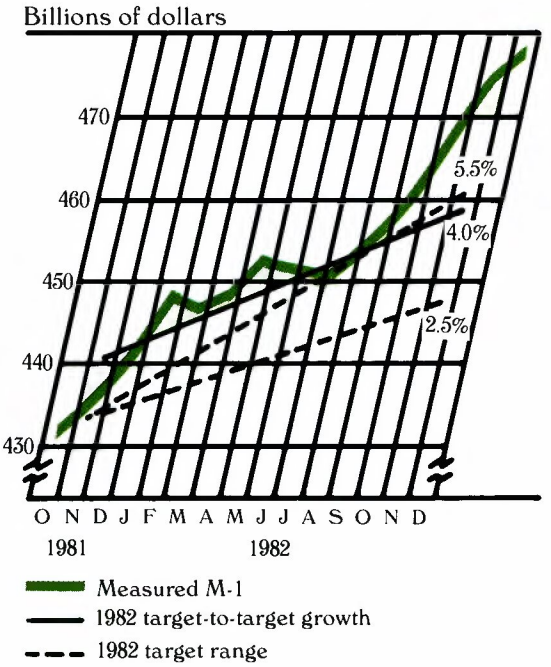
The Federal Open Market Committee (FOMC) charted a course for monetary policy during 1982 amid three major crosscurrents. The underlying direction of policy, of course, continued to emphasize reducing inflation over time by gradually slowing growth of money and credit. However, the FOMC first had the problem of setting annual targets for growth of its primary M-1 target when the base period level was itself below the target of the previous year. (M-1 consists of currency, demand deposits, travelers' checks, and other checkable deposits.) Second, while M-1 was advancing consistently with that target, the problem arose of substantial unforeseen demands for monetary assets in a weak economy. Third, regulatory actions caused massive shifts in asset holdings and large variations in money growth rates that, while not critical to policy objectives, were difficult to quantify.

Early 1982: "Catch Up"

Target setting in early 1982 was influenced by below-target growth in 1981. The base period level of M-1 in the last quarter of 1981 had fallen below that year's target, despite FOMC efforts to encourage faster growth. Consequently, when presenting the 1982 target range for congressional testimony at the beginning of the year, the FOMC expressed a willingness to aim high in the 1982 target range. Focusing on 5 percent M-1 growth from the 1981:IVQ level (within a 2.5 percent to 5.5 percent range) meant that, by 1982:IVQ, M-1 would have achieved a level equivalent to 4 percent growth from the 1981 target level. Although not a formal FOMC target, achieving the 4 percent "target-to-target" growth path would have compensated for the unintended 1981 shortfall.

In fact, most of the 1981 shortfall had been eliminated as the level of M-1 moved substantially above the target range late in 1981 and early in 1982 (see chart 1). Reflecting this surge in M-1, the FOMC's reserves targeting resulted first in a moderate tightening in money market conditions early in 1982 and then in an offsetting easing through mid-year.

Chart 1 M-1 and the 1982 Targets

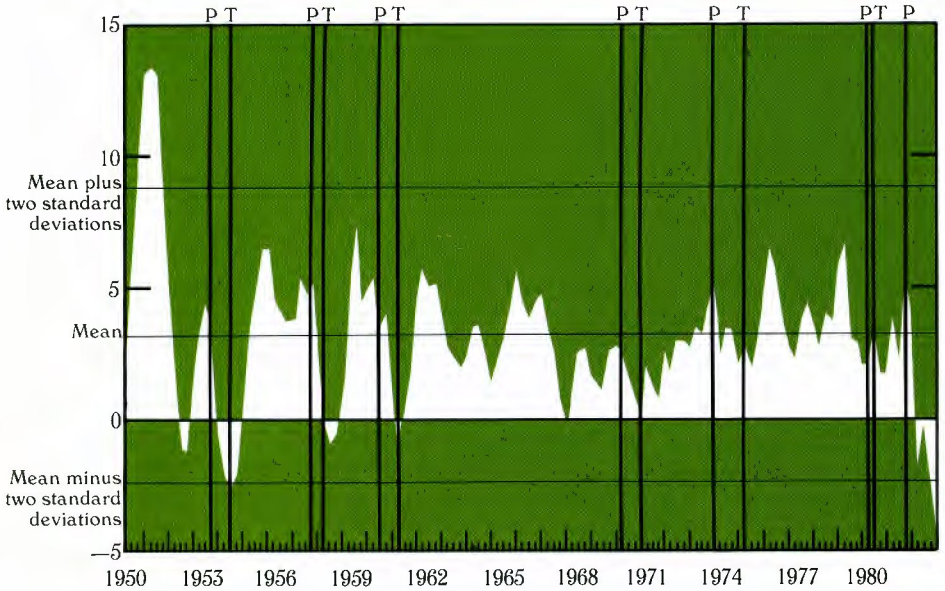


SOURCE: Board of Governors of the Federal Reserve System.

NOTE: The actual levels of M-1 shown do not incorporate benchmark revisions, as this information was not available to the FOMC at the time targeting decisions were made.

Chart 2 Velocity of Money Supply[a]

Percent change



SOURCES: Board of Governors of the Federal Reserve System and U.S. Department of Commerce.

a. If velocity growth were stable, we would expect it to fall within two standard deviations of the mean growth 95 percent of the time.

Mid-Year 1982: The Policy Conundrum

A second problem facing the FOMC was the potential inconsistency between money growth targets and economic recovery from recession. Economic activity was expected to pick up in the second half of 1982, assisted by the second installment of tax cuts at mid-year. As mid-year approached, however, resumption of economic growth became increasingly uncertain. While interest rates declined from their levels earlier in the year, they were still high by historical standards, especially if some of that decline reflected diminished inflation expectations. There was mounting evidence, moreover, of a change in the linkage between money and economic activity. Observed money growth in the face of relatively high interest rates seemed to be the result of above-average growth in demands for money relative to historical experience, and not an early indicator of economic recovery. The velocity of money, or the ratio of GNP to money, usually declines in periods of recession. Yet, the decline in velocity showed no signs of reversing in a cyclical rebound; indeed, by year-end this country had experienced a four-quarter decline in velocity of unprecedented proportions (see chart 2). Thus, the policy conundrum: economic recovery did not seem assured at levels of interest rates that barely constrained money growth to the target range.

The velocity decline in past business cycles reflected especially rapid growth of money relative to national income and output near the trough of a recession. Declining interest rates in a recession encourage the accumulation of liquid balances that is reflected in declining velocity.

Further explanation of above-average demand for monetary assets in 1982 may perhaps be found in the recent emergence of NOW account balances as a significant portion of the M-1 aggregate. Even with an interest-rate ceiling of only 5.25 percent, NOW account balances probably were more attractive instruments for storing temporary savings and accumulating liquid balances than noninterest-bearing demand deposits had been in prior economic downturns. In fact, NOW accounts were the fastest growing component of M-1 over the first nine months of 1982 (see chart 3).

The FOMC recognized the possibility of above-average money demand in its mid-year reconsideration of the 1982 annual target range. Rather than continuing to target 5 percent M-1 growth for the year, the FOMC decided to accept growth "around the top" of the 1982 target range (5.5 percent); indeed, the FOMC "would tolerate for some period of time growth somewhat above the target range should unusual precautionary demands for money and liquidity be evident . . . ."[1] Throughout the

1. See "Record of Policy Actions of the FOMC," *Federal Reserve Bulletin*, vol. 68, no. 9 (September 1982), pp. 541-49.

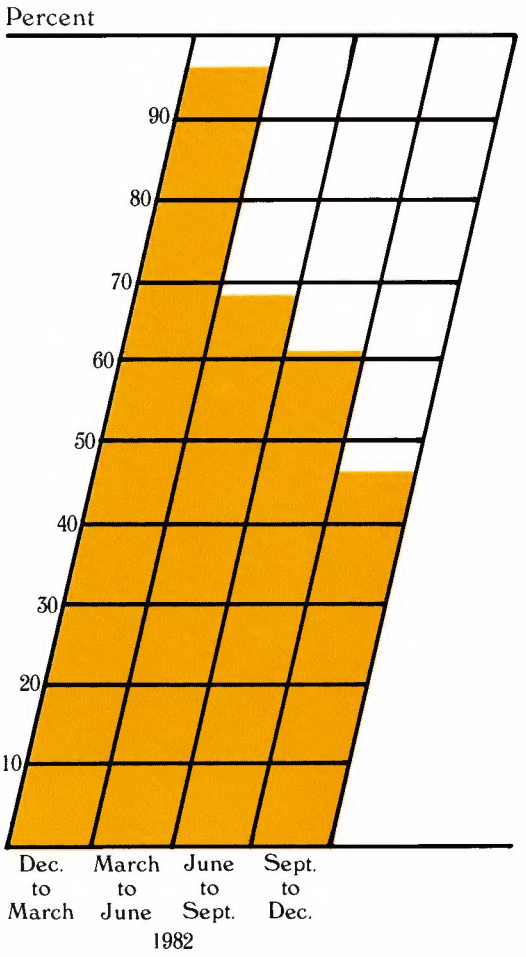
summer and into September 1982, M-1 continued to hover near a 4 percent target-to-target path, while the System provided reserves through open-market operations to accommodate that growth and began a series of reductions in the discount rate. By October, interest rates had declined to the neighborhood of their low levels in mid-1981, but recovery was not yet in sight.

Year-End 1982: The Detour

A third problem confronting the FOMC was the potential distortion of monetary aggregate measures by regulatory actions designed to improve the competitive climate in deposit markets. Money growth in the final months of 1982 was expected to be distorted by the maturing of the very large volume of all-savers' certificates (ASCs) issued under special legislation one year earlier. Temporary "parking" of the funds, or their passage through M-1 accounts, seemed likely to inflate the M-1 measure even if all ASC funds ultimately were reinvested in assets excluded from the M-1 aggregate. Any such bulge in M-1 growth could have been accommodated by temporarily raising short-run M-1 target paths. However, this transitory event was soon overshadowed by congressional passage of H.R. 6267, legislation that mandated regulatory permission for ceiling-free deposit accounts to be competitive with money market mutual funds. The result was a money market deposit account (MMDA), made available December 14, and a Super-NOW account, available January 5, 1983. These new accounts were expected to attract a substantial volume of deposits initially, at the expense of a variety of existing deposit instruments. A massive shift of funds into the new accounts would distort the growth of M-1 and the other monetary aggregates used by the FOMC for policy guidance, as well as the underlying behavior of the aggregates as distinctions among them became blurred.

For the last three months of 1982, at least, the FOMC agreed to de-emphasize the M-1 policy target, and place more emphasis on the broader M-2 and M-3 aggregates. Uncertainty about the sources of deposits that would be attracted to the new accounts and about redeployment of ASC balances was simply too great either to adjust measured M-1 so that it would be consistent with the existing annual target, or to adjust the target to be consistent with incoming M-1 data. In fact, by year-end measured M-1 had strayed far above the 2.5 percent to 5.5 percent target range, reflecting an unknown combination of an underlying growth rate, transitory movements of funds as portfolios were being adjusted, and permanent portfolio shifts out of M-1 and into MMDAs included in M-2.

Chart 3 NOW Accounts as a Percent of M-1 Growth



SOURCE: Board of Governors of the Federal Reserve System.

What the Initials Mean

DIDC, the Depository Institutions Deregulation Committee, was created by the Monetary Control Act of 1980 to phase in the complete deregulation of insured deposit accounts. Members of the committee are the Secretary of the Treasury, the respective chairmen of the Federal Reserve Board, Federal Home Loan Bank Board, Federal Deposit Insurance Corporation, and National Credit Union Administration, and, *ex officio,* the Comptroller of the Currency.

ASC, the all-savers' certificate, was authorized by the DIDC in 1981. Offered by depository institutions, the ASC was a new instrument in the form of a certificate of deposit that provided the holder with significant tax benefits. Under the provisions of the Economic Recovery Tax Act of 1981, up to $1,000 ($2,000 in the case of a joint return) earned from an ASC could be exempted from an ASC holder's taxable income. ASCs were available for specific maturities of one year during the 15-month period from October 1981 through December 1982.

MMDAs, money market deposit accounts, are a type of savings account with no interest-rate limitation or minimum maturity. The account requires a $2,500 minimum balance, is restricted to six transfers per month, and generally permits unlimited withdrawals in person. The DIDC permitted the introduction of these accounts as of December 14, 1982.

Super-NOW accounts are checking accounts with balances eligible to earn more than the 5.25 percent rate payable on regular NOW accounts. To earn the higher rate of interest, certain conditions—including a $2,500 minimum balance—must be met by the depositor. The DIDC authorized introduction of these accounts as of January 5, 1983.

MMMFs, money market mutual funds, are open-end investment companies that invest in short-term financial instruments. MMMFs sell shares to investors who receive dividends based on the composite yield of the MMMFs' investment portfolio. Minimum balance (share) requirements vary, but they can be as low as $1,000. MMMFs frequently offer check-writing features, generally have no limitation on the number of transactions per month, and often require a relatively high minimum amount on check-like transactions ($500 or more). Because there is no minimum maturity connected with these funds, withdrawals are permitted at any time.

RPs, repurchase agreements, are a financing arrangement involving the actual sale of securities to a borrower for a specified period of time, often just overnight. Embodied in this arrangement is the commitment of the lender of the RP to repurchase the securities at the same price plus a specified interest charge at the end of the contracted time period. In essence, the amount of the RP is "borrowed" for a short period of time.

M-2 at first became a tentative replacement for M-1 as the policy target during this period of uncertainty about deposit flows (see chart 4). M-2 is a broader measure of liquid assets that includes M-1, plus small time and savings deposits, noninstitutional money market mutual funds, overnight repurchase agreements and Eurodollars, and the new MMDA. The advantage of using M-2 as a primary target was that it seemed less likely to be distorted by maturing ASCs and the new MMDA. On the other hand, M-2 was not likely to be as dependable a policy target as M-1 had been. A large portion of M-2 is not reservable and bears interest that can vary directly with market rates. Policy actions therefore might have difficulty controlling either supply or demand for M-2 to achieve a targeted quantity. Moreover, the historical relationship between M-2 (before the new accounts) and ultimate objectives of policy was less dependable than for M-1. In addition, even that relationship is likely to have changed in recent years as the bulk of M-2 shifted from instruments with regulated rates of return to those with unregulated rates of return.

Detouring onto an M-2 target path left the FOMC with several issues to sort out at the beginning of 1983. First, how reliable could M-2 be as a guide to policy implementation? Any chance that

M-2 would be relatively unaffected by portfolio shifts into the new unregulated accounts was soon removed. The enormous success of MMDAs appeared to be inflating M-2 growth by attracting funds from accounts included in the broader M-3 aggregate and from market instruments not included in any of the monetary aggregates. (M-3 includes M-1 and M-2, and adds large time deposits, institutions' money market mutual fund balances, and other assets.) As 1982 came to an end, the FOMC found itself unable to use its M-2 target path as a rigid or unconditional basis for setting weekly objectives for nonborrowed reserve provision through open-market operations. Instead, the committee elected temporarily to accommodate, within a broad range, the levels of M-2 that resulted from portfolio shifts occasioned by the new instruments. This decision disconnected the mechanism linking money growth relative to target with money market conditions that had been contained in the reserves targeting procedure adopted in October 1979.

Second, while a detour from short-run M-1 and M-2 targeting may have been unavoidable, the length of the detour is not known. Significant shifts in portfolio composition in response to regulatory changes take time to complete. Resumption of either M-1 or M-2 targeting must await evidence that these portfolio shifts are substantially complete or that continuing distortions can be quantified.

Finally, M-1, like M-2, will now include a larger portion of deposits bearing explicit market-related rates of return. The reliability and controllability of monetary targets will have to be tested anew against alternative means of setting weekly policy objectives for nonborrowed reserve provision through open-market operations.

II. The Economy in 1982

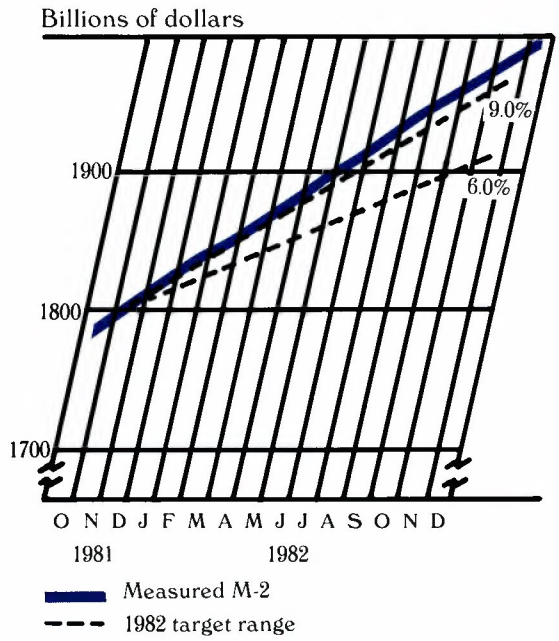
Monetary policy decisions in 1982 were made against a background of lamentably weak national and world economic conditions. The recession that began in mid-1981 did not end as expected, but worsened. Financial market strains became pronounced and widespread. Uncertainty about economic growth and inflation became more deep-seated. Some voices argued that inflation was under control and that the FOMC could take actions to assure a strong recovery without immediate danger of re-igniting inflation. Others foresaw re-ignition of inflation already looming because money growth was too rapid.

Elusive Recovery

At the beginning of 1982, most economic forecasters expected that the ongoing recession would end by the third quarter of the year, when the second phase of personal income tax cuts would boost disposable income. As the year proceeded, however, forecasters pushed the timing of the recovery further and further into the future until, at the end of 1982, recovery was not expected to be under way until 1983.

Expectations for a recovery by mid-1982 were tied mainly to a rebound in consumer spending that would remove excess inventories through higher sales rather than through lower production. After all, consumers had strengthened their balance sheets considerably by the end of 1981; both debts relative to assets and debt repayments relative to disposable personal income had fallen substantially from their peak 1979 values. Consumers had "room" to increase spending and acquire new debt.

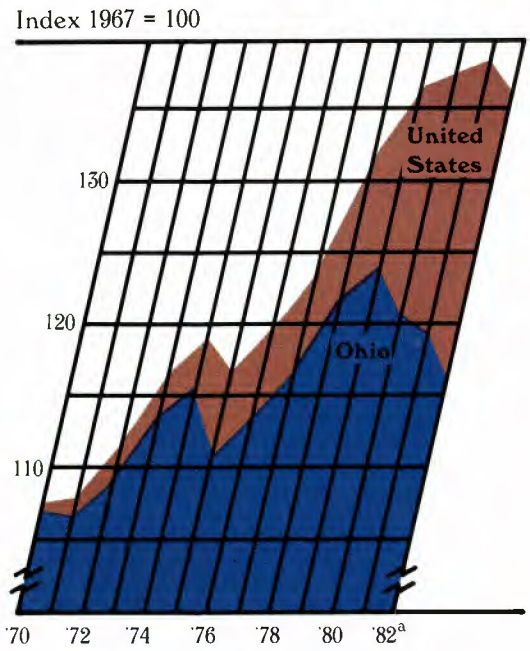
Chart 4 M-2 and the 1982 Targets



SOURCE: Board of Governors of the Federal Reserve System.

NOTE: These data do not reflect the most recent revisions, which include new benchmarks, seasonal adjustment factors, and definitional changes instituted in 1983.

Chart 5 Total Employment: United States and Ohio



SOURCE: Bureau of Labor Statistics.

a. 1982 data for Ohio are based on three quarters.

Unfortunately, other factors worked against this scenario. Business fixed investment expenditures in real terms peaked at the end of 1981. Producers' demands for capital equipment and then for structures declined in 1982, more than offsetting a slight improvement in demand for residential structures as interest rates declined. Demand for U.S. exports fell dramatically. Simultaneous recessions in many other nations alone would have taken their toll on U.S. exports. In addition, despite significant reductions in their dollar prices, exports declined because of continued rapid appreciation of the U.S. dollar in foreign exchange markets. Dollar appreciation in 1982 may have reflected some flight to the quality of the U.S. dollar as recession spread over the globe, as well as the attractiveness of dollar assets because of relatively high U.S. interest rates and continued evidence of firm disinflation policies in this country.

Production and employment cutbacks in the investment and export sectors dampened real disposable income growth. As a result, consumer spending remained depressed, perhaps further dampened by uncertainty about future income growth. In response to declining sales, firms curtailed production during the year in an effort to correct persistently high inventory levels, eventually leading to record low rates of capacity utilization, record high rates of unemployment, and reductions in capital spending plans for the future.

The Fourth Federal Reserve District experienced a decline in economic activity that was more severe than in the nation as a whole, as has been typical of previous cyclical experience in this district. Manufacturing activity, especially in such durable goods as steel, automobiles, and machine tools, fell sharply as the markets for such products were pinched between slack demand and increased imports. Employment fell (see chart 5). The unemployment rate reached post-depression highs and remained well above the national average. State and local governments experienced fiscal difficulties as sales and wage tax revenues declined, while the need to provide services to unemployed workers and their families increased.

The Fourth District's agricultural sector was also in distress. Low prices caused by bumper crops and slack foreign demand reduced farm revenues. High interest rates raised operating costs. Falling land prices reduced the equity that farmers might use as collateral for loans. Many farmers were unable to service their debts, and depository institutions had to decide whether to extend additional credit to farmers in difficulty.

The East 6th Street entrance to the bank's Cleveland office is flanked by two powerful stone statues. *Integrity*, the statue to the left of the bronze-doored entrance, clutches her rolls of office as if to swear to her worthiness of the trust invested in her.

Resilient Credit Markets

Demands for short-term business credit remained strong for much of the year. Reduced sales meant reduced cash flow for many businesses, and unplanned inventory growth increased their need to borrow. If the 1981-82 recession had been similar to recessions of the past, these short-term borrowing needs would have been less of a problem. In the past, cyclical reductions in long-term interest rates created an incentive for corporations to fund their short-term debts in long-term markets. But, with long-term rates at relatively

Each of the cast-iron window grilles in the main lobby of the Cleveland office features a seal of one of the twelve Federal Reserve cities.

high levels during much of 1982, this incentive for refinancing was weak. Only after relatively large declines in rates in the final quarter did firms begin to fund short-term debt. With sales low and costs high, profits fell to a historic low percentage of national income. Business failures and bankruptcies continued to rise. Debt roll-over, servicing, and repayment problems became severe. It is not surprising that the problems of nonfinancial firms created difficulties for the financial firms that held their debts.

The resilience of U.S. financial markets was tested by several especially troublesome market situations in 1982, including the failures of a large bank and several securities firms. What is reassuring is the localized impact of these incidents. Problems in particular markets did not mushroom into a wider loss of confidence that might have interfered with routine functioning of deposit and loan markets or money and capital markets.

The thrift industry continued to struggle during much of the year with the problem of financing low-yield, long-term assets in a market environment of higher interest rates. Mergers and consolidations were numerous, many with the assistance of the federal insurance agencies. Long-term adjustment of portfolios and earnings was further complicated at year-end by the introduction of MMDAs to compete more directly with money market mutual funds. While this had the effect of draining balances from accounts with regulated ceiling rates, raising the average cost of funds to depository institutions in the short run, it did provide an effective vehicle for increasing deposit growth in the industry.

The overnight market in repurchase agreements (RPs) has mushroomed in recent years as end-of-day demand deposit balances were swept into RPs to assure a return on idle funds. Within the RP market, however, the failure of several small securities firms in 1982 highlighted the untested legal status of these arrangements spawned by inflation-swollen interest rates. Such failures injected a note of prudent caution into markets that had grown quickly in an unregulated environment.

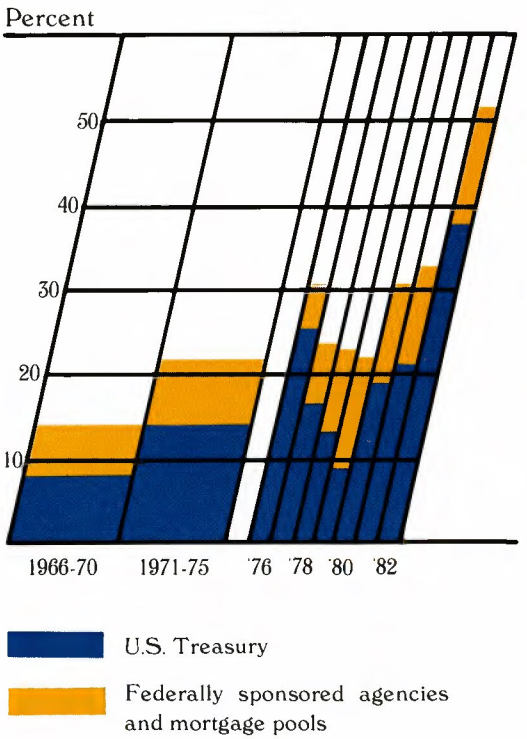
Deteriorating economic conditions worldwide changed the economic outlook for developing countries in the early 1980s. Export markets for manufactured goods weakened, commodity prices fell, and annual interest payments rose sharply as both the amount of indebtedness and interest rates rose. The bulk of foreign lending was to a small group of rapidly growing countries and was undertaken by a few banks with experience in international lending. In mid-1982 over 60 percent of the $270 billion owed to banks worldwide by developing countries was owed by just five countries—Argentina, Brazil, Mexico, Chile, and South Korea. At that time, U.S. claims on developing countries totaled about $100 billion, 60 percent of which was held by the nine largest U.S. banks. While the problem was in this sense localized, it was increasingly evident that the indebtedness of some borrowing countries needed prompt and forceful action by both governments and private institutions. Fortunately, institutions designed to cope with such problems were in place. Programs have been developed to coordinate the efforts of debtors, commercial banks, governments of the industrialized countries, and the International Monetary Fund.

Reduced world demand for petroleum, and for petroleum exploration and development, brought to light losses on some large loans in that industry, however, reflecting injudicious lending practices in several U.S. banks. The failure of one such bank caused potential losses to a number of small depository institutions that held its brokered certificates of deposit in excess of insured amounts.

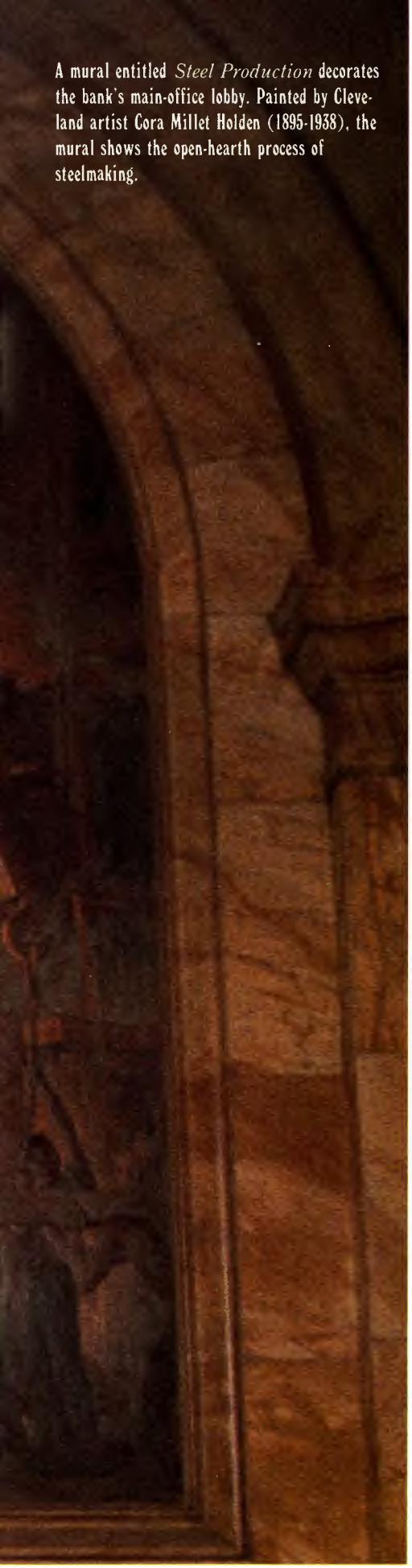
Credit market strains in 1982 might have been less severe had long-term interest rates not remained at relatively high levels. In part, high interest rates reflect unresolved issues of future federal budgets. The federal deficit, including agencies' borrowing, rose to an unprecedented 52 percent of nonfinancial borrowing in 1982 (see chart 6). Extrapolation of current federal tax and expenditure trends suggests that very large deficits will remain even after the recession is behind us. Unless these trends are changed, federal deficits will continue to absorb a substantial portion of private savings at full employment. The cost of financing private investment would therefore be unusually high, as competing private and public demands for funds bid up interest rates. Anticipation of this result contributes to current high long-term rates through expectations of high future real interest rates.

Another important reason for high current long-term interest rates is simply the uncertainty of many investors that the long-run inflation problem is being corrected. The possibility of inflationary monetization of large federal deficits undoubtedly contributes to this uncertainty.

Chart 6 Government Borrowing and Total Nonfinancial Borrowing



SOURCES: Board of Governors of the Federal Reserve System and Office of Management and Budget.



A mural entitled *Steel Production* decorates the bank's main-office lobby. Painted by Cleveland artist Cora Millet Holden (1895-1938), the mural shows the open-hearth process of steelmaking.

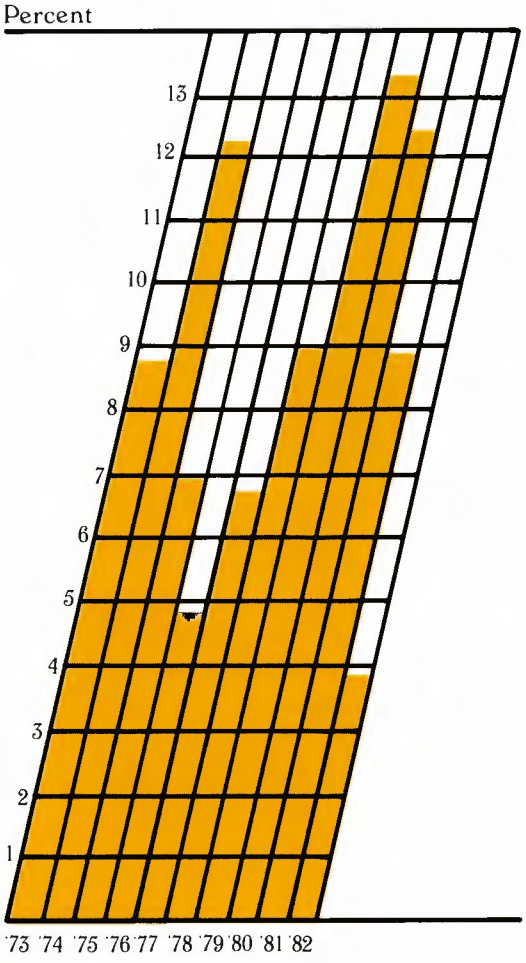
III. Prospects for Further Disinflation

Inflation declined dramatically in 1982. Measured by the consumer price index (CPI), the inflation rate was cut in half from the year ending in December 1981 to the comparable period in 1982. What's more, the 1982 inflation rate was less than one-third of the peak inflation rate of 1979 (see chart 7). The CPI tends to overstate both the rise in the inflation rate in the late 1970s and the rate's decline over the last three years. While the CPI is probably the most widely known measure of inflation, problems in its construction give an exaggerated reading of changes in inflation prior to the introduction of a revised index in 1983. Yet, other less volatile measures of inflation indicate that the inflation rate in 1982 declined to about half the peak values of a few years earlier.

Some of this apparent inflation improvement may be transitory. Special supply or demand factors in specific markets such as energy or food and business cycle impacts can heavily affect the rate of inflation in the short run of a year or so. A downward trend of annual inflation rates over a number of years is required for disinflation to bring eventual price stability to the U.S. economy.

Permanent inflation reduction may have been overstated in 1982 because of recession. Whether following a rising or falling long-run trend, inflation rates tend to show cyclical variations as demands for output alternately press closer to and then fall away from the short-run capacity limitations of the economy. The moderating effects of the 1981-82 recession were reinforced by particularly favorable prices of imports caused by almost 50 percent appreciation of the U.S. dollar in foreign exchange markets since 1980. Dollar appreciation is likely to be reversed, at least in part, as world trade recovers, as U.S. interest rates decline with disinflation, and as nervousness in the international money and capital markets diminishes. Upward pressure on the U.S. inflation rate will follow.

Chart 7 Changes in Consumer Prices
December over December percent change



SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Evidence is encouraging, nonetheless, that the upward trend of inflation, lasting almost 20 years, need not resume as economic recovery begins and economic expansion proceeds. The inflation process is frequently described as a wage-price spiral. Workers, seeing the potential for price increases to erode real wage rates, arrive at multi-year contracts with wage increases specified in advance. Even when demand for output declines and unemployment rises, such contractual arrangements prevent costs of production from rising any less rapidly in the short run. They become an effective floor from which the inflation rate rises as demand and production resume greater capacity utilization. This self-perpetuating inflation tendency is removed to the extent workers recognize that inflation is declining and accept more moderate contractual increases in wage rates. It is encouraging that in 1982 average negotiated wage and benefit decisions in all industries over the duration of labor contracts apparently responded to the recent moderation in inflation by rising at the lowest rate in 15 years.

Increases in wage rates and labor costs can be consistent with stable costs and prices if they are offset by sufficient improvements in labor productivity. The postwar slowdown in productivity growth in the United States remains a basic problem that obscures the outlook for continued disinflation, as discussed in some detail in our *1981 Annual Report.* Productivity growth improved significantly in the last half of 1982, as output per hour in the nonfarm business sector reversed its 1981 decline. Some of this improvement was a cyclical adjustment by businesses through successive cutbacks in labor inputs as the recession dragged on. Continued favorable productivity growth is likely in the early stages of recovery, reflecting typical cyclical experience.

Looking beyond these transitory factors, the long-term outlook for productivity growth promises no easy permanent improvement that would provide a source of further disinflation without a parallel moderation in labor costs. No substantial change in technology or the capital stock or the output mix of the American economy is evident that would suggest an immediate improvement in the long-term outlook for productivity growth. For this reason, recent rapid productivity growth rates cannot be expected to persist long enough to provide an independent contribution to inflation rates as low as or lower than in late 1982. Rather, it is the other way around: persistent gains in productivity could be reinforced by a lower rate of inflation through improved saving and investment performance. Unfortunately, such productivity gains are seriously jeopardized as long as there is no change in the trend toward large future federal deficits.

The federal budget problem beclouds any vision of the economic future. The problem is the size of projected deficits for future years and their impact on attitudes, decisions, and markets now and into the future. The problem is structural rather than cyclical. Even if steady progress could be made toward full employment and continued disinflation, the current tax and expenditure programs of the federal government do not appear likely to result in any significant reduction in federal budget deficits. Moreover, the size of these projected structural deficits may be inconsistent with achieving steady progress toward full employment, sustained growth, and disinflation.

Economic decisionmakers labor under the weight of enormous uncertainty about how the budget problem might be corrected. Spending and saving decisions today and for the future must reflect the possibility of tax increases of unknown size and incidence. Investment, employment, and spending decisions must reflect the possibility of program reductions of unknown impact.

Whether, or when, the budget problem might be corrected is also in doubt. If economic recovery proceeds and federal budget deficits do not recede, continuing massive annual issues of Treasury debt would be marketed in competition with growing corporate and household demands to finance the building of factories, machinery, and houses required for a growing

economy. Unrelenting competition for the limited pool of private saving at full employment would require high enough interest rates to squeeze out private borrowers until the Treasury's needs were met. Even with implacable central bank control of money required to maintain disinflation, real interest rates would have to be high enough to ration savings net of the deficit among private borrowers, preventing the investment required for sustained economic growth. High long-term interest rates today may reflect expectations of this impact of future federal deficits.

Financial markets may set high long-term interest rates today for another reason. Uncertainty about the resolution of the federal budget problem may lead to apprehension that, in a democratic society, a central bank may be unable to withstand pressures to hold down interest rates artificially in the short run. The attempt to hold rates down by excessive purchases of Treasury debt would inflate the supply of money and credit. Expectations of a consequent rekindling of inflation may prevent interest rates from falling today.

Capital accumulation, technological improvement, and productivity growth suffer when the capital markets are the arena in which the public sector competes with the private sector for real resources at full employment. The central bank, whether implacable foe or unwilling source of inflation, is powerless to prevent private borrowers from being "crowded out" of the capital markets by large structural budget deficits.

Detail of high-speed currency processor, a machine that can process up to 67,000 pieces of currency per hour. Approximately 90 percent of the currency deposited with the Federal Reserve Bank of Cleveland is processed through high-speed equipment.

Continued disinflation is neither easy nor assured, and ultimately depends on Federal Reserve policy as the economic expansion proceeds. Recent rapid growth of the monetary aggregates does not preclude further reductions in inflation and, in fact, may be entirely consistent with that goal. The introduction of new ceiling-free accounts, a cyclical buildup in precautionary balances, and some shifting of portfolios in reaction to lower expected inflation rates have temporarily distorted measured growth rates of money and credit. Because of the uncertain impact of these distortions, the Federal Reserve must temporarily rely more heavily on judgment than on rigid monetary targets to maintain a policy that promotes an economic recovery consistent with lower inflation. In time, however, the detour must end if progress against inflation is to be extended and sustained.

The New Focus

In the past year this bank has experienced a tremendous number of changes—in focus, in function, and in personnel. Stemming in part from the retirement of some key individuals, these changes also reflect the new focus and resultant functions thrust on the Federal Reserve System by the Depository Institutions Deregulation and Monetary Control Act of 1980. This legislation mandated that the Federal Reserve price the services that it provides to depository institutions. Along with pricing services, Federal Reserve Banks have begun to expand access to those priced services and compete in the marketplace with suppliers of similar services. At the same time, the Federal Reserve continues its role in the marketplace of supplying services to all users, regardless of size.

Public vs. Private

The objectives of the Federal Reserve's participation in this nation's payments mechanism remain focused on the balancing of public and private interests. At times the public goals of the Federal Reserve conflict with the private efficiency goals imposed by the marketplace. Yet, the Federal Reserve's public goals for the payments mechanism will continue to:

- ensure efficiency, protection, security, and reliability of the nation's payments system as a whole,
- establish the Federal Reserve as a supplier of essential facilities for transportation, communication, clearing, and settlement of payment items,
- offer an alternative for private-sector payment services to all depository institutions.

In addition to these public goals, a major private goal guiding the Reserve Banks is to assure that the price attached to a unit of service covers the cost, including a profit, of that unit of service.

The fundamental reality facing the Federal Reserve Bank of Cleveland in 1983 is that the ultimate test of success in priced services depends on our ability to balance the private and the public goals of the payments mechanism. One thing is certain: from this balancing between public and private sectors will emerge a new focus and new business practices for this bank.

Marketing in 1982

In mid-1982 a major management decision was made to focus the bank's marketing efforts on sales to satisfy market needs. Using a matrix management approach to aid in the transition to a market-driven organization, we are optimizing existing products, maintaining quality services, enhancing processing flows, minimizing costs, and improving service availability. Our marketing goals are to strengthen our competitive position, develop a marketing image, increase market penetration, and establish excellence in all product lines. The marketing effort will emphasize the benefits of Federal Reserve services and products.

Named *Services Management,* the marketing tool of this bank has three prongs—sales, market research, and product development. *Market research* will define customer needs through customer contact, market trends, technological developments, and knowledge of existing services. *Product development* will translate market needs into deliverable services and products at competitive prices. *Sales* will develop strategy, sell existing products and services, introduce new products/services, and handle support activities such as advertisement and marketing brochures. Our sales staff is currently implementing a depository institutions calling and support program, focusing on key features and benefits of Federal Reserve services.

We improved many of our services in 1982, in addition to establishing some new products and services. These improvements support the Federal Reserve's public goals of ensuring an efficient, reliable payments mechanism while also supplying essential payments services to all users.

Cash. Our efforts in cash services illustrate cost-effective improvements to the payments mechanism that have had positive effects on the cost of industry services to depository institutions. When the Federal Reserve Bank of Cleveland began pricing its armored transportation services, it became evident that the cost of our service was not competitive with comparable contract rates offered by private carriers operating within the district. As a result of competitive bidding, our rates could be lowered, resulting in reduced prices for essentially the same level of service to depository institutions. Our reduced rates have stimulated many of the private contract carriers to effect price reductions to depository institutions throughout the district. In 1982 we restructured our service boundaries to include several endpoints in the Philadelphia and Richmond Federal Reserve Districts that could more effectively be serviced at lesser rates from our Pittsburgh Branch.

The Fourth District is the only district in the Federal Reserve System that wraps coin for its depository institutions. In 1982, we centralized our coin-wrapping operations at the Pittsburgh Branch, allowing us to pass on the cost savings to depository institutions that use this service.

Located in the data-processing department at the main office, the IBM system console in the foreground is one of the centers that supports all functions for on-line users throughout the district. This equipment can handle 50,000 transactions daily, including IMS, Fed wire, and about 1,250 Fourth District batch jobs. The hardware in the background is microfiche-processing equipment, which photographically compresses over 200 pages of computer output to the size of a postcard.

Check Collection. We have improved the availability schedules in check collection services, allowing depository institutions to increase earnings and/or service potential to premium customers. Many of our new services and products are designed to improve the flow of payments to depository institutions and the Treasury. The check magnetic ink character recognition (MICR) line capture, for example, allows depository institutions to receive check information on magnetic tape processed by the Federal Reserve for entry into cash management and/or on-line MICR processing systems. This product replaces a manual reconcilement system with a more timely automated system. By removing processing constraints through the MICR line system, depository institutions can offer more efficient and timely services.

Coupon Collection. The availability schedules of our coupon collection services have also been improved. We have expanded our customer deposit services to provide several mixed deposit options at any Fourth District office. These options reduce the need for sorting by depositing institutions and minimize the number of handlings in coupon transactions. More effective routing of transactions and

reductions in the number of incorrectly sorted transactions improve the efficiency of the payments mechanism.

ACH. The automated clearinghouse (ACH) allows paper transactions to be replaced with more efficient electronic transactions. The ACH is becoming increasingly efficient in moving transactions from originator to receiver. The volume of transactions is growing to the level where economies of scale in processing could force the price of ACH transactions below the price of comparable paper transactions. In 1982 we expanded the number of Fourth District automated endpoints by implementing data links and developing corporate trade payment software for both the Federal Reserve System and the National Automated Clearinghouse Association. The corporate trade payment program should become operative nationwide in late 1983 and should inject significant volume into the ACH payments stream.

Safekeeping. We have established a new safekeeping service—definitive safekeeping of customer and trust securities. We also have expanded our reserve city bank securities safekeeping program. In offering an alternative supplier, our involvement in the safekeeping market should benefit the payments system and the public through increased price and service competition.

On-line Communications. In 1982 the Federal Reserve System completed the first implementation phase of a wire communications system known as FRCS-80. In the latter half of the year, we added several new user applications and improved service in the on-line portion of the network, such as currency and coin ordering and original issues tenders. These applications allow the substitution of automated systems for manual procedures between the Federal Reserve and customer institutions, resulting in cost savings and productivity improvements to customers who install on-line terminals. We also anticipate service improvements as communications technology expands to allow more effective utilization of the FRCS-80 network.

Treasury Services. In 1982 we implemented automated systems to improve the flow of payments between the Treasury and the Federal Reserve Banks, namely public debt reporting via magnetic tape and the automated issuance of Treasury checks. These systems should result in more efficient Treasury services at reduced costs to depository institutions and to the public.

Reorganization/ Realignment

To complement our new marketing program, the bank's operating, support, and overhead services were realigned in late 1982 to develop and maintain cost-effective, high-quality services to meet the needs of depository institutions, the Treasury, and the general public. For efficiency we have consolidated certain operations for the entire Fourth District at one office. The off-line wire transfer operations of the Cleveland and Pittsburgh offices were consolidated at the Cleveland office, for example, while the coin-wrapping functions were consolidated at the Pittsburgh Branch. The operational reorganization at this bank will capitalize on the strengths of our staff while increasing our participation in the financial community and in activities of the Federal Reserve System. The realignment of the staff reflects our efforts to improve the operations and hence the quality of services of this bank.

William H. Hendricks was named first vice president on October 1, 1982. Formerly a senior vice president, Hendricks succeeded Walter MacDonald as chief operating officer of the Federal Reserve Bank of Cleveland and its branches. Having joined the bank in 1958 as an assistant economist, Hendricks was most recently responsible for computer operations, programming, fiscal services, budget, securities, accounting, and data reporting.

Harold J. Swart was named senior vice president of the Pittsburgh Branch on January 1, 1982. Having begun his banking career at the main office in 1963, Swart was promoted to assistant general auditor in 1968. Before joining the Pittsburgh Branch in 1981, Swart was vice president in charge of cash, fiscal, securities, and check collection.

Four senior officers were promoted to the level of senior vice president as of November 15, 1982:

Randolph G. Coleman became senior vice president responsible for bank services operations, which includes cash, fiscal, securities, check, automated clearinghouse, and funds and securities transfer. He also is responsible for the Columbus regional check processing center (RCPC). Before joining the bank in 1979 as vice president in charge of computer operations, Coleman had worked at Society National Bank of Cleveland for 20 years.

Donald G. Vincel was promoted to senior vice president in charge of services management and automation. Vincel joined the bank as a management trainee in 1962 and was named assistant vice president in the planning and data processing departments in 1972. In 1975 he became officer in charge of check collection, ACH operations, and the Columbus operation.

Lee S. Adams was named senior vice president and general counsel, responsible for the legal and the supervision and regulation departments. Having joined the bank in 1981 as vice president and general counsel, Adams previously was a senior counsel at the Board of Governors. He also served as a lecturer at Catholic University School of Law and as assistant dean and adjunct professor of law at Georgetown University Law Center.

Thomas E. Ormiston, Jr., was named senior vice president in charge of administrative support and correspondence administration. Ormiston formerly was the vice president responsible for accounting, budget and operations review, and data services. He will continue to assist accounting in developing an improved budget and control system. Having joined the bank in 1950 as a research assistant, Ormiston has served as manager in data processing, assistant cashier in cash, and assistant vice president in accounting.

In addition to the reorganization of responsibilities among senior-level staff, five other people were named vice presidents, effective January 1, 1983:

Andrew J. Bazar is vice president in charge of automation services, which includes data processing, communications, and data systems support. Bazar joined the bank in 1967 as an analyst programmer and was promoted to assistant vice president in 1979.

Creighton R. Fricek is vice president in charge of check, automated clearinghouse, and funds transfer at the main office. After joining the data systems support department in 1977, Fricek became an assistant vice president in 1981. Prior to joining the bank, Fricek was manager of time-sharing services at Chi Corp. in Cleveland.

John J. Ritchey is vice president and associate general counsel. He joined the bank in 1979 as assistant to counsel and was promoted to assistant general counsel in 1981. Ritchey previously was an assistant attorney general for the state of Ohio and a staff attorney with the Community Law Office in Columbus, Ohio.

Samuel D. Smith is vice president in charge of fiscal, securities, and cash. Smith previously was assistant vice president of product development and planning at the Federal Reserve Bank of Atlanta, where he worked for the past twelve years.

Charles F. Williams is vice president in charge of the Columbus RCPC. Having joined the bank's Cincinnati Branch in 1970 as a management trainee, Williams became manager of the Cincinnati Branch's data systems support department in 1972. In 1976 he was promoted to assistant vice president and assigned to the Columbus RCPC.

Robert F. Ware accepted a major transfer of responsibilities, being named vice president of finance services. This is a functional group that includes accounting, billing, budget, expense, and data services. Ware was vice president and economist in the research department, in charge of research administration, discount window, bank structure, and Community Reinvestment Act activities.

Retirements

Last, we wish to recognize the contributions of four men who retired from this bank in 1982. We are grateful for their many years of dedicated service, not only to this institution but to the System and its constituents.

Willis J. Winn retired on April 30, 1982, after nearly eleven years as president of this bank. Much of his public-service career was associated with the Federal Reserve System: before joining the Federal Reserve Bank of Cleveland, Winn served as a director and chairman of the board of the Federal Reserve Bank of Philadelphia. Formerly dean of the Wharton School of Business, Winn was a professor of finance as well as vice provost of the University of Pennsylvania. He was active in civic activities in both Cleveland and Philadelphia. Upon retiring from the bank, Winn and his wife Lois moved to a new home on his grandfather's farm in Missouri.

Walter H. MacDonald, first vice president, retired on September 1, 1982. MacDonald began his career with the bank in 1937 at the Cincinnati Branch. After serving in World War II, he returned to the bank, working first in Cincinnati and then at the main office. He was named to the position of first vice president in 1966. MacDonald served with six of this bank's seven presidents in various capacities and with three presidents as first vice president.

Harry W. Huning, vice president of bank supervision and regulation, retired on September 1, 1982, after 28 years with the Federal Reserve. He joined the bank in 1954 as an assistant trust examiner in the bank examination department. After serving for a short time with the examination staff at the Board of Governors, he returned to the Federal Reserve Bank of Cleveland. In 1964 Huning was promoted to vice president of bank supervision and regulation, a post that he held until his retirement.

George E. Booth, Jr., vice president, retired on January 30, 1982, following a career of 33 years with the Cleveland Federal Reserve Bank. He served as counsel in the legal department, and in 1964 he was named vice president and cashier in charge of cash operations. More recently, Booth was vice president in charge of vault custodies, correspondence administration, and special studies. He also edited the bank's circular and operating letters and assisted the bank's president and first vice president in many of their System-related activities.

We appreciate the contributions that these men have made to this institution; we wish them every success in their future endeavors.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OR SPINDLE
VALUE
10
DOLLARS
HAMILTON
DEPARTMENT OF AGRICULTURE
BX-3

Federal Reserve Bank of Cleveland Officers

As of January 1, 1983

Karen N. Horn
President

William H. Hendricks
First Vice President

John M. Davis
Senior Vice President and Economist

Lee S. Adams
Senior Vice President
and General Counsel

Randolph G. Coleman
Senior Vice President

Thomas E. Ormiston, Jr.
Senior Vice President

Donald G. Vincel
Senior Vice President

Andrew J. Bazar
Vice President

Patrick V. Cost
General Auditor

Creighton R. Fricek
Vice President

John W. Kopnick
Vice President

John J. Ritchey
Vice President
and Associate General Counsel

Lester M. Selby
Vice President and Secretary

Samuel D. Smith
Vice President

Robert F. Ware
Vice President

Oscar H. Beach, Jr.
Assistant Vice President

Margret A. Beekel
Assistant Vice President

Thomas J. Callahan
Assistant Vice President
and Assistant Secretary

Jill Goubeaux Clark
Assistant Counsel

John J. Erceg
Assistant Vice President
and Economist

Robert J. Gorius
Assistant Vice President

Norman K. Hagen
Assistant Vice President

David P. Jager
Assistant Vice President

Cathy L. Petryshyn
Assistant Vice President

David E. Rich
Assistant Vice President

Susan G. Schueller
Assistant Vice President

Burton G. Shutack
Assistant Vice President

William J. Smith
Assistant General Auditor

Robert Van Valkenburg
Assistant Vice President

Andrew W. Watts
Assistant Vice President

John J. Wixted
Assistant Vice President

Cincinnati Branch

Robert E. Showalter
Senior Vice President

Charles A. Cerino
Vice President

Roscoe E. Harrison
Assistant Vice President

David F. Weisbrod
Assistant Vice President

Jerry S. Wilson
Assistant Vice President

Pittsburgh Branch

Harold J. Swart
Senior Vice President

Donald G. Benjamin
Vice President

Paul E. Anderson
Assistant Vice President

Joseph P. Donnelly
Assistant Vice President

Ronald J. Ford
Assistant Vice President

Lois A. Riback
Assistant Vice President

Columbus Office

Charles F. Williams
Vice President

Record numbers of food coupons were received by this bank in 1982. The bank acts as fiscal agent for the U.S. Treasury in processing food coupons, which are credited to the depositing bank's reserve account and then destroyed.

Comparative Financial Statements

Condition

	Year ended December 31	
	1982	1981
Assets		
Gold certificate account	**$744,000,000**	$805,000,000
Special drawing rights certificate account	**302,000,000**	253,000,000
Coin	**48,352,029**	38,486,707
Loans to depository institutions	**18,640,000**	18,590,000
Federal agency obligations—bought outright	**589,824,645**	662,500,183
U.S. government securities:		
Bills	**3,592,053,786**	3,583,457,763
Notes	**4,133,263,304**	4,354,424,538
Bonds	**1,224,664,884**	1,335,875,027
Total U.S. government securities	**8,949,981,974**	9,273,757,328
Total loans and securities	**9,558,446,619**	9,954,847,511
Cash items in process of collection	**497,489,683**	383,277,625
Bank premises	**26,959,141**	26,595,475
Other assets	**622,823,041**	594,580,271
Interdistrict settlement account	**(1,322,017,967)**	(1,066,590,844)
Total assets	**$10,478,052,546**	$10,989,196,745
Liabilities		
Federal Reserve notes	**$8,822,691,792**	$8,972,143,190
Deposits:		
Depository institutions	**1,050,526,845**	1,259,039,221
Due to other Federal Reserve Banks' collected funds	**326,044**	-0-
U.S. Treasurer—general account	**-0-**	-0-
Foreign	**15,750,000**	25,201,000
Other deposits	**41,324,088**	20,021,713
Total deposits	**1,107,926,977**	1,304,261,934
Deferred availability cash items	**214,983,382**	338,827,588
Other liabilities	**134,157,795**	181,061,433
Total liabilities	**$10,279,759,946**	$10,796,294,145
Capital accounts		
Capital paid in	**$99,146,300**	$96,451,300
Surplus	**99,146,300**	96,451,300
Total liabilities and capital accounts	**$10,478,052,546**	$10,989,196,745

Earnings and Expenses

	Year ended December 31	
	1982	1981
Earnings		
Loans	**$7,476,261**	$15,236,123
U.S. government securities	**1,047,056,094**	1,062,401,528
Foreign currencies	**32,333,016**	44,290,531
Priced services	**23,999,246**	9,836,160
All other	**318,797**	638,632
Total current earnings	**1,111,183,414**	$1,132,402,974
Net expenses	**59,109,587**	55,151,690
Current net earnings	**1,052,073,827**	1,077,251,284
Additions to current net earnings:		
Profit on sales of U.S. government securities (net)	**5,533,134**	-0-
Profit on foreign exchange transactions (net)	**-0-**	-0-
All other	**707**	450,960
Total additions	**5,533,841**	450,960
Deductions from current net earnings:		
Loss on sales of U.S. government securities (net)	**-0-**	9,171,623
Loss on foreign exchange transactions (net)	**11,220,916**	24,173,356
All other	**43,094**	186,188
Total deductions	**11,264,010**	33,531,167
Net deductions	**5,730,169**	33,080,207
Earnings credits used by depository institutions	**1,996,859**	137,957
Assessment for expenses of Board of Governors	**4,639,900**	4,970,500
Net earnings before payments to U.S. Treasury	**1,039,706,899**	1,039,062,620
Dividends paid	**5,891,495**	5,756,998
Payments to U.S. Treasury (interest on F.R. notes)	**1,031,120,404**	1,032,044,272
Transferred to surplus	**2,695,000**	1,261,350
Total	**$1,039,706,899**	$1,039,062,620

Federal Reserve Bank of Cleveland Directors

Through December 31, 1982

Chairman and Federal Reserve Agent
J.L. Jackson
Executive Vice President and President—Coal Unit
Diamond Shamrock Corp., Lexington, KY

Deputy Chairman
W.H. Knoell
President and Chief Executive Officer
Cyclops Corporation, Pittsburgh, PA

John W. Alford
Chairman of the Board and Chief Executive Officer
The Park National Bank, Newark, OH

J. David Barnes
Chairman of the Board
Mellon Bank, N.A., Pittsburgh, PA

Raymond D. Campbell
Director
The Oberlin Savings Bank Company, Oberlin, OH

John W. Kessler
President
John W. Kessler Company, Columbus, OH

E. Mandell de Windt
Chairman of the Board
Eaton Corporation, Cleveland, OH

Richard D. Hannan
Chairman of the Board and President
Mercury Instruments, Inc., Cincinnati, OH

John D. Anderson
Senior Partner
The Andersons, Maumee, OH

Member, Federal Advisory Council, Fourth District

John G. McCoy
Vice Chairman and Chief Executive Officer
Banc One Corporation, Columbus, OH

Directors, Cleveland office: l. to r., John W. Kessler, Chairman J.L. Jackson, Richard D. Hannan, and E. Mandell de Windt.

Directors, Cleveland office: Standing, l. to r., J. David Barnes, John W. Alford, Raymond D. Campbell, and John D. Anderson. Seated, Deputy Chairman William H. Knoell.

Cincinnati Branch

Chairman
Clifford R. Meyer
President and Chief Operating Officer
Cincinnati Milacron Inc., Cincinnati, OH

Oliver W. Birckhead
Chairman of the Board and Chief Executive Officer
The Central Trust Company, N.A., Cincinnati, OH

O.T. Dorton
President
Citizens National Bank, Paintsville, KY

Sherrill Cleland
President
Marietta College, Marietta, OH

Richard J. Fitton
President and Chief Executive Officer
First National Bank of Southwestern Ohio, Hamilton, OH

Sister Grace Marie Hiltz
President
Sisters of Charity Health Care Systems, Inc.
Cincinnati, OH

Don Ross
Owner
Dunreath Farm, Lexington, KY

Directors, Pittsburgh Branch: l. to r., William D. McKain, Ernest L. Lake, Robert S. Kaplan, James S. Pasman, Jr., and Robert C. Milsom. Not present, Chairman Milton G. Hulme, Jr., and Quentin C. McKenna.

Directors, Cincinnati Branch: l. to r., O.T. Dorton, Richard J. Fitton, Sister Grace Marie Hiltz, Sherrill Cleland, and Don Ross. Not present, Chairman Clifford R. Meyer and Oliver W. Birckhead.

Pittsburgh Branch

Chairman
Milton G. Hulme, Jr.
President and Chief Executive Officer
Mine Safety Appliances Company, Pittsburgh, PA

William D. McKain
President
Wheeling National Bank, Wheeling, WV

Ernest L. Lake
President
The National Bank of North East, North East, PA

Robert C. Milsom
President
Pittsburgh National Bank, Pittsburgh, PA

James S. Pasman, Jr.
Vice Chairman
Aluminum Company of America, Pittsburgh, PA

Robert S. Kaplan
Dean, Graduate School of Industrial Administration
Carnegie-Mellon University, Pittsburgh, PA

Quentin C. McKenna
President and Chief Executive Officer
Kennametal Inc., Latrobe, PA

Above: A guard watches closed-circuit TV monitors of strategic locations in the Cincinnati Branch.

Upper right: Armed guards patrol the Federal Reserve Bank buildings twenty-four hours per day, seven days per week.

Lower right: Officers of the Cincinnati Branch discuss bank operations in their territory.