ANNUAL REPORT 1970

FEDERAL RESERVE BANK MINNEAPOLIS

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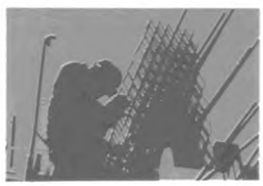
TO THE DIRECTORS AND MEMBER BANKERS OF THE NINTH FEDERAL RESERVE DISTRICT:

FEDERAL RESERVE BANK MINNEAPOLIS

At least once every decade there comes a year when again the truth of the old saw, "There ain't no free lunch," is driven home by intractable economic forces. 1970 has been such a year. Wanting to believe that we could have the equivalent in the 60's of a free lunch – guns and butter – the American public developed excessive and exuberant expectations that forced monetary policy to become increasingly restrictive in 1969. We entered 1970 with money rates at historic highs, an economy that was only then beginning to show signs of slowing, a still tight labor market, little real evidence of any change in the rate of inflation, and a general lack of conviction in the business community that demand inflation would be curbed. A sorry configuration, indeed.

There were two especially troublesome concerns last January. The first of these was the illiquidity in the business community that developed as the 60's soared to their close. The financial community was also affected by this trend, very much to the concern of the supervisory authorities.

The worst of our fears almost became reality in mid-summer with the Penn-Central bankruptcy petition. In a few short days (or excessively long days, depending on your vantage point) the survival of the commercial paper market became an urgent question, overriding most other monetary policy considerations. In a remarkable cooperative effort with the money market banks, steps were taken by the Fed to inform commercial banks that the discount window would be available to provide emergency funds should businesses be unable to meet their financial obligations as a result of the loss of confidence in commercial paper generally. In addition to the response at the discount window by the Federal Reserve Banks, the Board of Governors suspended the ceilings on interest rates payable on single maturity time deposits of $100,000 or more having a maturity of 30-89 days. This enabled the banking system to absorb the money that had previously been in commercial paper. Order was restored. Businesses since then have striven to reduce their reliance on short-term credit, and the



drive to rebuild liquidity with longer-term capital is still going on.

As "lender of last resort," the Fed worked through and with the banking community to avert the liquidity crisis that could have developed as an aftermath to the widespread frantic search for funds.

On the whole, commercial banks themselves have conducted themselves with growing discretion. The practice of granting indiscriminate and unrealistic "lines of credit" to corporations in efforts to keep and secure prestigious customers may be expedient in the short run, but in a time of tightening monetary policy can be terribly counter-productive, for if the Federal Reserve were by this practice to be brought into a position of having to validate these credit commitments, the conduct of monetary policy in the national interest would be taken out of the hands of the System. With the lessening of pressures within the economy and the slackening of loan demands later in the year, the immediate concern resulting from this practice has lessened, but commercial banks themselves will have to continue to guard against it.

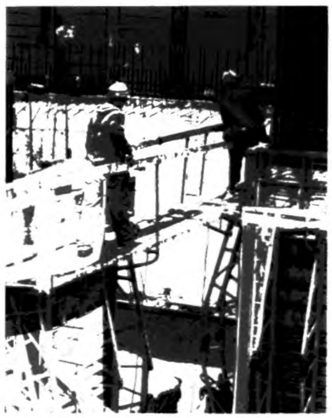
One of the results of the pressures for funds to meet these loan commitments was to cause banks to tap other sources outside the United States in recent years. The Euro-dollar market blossomed from seed to a full-blown $15 billion in two years. When the demand for funds was high, this source partly outside of direct rate regulation enabled some banks to obtain funds, in spite of the tight money market that existed in the winter of 1969-70. Now as rates have moderated here, there is a natural desire to pay off these Euro-dollar loans. Because of the potential threat to the United States balance of payments position if this is done too rapidly, the Federal Reserve System view of Euro-dollar borrowing was reversed in part, driving home the point that indeed these funds did not provide a "free lunch." We hope this latest round of liquidity problems will be resolved without undue difficulty.

The other concern — that of continuing inflationary pressures in an economy




with over 5 percent unemployed – is almost intractable. The inflationary exuberance in recent years masked to many the fact that wage increases have exceeded productivity gains. That this should continue during a period of rising unemployment does not create the best of all possible worlds. Widespread support has developed for some sort of incomes policy to restore a reasonable relationship of wages, productivity, and prices more quickly than will be possible for conventional monetary and fiscal measures. The American citizen has not been noted for his patience. It is not enough to join in the good fight for an incomes policy; its form has to be carefully thought out. Here too, there is no "free lunch."

To another matter: National banks and state member banks have always known that their membership in the System involved a real economic cost. We recognize commercial banks are facing increasing competitive pressures and rising costs. Intensive efforts at the Federal Reserve Bank of Minneapolis have been pushed



further during the year to serve member banks better. We held four more member bank service conferences in Sioux Falls, Fargo, Hibbing, and Iron Mountain to acquaint our members with the various ways that the Fed can be helpful in its services. In addition, our officers calling on member banks provide computer print-outs on individual member bank reserve management and operating ratios. The Check Department, in November, started door-to-door delivery of check shipments to the Upper Peninsula, an area plagued by uncertain mail deliveries. Beginning in January 1971, armored carrier routes for currency and coin will be extended into the Dakotas, bringing to 283 the number of member banks in the Ninth District so served. Testing of new coin wrapping machinery was completed during the year and new equipment on order assures that this service will continue.

Our directors have also been concerned with doing as much as possible to ease the burden of membership. A directors committee consisting of John Bailey, director from Elk River, and John Bosshard, director from La Crosse and Bangor, Wisconsin, working with management, surveyed different ways in which membership may be enhanced. The Board adopted recommendations at the December meeting which may result in the Bank's assuming many charges on member bank transactions that fall into the petty annoyance category. In addition, our Board of Directors has repeatedly urged early adoption of the discount study recommendations made in 1968.

While waiting for refinement of the discount study recommendations and their hoped-for adoption, the System has announced several changes (effective February 4, 1971) that will eliminate some of the rigamarole connected with borrowing at the discount window. A continuing lending agreement and pledge of securities will take the place of individual notes and securities descriptions. In addition, interest will be paid at the completion of the loan rather than discounted in advance and the discount rate for outstanding loans will follow changes that occur during their term.

The long-range planning and intermediate planning efforts started at the Minneapolis Bank in 1969

have continued. During the year, study papers commissioned on a variety of subjects related to the Federal Reserve and the financial community in 1990 were received. These are being analyzed and a report will be available in 1971. In addition, two seminars growing out of these efforts were held – one on bank operations and future technology, and one on regional economic policy. Another is planned on bank structure and regulation. At mid-year, a Twin City area payments mechanism study group was formed to assure that the Ninth District stays in the forefront of national developments in the payments mechanism. At year end, our vice president in charge of check operations took on some Systemwide responsibilities in this area.

Closer at hand, both geographically and in time as well, our immediate planning efforts under our Planning, Programming, and Budgeting System have progressed on schedule. Departmental officers have developed goals and objectives in line with Bankwide goals which are under constant review. During the next year, goals and objectives will be developed for the intermediate range under the review and scrutiny of our Board of Directors.

The concern of our directors about their role and their participation in the monetary policy and management affairs of the Bank have been heartening. We have moved towards greater rotation of directors, particularly among member bank directors, in order to assure wider member bank participation. As a result, the valuable services of Warren Vaughan (Group 1 Class A banker director) came to an end upon completion of his term on December 31. His successor will be Philip Nason from St. Paul. The advisory committee of member bankers who suggest names for nomination recommended to our Board that when the director of this class comes from the Twin Cities, the Federal Advisory Council member be selected from outside the metropolitan area. This recommendation was followed, and the directors selected Thomas Reardon of Sioux Falls to be the FAC member from the Ninth District for 1971. Also at year-end, two outstanding Montana bankers, Glenn Larson and Charles Brocksmith,

completed their service on the Helena Branch Board of Directors. Their successors selected by the Minneapolis Board will be E. Lowry Kunkel of Butte, and Robert Penner of Wolf Point.

For the past six years, Byron Reeve has been a stalwart on our Board. Appointed by the Board of Governors in 1965 as a Class C director, he has represented the Upper Peninsula of Michigan and served as acting chairman on several occasions with distinction. His successor appointed by the Board of Governors commencing January 1, 1971, is Russ Hart from Billings, Montana.

Also at year-end, the Board of Governors announced the appointment of David Lilly as Chairman and Federal Reserve Agent with Bruce Dayton as Deputy Chairman, our other two Class C directors.

We are pleased that Dale Andersen of Mitchell, South Dakota, was reelected. Not only did this make it possible to continue our efforts to have every state represented, but it assured us of his continued presence as a contributing member of the Board.

The vitality of the Federal Reserve Bank of Minneapolis is a reflection of the directors who served so generously on the Board and gave so unstintingly of their time. One of the most valued sources of inspiration to management and his fellow directors was our Chairman of these past several years, Bob Leach, who died December 10. He inspired us by his example, infected us with his enthusiasm, and his memory will sustain our efforts in the years ahead. Those of us who knew and loved him will miss him always.

Hugh D. Galusha, Jr.

Hugh D. Galusha, Jr.
President

Statement of Condition

ASSETS	Dec. 31, 1969	Dec. 31, 1970
Total Gold Certificate Account	$ 131,236,919	$ 160,661,886
Special Drawing Rights Certificate Account	–	7,000,000
Federal Reserve Notes of other Federal Reserve Banks	20,665,780	30,853,250
Other cash	3,392,541	6,424,132
Discounts and advances		
Secured by U.S. securities	3,450,000	500,000
Other	–	–
United States Government securities	1,149,629,000	1,218,595,000
Total loans and securities	1,153,079,000	1,219,095,000
Foreign currencies	45,218,000	–
Cash items in process of collection	431,510,646	466,578,833
Bank premises	5,533,279	11,503,438
Other assets	10,531,551	16,947,483
Total Assets	1,801,167,716	1,919,064,022

LIABILITIES		
Federal Reserve Notes in actual circulation	$ 818,646,176	$ 875,075,663
Deposits:		
Member banks – reserve accounts	537,617,765	623,255,884
United States Treasurer – general account	49,171,584	48,641,969
Foreign	2,990,000	2,750,000
Other deposits	5,954,879	5,575,318
Total deposits	595,734,228	680,223,171
Deferred availability cash items	344,501,932	320,269,838
Other liabilities	12,300,880	11,899,350
Total Liabilities	1,771,183,216	1,887,468,022

CAPITAL ACCOUNTS		
Capital paid in	14,992,250	15,798,000
Surplus	14,992,250	15,798,000
Total Liabilities and Capital Accounts	1,801,167,716	1,919,064,022
Ratio of gold certificate reserves to Federal Reserve Note liabilities	16.0%	18.4%

Earnings and Expenses

CURRENT EARNINGS	1969	1970
Discounts and advances	$ 1,990,330	$ 1,387,356
United States Government securities	62,198,740	74,457,250
All other	2,853,116	1,127,708
Total Current Earnings	67,042,186	76,972,314

CURRENT EXPENSES		
Operating Expenses	10,644,094	12,530,328
Assessment for expenses of Board of Governors	344,600	476,800
Federal Reserve Currency	376,622	414,201
Total Current Expenses	11,365,316	13,421,329
Less: reimbursement for certain fiscal agency and other expense	792,671	863,575
Net Expenses	10,572,645	12,557,754

CURRENT NET EARNINGS	56,469,541	64,414,560
NET ADDITIONS TO CURRENT NET EARNINGS		
Profits on sales of U.S. Government securities (net)	(Loss)–119,195	165,029
All other	136,311	80,772
NET EARNINGS BEFORE PAYMENTS TO UNITED STATES TREASURY	56,486,657	64,660,361
PAYMENTS TO U.S. TREASURY	55,080,773	62,925,367
DIVIDENDS PAID	888,334	929,244
TRANSFERRED TO SURPLUS	517,550	805,750
SURPLUS January 1	14,474,700	15,798,000
SURPLUS December 31	14,992,250	15,798,000

Volume of Operations*

	Number		Dollar Amount	
	1969	1970	1969	1970
Discounts and advances	1,144	700	$ 3,039,609,000	$ 1,352,157,000
Currency received and counted	81,164,812	87,912,316	556,615,325	613,174,846
Coin received and counted	231,344,143	270,427,398	26,830,236	28,263,503
Checks handled, total	329,598,740	358,372,947	79,851,442,208	77,852,735,345
Collection items handled	855,607	845,230	1,127,334,789	1,268,434,167
Issues, redemptions, exchanges of U.S. Government securities	5,892,588**	5,760,027	11,963,832,800**	15,601,359,115
Securities held in safekeeping	344,171	337,309	2,076,225,860	2,475,131,569
Transfers of funds	239,758	271,090	203,748,723,303	260,568,120,527

*All figures are for Minneapolis and Helena combined.
**Includes December estimate.

FEDERAL RESERVE BANK MINNEAPOLIS

HEAD OFFICE DIRECTORS

Class A — Elected by Member Banks	Term Expires December 31
Gustav A. Dahlen, President, The First National Bank, Ironwood, Michigan	1971
John Bosshard, Executive Vice President, First National Bank, Bangor, Wisconsin	1972
Philip H. Nason, President, The First National Bank, Saint Paul, Minnesota	1973
Class B — Elected by Member Banks	
John H. Bailey, President, The Cretex Companies, Inc., Elk River, Minnesota	1971
David M. Heskett, President, Montana-Dakota Utilities, Inc., Bismarck, North Dakota	1972
Dale V. Andersen, President, Mitchell Packing Company, Mitchell, South Dakota	1973
Class C — Appointed by Board of Governors	
Bruce B. Dayton, Chairman of the Board, Dayton Hudson Corporation, Minneapolis, Minnesota	1971
David M. Lilly, Chairman of the Board, Toro Manufacturing Corporation, Minneapolis, Minnesota	1972
Russ B. Hart, President, Hart-Albin Company, Billings, Montana	1973

OFFICERS

Hugh D. Galusha, Jr., President; Maurice H. Strothman, Jr., First Vice President; Earl O. Beeth, Assistant Vice President; Carl E. Bergquist, Assistant Vice President; Christopher E. Bjork, General Auditor; Melvin L. Burstein, Assistant General Counsel and Assistant Secretary; Frederick J. Cramer, Vice President; Ralph J. Dreitzler, Vice President; Leonard W. Fernelius, Vice President; Lester G. Gable, Vice President; Thomas E. Gainor, Assistant Vice President; Roland D. Graham, Vice President and General Counsel; Harold O. Hallin, Emergency Operations Officer; Richard C. Heiber, Assistant General Auditor; Douglas R. Hellweg, Vice President; Richard J. Herder, Assistant Research Director; Ronald O. Hostad, Assistant Vice President; LeRoy G. Hughes, Building Officer; Arthur I. Lee, Assistant Vice President; John A. MacDonald, Senior Vice President; David R. McDonald, Vice President; Clarence W. Nelson, Vice President and Director of Research; William A. O'Brien, Assistant Vice President; John P. Olin, Vice President and Secretary; Richard B. Thomas, Assistant Vice President; Clement A. Van Nice, Senior Vice President; Joseph R. Vogel, Chief Examiner; Robert W. Worcester, Vice President

HELENA BRANCH DIRECTORS

Appointed by Board of Governors	Term Expires December 31
William A. Cordingley, Publisher, Great Falls Tribune Company, Great Falls, Montana	1971
Warren B. Jones, Secretary-Treasurer, Two Dot Land & Livestock Company, Harlowton, Montana	1972
Appointed by Board of Directors, Federal Reserve Bank of Minneapolis	
Richard D. Rubie, Chairman of the Board, Montana BanCorporation, Great Falls, Montana	1971
E. Lowry Kunkel, President, First National Bank, Butte-Anaconda, Butte, Montana	1972
Robert I. Penner, President, Citizens First National Bank, Wolf Point, Montana	1972

OFFICERS

Howard L. Knous, Vice President; Bruce J. Hedblom, Assistant Vice President; John D. Johnson, Assistant Vice President

Member of Federal Advisory Council

Thomas M. Reardon, Chairman of the Board, Western Bank, Sioux Falls, South Dakota

January 1, 1971