

# NORTHWESTERN Banker Newsletter

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November 18, 1974

## The Outlook for Interest Rates

*The following address was presented at the American Bankers Association convention in Honolulu last month by Albert H. Cox, Jr., executive vice president and chief economist of Lionel D. Edie and Company, Inc., well-known management consultant firm, New York City.*

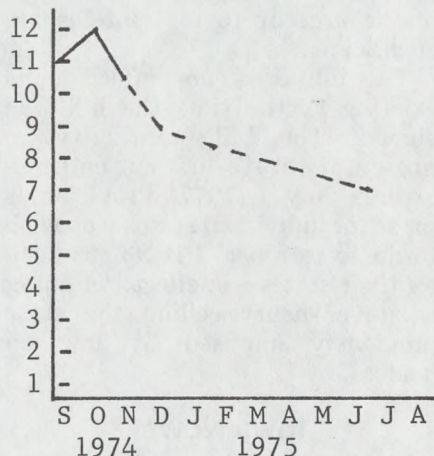
To put it politely, interest rates have not been kind to most forecasters over the past year or so. Our own forecast is probably about as apt an example as any.

About a year ago we decided that a recession was getting underway, because inflation was deeply eroding consumer sentiment and cutting into discretionary spending power. As a result, we thought that short term rates would recede, though long term rates were expected to remain under upward pressure because of the likely persistence of high inflation. At that time, "high inflation" to us was in the neighborhood of about 8%.

Well, a recession **did** start about a year ago, in our book anyway. But instead of trending downward, short term rates went through the tops of our charts and long term rates rose by a lot more than we had expected.

Why? Because inflation this year

has been running 50% higher than we had expected -- 12% or thereabouts, instead of 8%. The quadrupling of world oil prices was a large part of the difference -- probably 3 of the 4 points. The remainder can be traced to some underestimation on our part of the



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pent-up price pressures that were released with the ending of controls. And both of these developments -- the jump in oil prices and the ending of controls -- greatly re-inforced "shortage psychology" early this year. As a result, inventory accumulation,

particularly of raw materials, zoomed. The book value of business inventories, which was rising at an annual clip of about \$20 billion last fall, had ballooned to an annual rate of \$60 billion by last July, the peak month. Thus, business loan demand far exceeded our expectations.

At the same time, the Federal Reserve has progressively clamped down on monetary expansion, partly in reaction to the alarming rate of inflation. In the sense that a sizeable chunk of this inflation stems from the jump in oil prices, that jump has indeed proven to be deflationary via its influence on tightening monetary policy, here and in most of the other major industrial nations.

Now, recessionary forces are visibly strengthening further and spreading. Consumer spending remains exceedingly weak, and no recovery is in sight for another six to nine months. And this prolonged weakness is cutting into demand for basic industrial materials. Shortages are vanishing and so is the shortage mentality. The pent-up pressures from the ending of controls have also largely played out. Between now and late winter, a sharp drop in inventory accumulation is highly probable. This, also, should greatly reduce business loan demand.

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## New Insurance Ceiling Takes Effect Nov. 27

Beginning November 27, the basic insurance ceiling for deposits and savings accounts in insured banks, savings and loan associations, and credit unions doubles from \$20,000 to \$40,000 under legislation (HR 11221) signed into Public Law 93-495 by President Ford October 28.

Also on the same date, new authority takes effect providing \$100,000 Federal deposit insurance for time and savings deposits of public funds by Federal, State and local governments in Federally insured banks, s&ls, and credit unions.

## Law Authorizes Lenders To Exceed State Usury

FDIC insured banks (national and state) now have authority to exceed state usury laws in making business or agricultural loans in excess of \$25,000. This is contained in Public Law No. 93-1440 (S. 3838) signed October 29, 1974, by

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President Ford. The bill specifically authorizes national and federally-insured state-chartered banks, institutions insured under the National Housing Act, and small business investment companies "to charge interest on business or agricultural loans in the amount of \$25,000 or more at a rate not in excess of 5% more than the Federal Reserve discount rate on 90-day commercial paper, notwithstanding any State Constitution or statute." The current Fed discount rate generally is 8%; thus, banks now may charge up to 13% interest on such loans.

The bill does not affect loans existing at the time the bill was signed. The bill's authority to pre-empt state usury ceilings expires July 1, 1977. Provision is made for individual states who wish to do so to repeal PL No. 93-1440 for their states—in effect, retaining whatever usury ceiling the state previously imposed by law on lenders.

## Iowa News

EFTS workshops, sponsored by the Iowa Bankers Association, begin this week. There will be two meetings each day, the first at 9 a.m. and the second at 2 p.m. Following are the sites, with morning meeting listed first each day:

Nov. 18: Iowa Wesleyan College Student Union, Mt. Pleasant, and Tipton State Bank community room.

Nov. 19: Ramada Inn, Waterloo, and Luther College, Centennial Union, Oneota Room, Decorah.

Nov. 20: Holiday Lodge, between Mason City and Clear Lake, and Fort Dodge Country Club.

Nov. 22: Ramada Inn, 2216 27th St., Council Bluffs, and Hotel Savery, Des Moines.

DES MOINES: Monday and Tuesday, Nov. 25-26, are the dates of the 27th annual Tax School being held at Johnny and Kay's Hyatt House, 6215 Fleur Drive. The school is sponsored by the Iowa Bankers Association. Iowa Trust Association will again sponsor the Trust Workshop on Tuesday, Nov. 26, for trust officers and persons responsible for the preparation of fiduciary returns.

DES MOINES: The application of Capital City State Bank for an office at 2590 Hubbell has been approved by Cecil Dunn, Iowa superintendent of banking.

DIXON: The new office manager and assistant cashier at First Trust and Savings Bank is Gary Martin replacing Craig Bentrott who was promoted to the Wheatland office where he will be in charge of the loan department for the bank's three offices located in Dixon, Wheatland and Lost Nation.

DUBUQUE: The Eastern Iowa chapter of the Bank Administration Institute will meet at the Chateau Wednesday, Nov. 20. Social hour

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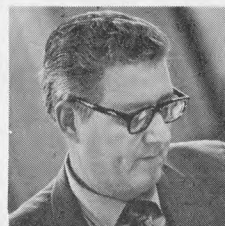
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begins at 5:30 p.m. followed by dinner at 6:30 and the program.

**GRIMES:** The Iowa department of banking has denied the application of Roy Meadows for a state chartered bank here.

## Nebraska News

The Nebraska Bankers Association will sponsor a bank security school on December 3-4 at the Ramada Inn at the 72nd Street Interchange of Interstate 80 in Omaha.

**HASTINGS:** Hastings State Bank has received permission to establish a detached auxiliary tellers office at 910 East South Street in Hastings.

## Minnesota News

**PINE ISLAND:** Mike Liffriq has joined the Security State Bank.

**RED LAKE FALLS:** Allen Bertilrud has joined the Red Lake County State Bank as instalment loan officer.

**ST. PAUL:** Northwestern National Bank has elected Roger T. Donley vice president and manager of corporate sales finance.

**WORTHINGTON:** The State Bank of Worthington has announced the following promotions: Deloris L. Lohr, cashier; Carol Steen and Doug Miller, assistant consumer loan officers.

## Illinois News

A two-day meeting of the Illinois Group, National Association of Bank Women, Inc., is scheduled for Nov. 20-21 at the Continental Plaza Hotel in Chicago.

**BRIDGEVIEW:** The Bridgeview Bank has received consent to exercise limited trust powers.

**CHRISTOPHER:** A permit to organize the Rend Lake Bank in the 500 block of North Victor Street has been issued. Total capitalization will be \$750,000, consisting of \$200,000 in both capital and surplus and \$150,000 in reserve.

**SPRINGFIELD:** The Sangamon Bank's application for Federal deposit insurance has been approved. The bank's capital accounts total \$20,500,000.

## North Dakota News

The North Dakota Bankers Association Agricultural Credit Conference will be held December 5-6 at the Ramada Inn in Jamestown. Registration begins at 3 p.m. Thursday, Dec. 5. Topics to be discussed include: stockmen's credit problems, extension for tomorrow's agriculture, impact of changing agri-business on banks, agricultural credit legislation and overlines and participations.

**JAMESTOWN:** The James River chapter of Bank Administration Institute will meet at the American Legion Club here on Wednesday, Nov. 20. Doug Hellweg, vice president, Federal Reserve Bank of Minneapolis, will speak about the economic outlook.

## South Dakota News

**CLARK:** Citizens State Bank has been issued a certificate of authority to operate a branch bank at Henry.

## Montana News

**GREAT FALLS:** The Glacier chapter of the Bank Administration Institute will hold its winter meeting at the Heritage Inn here December 13-14. Registration begins at 8:30 a.m., Saturday, Dec. 14. Topics to be discussed include Pension Reform Law, review of recent counterfeiting activities in

Montana, float control and how it affects banks, customer profitability, Equal Employment Opportunity and the banking office, 1980.

## Colorado News

**FOUNTAIN:** United Banks of Colorado, Inc., a major bank holding company, said it has acquired the First State Bank of Fountain in a transaction valued at about \$325,000. Neil F. Roberts, UBC president, said 2.75 shares of UBC stock were exchanged for each of the 9,500 outstanding shares of First State Bank stock.

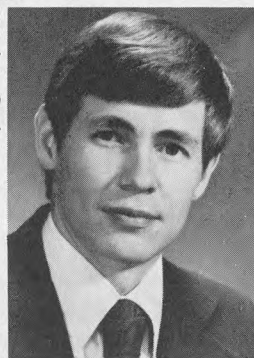
INTEREST RATES. . . .  
(Continued from page 1)

At the same time, the Federal Reserve is bound to push for higher monetary expansion. Money supply has been virtually unchanged for three months. Furthermore, there is likely to be a substantial influx of Arab oil funds into government securities. This is likely to be the primary international influence on our interest rate outlook and it should more than offset upward pressures from foreign loan demand.

Thus, the stage is finally set for a big drop in money rates. Our best guess is a 9% prime rate by December and 7% by next spring or summer. The drift of economic news in recent weeks, aside from the cuts in the prime rate itself, is tending to raise the odds in favor of the forecast.

Bond yields should be slower to retreat, partly because of the continuing bad news about inflation that we foresee, particularly on

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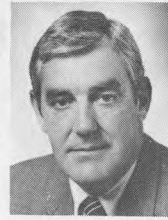
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the food price front. Bond offerings are also likely to remain heavy in the next few months, as short term debt is funded. However, by early next year, the trend toward lower inflation is likely to clarify. We expect inflation to be cut in half by next summer, unless next year's grain crops are another disaster or unless, somehow, the Arabs have the nerve to raise oil prices substantially further. By the middle of next year, Aa industrial bonds could be coming out in a range of 8 3/4% to 9% or lower. Thus, the yield curve should again shift toward the more usual, positive slope.

If we're right about inflation and interest rates, the economy should begin to recover in the second half of next year, following the longest recession since the thirties. What happens to interest rates at that time will depend heavily on the reaction of Congress, the Administration, and the Federal Reserve to the recession itself as it continues to unfold, pushing the unemployment rate toward 7%. My guess is that the combination of fiscal and monetary ease will be less extreme than is widely feared, and that rates will not rise sharply again as we move into 1976.

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