

NORTHWESTERN Banker Newsletter

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June 14, 1976

Long Term View: High Interest & Inflation

The threat of a renewed boom with greater inflation and prohibitive interest rates is one Americans will have to live with for many years, Sidney Homer, a limited partner of Salomon Brothers, international investment banking and market making firm, said recently.

The nation's old defenses against inflation are gone, he pointed out, including a convertible stable currency and generally accepted fiscal policy aimed at stability.

Noting that the recent great spiralling inflation was not counteracted by effective government action, but was brought down only by an unsought, unplanned major recession, Mr. Homer declared that "to date then, our only effective defense against high inflation is recession."

He stated that it would be luck, rather than planning, if the United States avoids a repetition of the recent disasters.

But, he noted, he is optimistic that luck will be with the United States for at least a year or two. The principal reason, he pointed out, was that our vast capital markets, while not able to finance a boom, are comfortably able to finance a recession in spite of gigantic Treasury deficits. The markets can also comfortably

finance a gradual economic recovery.

Interest Rates

In the outlook for interest rates, Mr. Homer remarked that if there is an orderly sustainable economic recovery for the rest of this year, he expects that:

- Short-term interest rates will rise moderately further in 1976;
- Long-term bond yields, which are still too high, should continue their pattern of wide swings in both directions, at times declining considerably below their present levels and then swinging up moderately above current levels, averaging out in 1976 somewhat below today's levels.

The critical factor in the interest rate outlook, he noted, was whether the great worldwide inflationary boom, which started in 1965 and was temporarily interrupted in 1970 and 1974, is or is not to be resumed.

"Boom or no boom" is the key question on the outlook and not "recovery or recession."

"The idea that when even a deflated economy moves up a notch, the Fed must tighten and rates must rise, is a misleading oversimplification," he stated. "Yet market opinion often creates temporary bulges in yields out of fear that this is about to

happen...Our capital markets are amply able to finance both recession and gradual healthy economic growth without strong pressures on the rate structure."

Mr. Homer added there is one threat to the rate structure which will be present even without a revival of rapid inflation. "This," he said, "is the vivid memory of recent double digit inflation and double-digit interest rates." The result, he said, has been and will be two-fold: Higher long-term yields than would be justified either by credit demands or by the level of short-term interest rates and large unjustified upswings in yields whenever demand pressures favor any rise in yields at all.

Despite the sizable decline in bond yields since 1974, Mr. Homer stated they are still very high, measured in any one of three ways:

- 1) Except for the last five years, long-term, high-grade bond yields are the highest in over 175 years;
- 2) Compared against short-term rates of all sorts, the spread between long and short rates is near a record;
- 3) Supply and demand for credit analyses indicate that the total expected credit demands are well within the capacity of the market.

Mortgage Market

In discussing the future of the
LONG TERM VIEW . . .
[Turn to page 3, please]

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Iowa News

DES MOINES: First Federal State Bank, a member of Hawkeye Bancorporation, has applied for a banking office in downtown Des Moines at 315 Seventh, now occupied by a Dial Finance office.

FARLEY: Application has been made by the Farley State Bank for an office in Holy Cross.

GRAETTINGER: A grand opening will be held by the Graettinger State Bank on July 1 and 2 in the bank's new facilities. Jane Kempft, bicentennial queen, will greet residents, following her crowning, at the door at 11 a.m. on July 1.

HARLAN: H. Rand Petersen, president, Shelby County State Bank, and chairman, Group 5, is a candidate for treasurer of the Iowa Bankers Association for the 1976-77 period. He would succeed John

Dean, president, Glenwood State Bank.

OTTUMWA: Northwest Bancorporation has agreed in principle with First National Bank here to acquire all the stock of the First through a cash tender offer of \$78 a share or about \$3.7 million. The offer is subject to approval by both boards and the acquisition requires approval of regulatory authorities. Two of the major stockholders, Mr. and Mrs. Leon Yates, were killed in a car/train accident recently.

WEST CHESTER: The correct telephone number for West Chester Savings Bank is 319/698-2225. Subscribers of the Iowa Bank Directory should make the correction.

Nebraska News

LINCOLN: Jack Moors, who will be one of the principals in a newly-formed Lincoln-based company involved in ownership and management of several banks in Iowa and Nebraska, has been elected chairman of the board of one of the company's existing holdings, Citizens State Bank of Lincoln, effective June 16. He has been executive vice president and director, First National Bank & Trust Co., Lincoln.

OMAHA: United States National Bank has announced that G. W. "Sam" O'Keefe, president, Northwestern State Bank, Virginia,

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National Bank of Waterloo

Minn., will become senior vice president in charge of lending on September 1, and Charles D. Angus, vice president and representative of Northwestern National Bank, Fergus Falls, Minn., will join the bank as vice president and credit officer in the correspondent bank department on July 1.

Minnesota News

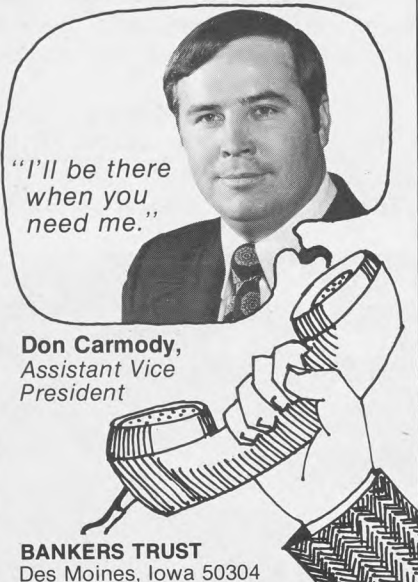
BLAINE: Dr. Neil E. Christenson has been named a director of Northtown National Bank. He is president of Anoka-Ramsay Community College.

BENSON: Swift County Bank observed its 100th anniversary on May 27.

BRAINERD: American National Bank, which is constructing a new building and will open its doors late this summer, has established a temporary office at 522 C Street, according to Ray Kirkhorn, chairman. Richard O. Jacobson, former vice president, Fridley State Bank, has been hired as vice president and cashier.

DULUTH: Don Nygaard has been elected vice president and trust officer of Northern City National Bank.

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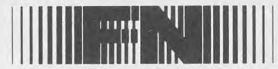
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MINNEAPOLIS: The annual convention of the Minnesota Bankers Association is now in session at the Radisson South. Extending through Wednesday noon, the program features a talk by George LeMaistre, FDIC director.

South Dakota News

PIERRE: The State Banking Commission will meet at 9:00 a.m. on June 22 at the division of banking and finance. A hearing will be held on the Valley State Bank, Yankton, for a detached drive-in.

PIERRE: The State Banking Commission, at its meeting in May, denied the application for a new state bank, to be known as the First State Bank, Custer. A hearing was also held on the applications for Dakota State Bank, Colman, to move its main office to Brookings and retain a branch at Colman, and for a new state charter at Brookings (to be known as the State Bank of Brookings). No action was taken.

Colorado News

COLORADO SPRINGS: John E. Harker, chairman, First National Bank, Burlington, was elected president of the Colorado Bankers Association during the 75th annual convention at The Broadmoor here June 5.

Montana News

BILLINGS: William H. Ruegamer has been named vice president in the commercial loan department. He has been a national bank examiner for the past nine years.

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GREAT FALLS: Bruce K. Weldele was promoted to vice president of Bancorporation of Montana. He was also re-elected to the positions of treasurer and controller.

Wyoming News

GILLETTE: The State Examiner has issued an order granting a state bank charter authorizing the proposed First Wyoming Bank-Gillette, to open for business. Applicants include Paul L. Howes, Jr., Arthur R. Abbey, Sol Bernstein, K. L. McShane, and Floyd Rummell, affiliated with Wyoming Bancorporation. A similar application was denied on July 21, 1975.

LONG TERM VIEW
[Continued from page 1]

mortgage market, Mr. Homer said that it will continue to be much more volatile than it used to be and will be more heavily influenced by the fluctuations of the corporate bond market and the government bond market.

The main reason for this development, he said, was that the increased liquidity for mortgages, the intermediation of mortgages into the Federal lending agencies, and the breakdown of traditional

compartmentalized institutional lending roles have all served to erase the yield premium of about two percentage points which used to favor mortgages.

In discussing the success of the mortgage market in raising funds,

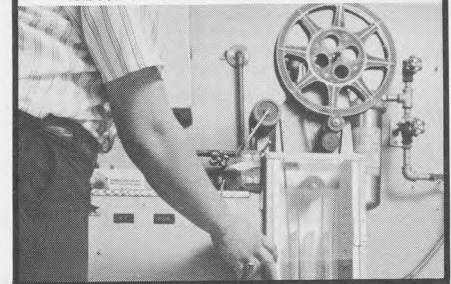
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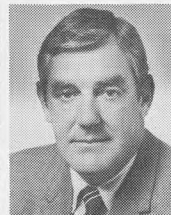
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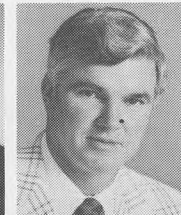
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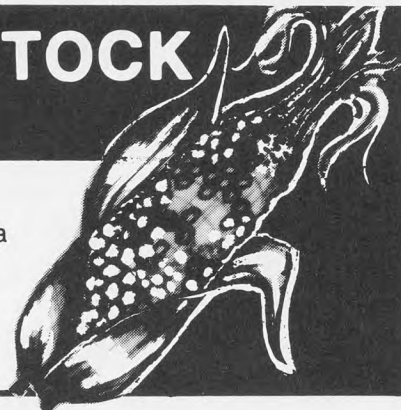


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Mr. Homer said that real estate mortgages of all kinds outstanding at year-end 1975 totalled \$741 billion, more than twice the \$300 billion in corporate bonds outstanding, over double the privately held Treasury debt, and three times the total of all state and local debt.

"In four years through 1974, \$81 billion in net new money was raised through corporate bonds while \$197 billion was raised with mortgages, or a ratio of more than two to one," he stated.

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