# MONTHLY REVIEW

Contents:




FEDERAL RESERVE BANK OF MINNEAPOLIS

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# Nonpar banking: near the end of an era?

The executive council of the American Bankers Association two years ago adopted a resolution endorsing the principle that all bank checks payable in the United States should be cleared "at par." The emergence of the resolution brought again into the news a question which has been discussed and debated, scourged and praised from time to time since soon after checks first began to be used in the United States. And it is a question of particular interest to bankers and bank customers in the Ninth Federal Reserve district, for in this district more than 40 per cent of the nation's "nonpar" banks are located.

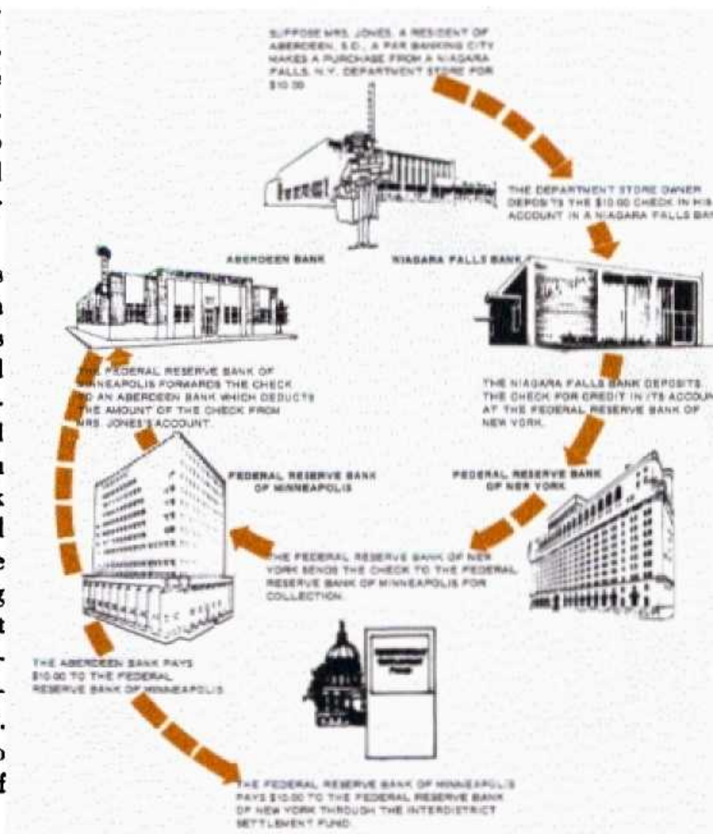
The par question is one that relates to payment for transferring funds from one place to another — most generally from one city to another. Checks, written orders to banks to make transfers, are by far the most popular means for moving funds. Millions are written each day and circulated to all parts of the country. Since they can be shipped safely, they have a definite advantage over currency.

The transaction between the person who orders the funds to be transferred (the one who writes a check) and the person who receives the funds is not completed until the check has been presented to the bank where the check writer holds his account. Checks drawn on par banks may be routed through Federal Reserve banks, and each such drawee bank pays the face amount of the check (Chart 1). Nonpar checks by law cannot be routed through the Federal Reserve banks; they are routed only through the correspondent banking system (Chart 2). The payment process is almost identical for both par and nonpar checks, except that the nonpar bank in making payment deducts a charge from the face amount of the check. Typically these charges range from 5 cents to $1.00 (sometimes more depending on the size of the check).

About 90 per cent of the U.S. banks collect and pay checks — "clear" them — at par; but at year-end 1965 there were 1,492 nonpar banks in 15 states (Chart 3). In the Ninth district states of Minnesota, with 402, of North Dakota, with 100, and of South Dakota, with 101, nonpar banks constituted a majority of all banks located in these states.[1] Other states of the union where the number of nonpar banks exceeded par banks were Georgia and Mississippi.

[1]Federal Reserve Bulletin, February 1966.

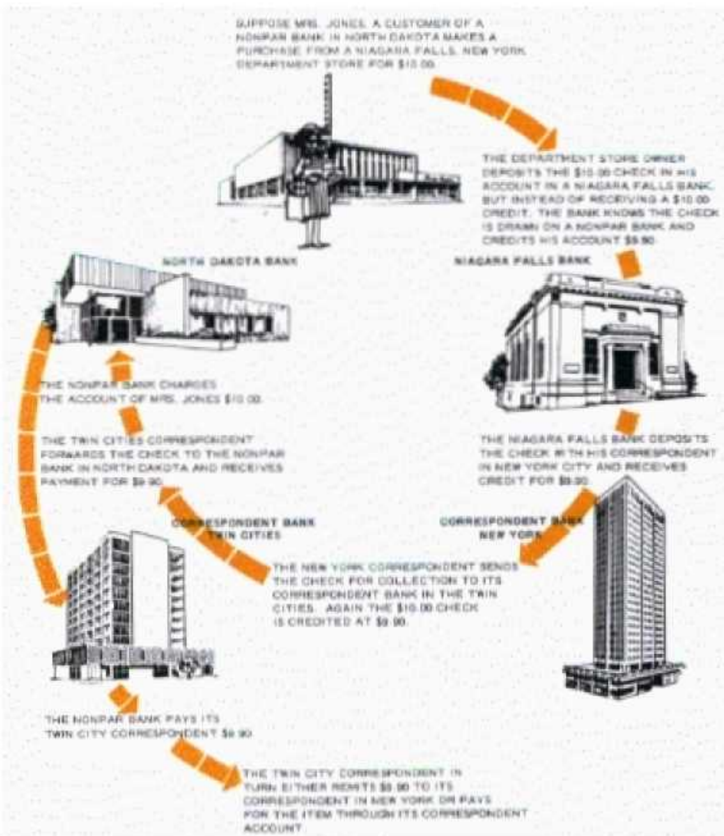
Chart 1 — Route of a par check



### The origins

Exchange charges historically date to a time in the early days of U.S. history when the only practical way that money could be moved between banking centers was by horse-drawn vehicles, canal boats, or by sailing ships. To say the least, these methods were cumbersome: robbers and pirates abounded; it was slow and expensive. With these difficulties, a system was devised so that banks or persons owing money in other cities could purchase "exchange drafts" from banks or persons having balances owed to them in the cities where the payments were to be made. Charges for these drafts varied, but they were justified because they saved the purchaser the expense and trouble of shipping coin or currency.

Chart 2 — Route of a nonpar check




In those days the practice of writing checks already had been developed, but they did not circulate freely outside towns where they were drawn. The country lacked a central check clearing mechanism. Later, as the volume of commerce expanded, banks which had frequent transactions with each other found it convenient to set up accounts with one another. One early cooperative arrangement of this sort was inaugurated by the Suffolk Bank of Boston in 1819 when it agreed to accept any banks' notes without charging a fee (accept them at par) if these banks would maintain a balance with it. With the beginning of this system in New England, par collection of banks' notes was begun; and from this plan developed the correspondent bank arrangements still known today.

Both the exchange draft and the par collection systems expanded during the first half of the 19th Century, and with the expansion came both improvements and abuses. Rates increased. At the time of the Civil War domestic exchange costs were as high as $1\frac{1}{2}$ per cent, but the rates went down as improved transportation facilities made it easier to make coin and currency shipments.

The use of checks became more and more prevalent and the need for exchange drafts diminished; but many banks continued to apply exchange charges to checks even though the original reason for their levy had ended. These charges led to undesirable practices in check handling which placed burdens on smooth and easy commerce among sections of the country. Probably the most undesirable practice was that of routing checks by long, circuitous routes in order to avoid payment of exchange charges. Because of correspondent arrangements, it was possible to find "free" routes; but as a result shipping pathways between cities and the time required to collect checks were lengthened and the total handling costs were increased.

Competition among banks for business forced some to absorb check collecting costs, although in some sections of the country rules set forth by clearinghouse associations for the clearing of checks (another development of expanding commerce) required that clearinghouse member banks pass on the collecting charge. About 1900 merchant resistance to the charges became common; and nonpar checks came to have limited acceptability. Frequently the small-town businessman or merchant found that he had to maintain an account with a large city bank in order to facilitate his accounts payable in that city. This merchant resistance generated a number of unsuccessful state and federal proposals providing for universal par collection. Bankers themselves, in fact, began to recognize the nuisance of exchange charges and many began to accept the idea of a national check clearing plan.

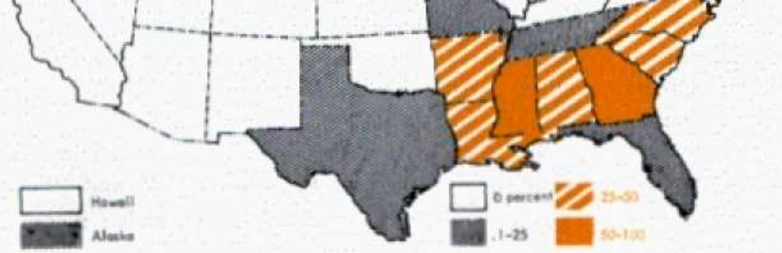
The Panic of 1907 brought the nation's monetary system under heavy criticism — and it ultimately led to remedial legislation. The National Monetary Commission, established by Congress in 1908 to investigate and recommend changes, listed 17 deficiencies in the monetary system; among them, the inefficient process of check collecting through correspondents, high exchange charges, and circuitous routing of checks. Thus, when the bill which was later to become the Federal Reserve Act was submitted to Congress, one proviso was for the establishment of a free check clearing service in each of the Federal Reserve banks.

**Compulsion and litigation**

One banker who has written concerning the par collection problem states that despite all the difficulties experienced by banks and businesses in the collection of checks prior to the enactment of legislation, "in no particular line of development of the Federal Reserve System has there been more constant and bitter opposition than the attempt to establish a uniform clearing and collection system based upon the principle of par remittance."[2]

That this statement is credible stems from confusion that often ensues when new legislation and policies are initially applied. The Federal Reserve Act as signed by President Wilson in 1913 provided for the collection of checks through Federal Reserve banks, but there were some practical difficulties that had to be overcome before the collection system could be inaugurated. A partial system of collection was put into effect during 1915; and later, in July 1916, a uniform collection system at all of the Federal Reserve banks was established pursuant to the authority of the law. Under the system established, checks drawn on member banks were collected *for* member banks. Also, member banks were required to remit at par for checks presented to them by the Federal Reserve banks.

Chart 3 — Percentage of nonpar banks to total number of banks in a state, 1965




In September 1916 the law was amended so as to broaden the classes of checks which Federal Reserve banks were authorized to accept, and in June 1917 Congress again amended the law relating to the collection powers of the Federal Reserve banks. The latter amendment allowed non-member par banks to clear checks directly through the Federal Reserve banks — with no other obligation than to maintain a small balance sufficient to cover items in transit.

[2]Melvin C. Miller, **The Par Check Collection and Absorption of Exchange Controversies** (Cambridge, Mass.: The Bankers Publishing Co., 1949), p. 15.

The Federal Reserve Board interpreted the Federal Reserve Act as imposing an obligation to establish a universal par clearance and collection system. To satisfy this obligation, representatives of the individual Federal Reserve banks began to present nonpar collection items "over-the-counter" so that they had to be paid at par by the nonpar drawee bank. By this time (1918) all banks in the First Federal Reserve district (Boston) had been on the par list for three years, so officers of the other Federal Reserve banks felt that in justice to their members and to the public, there should be no discrimination. Thus, as more and more over-the-counter presentations were made, the nonpar banks were automatically added to the par list — much to their disquiet since it gave the impression that they were sanctioning the system.

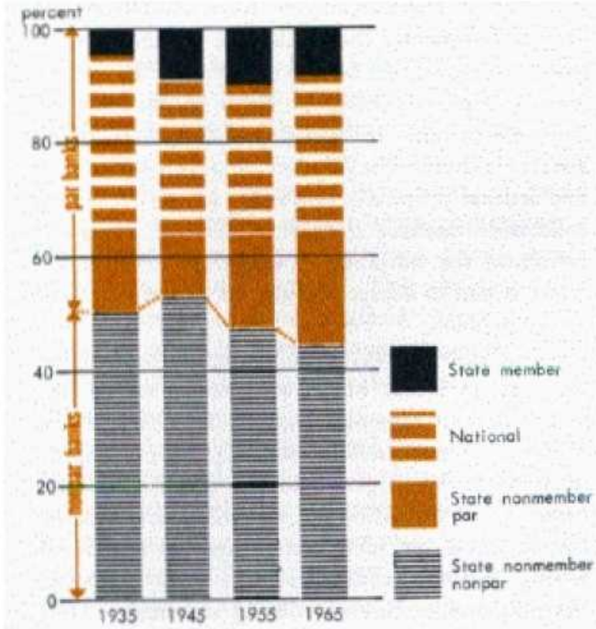
As the par list was expanded — both voluntarily and by coercion — opposition became organized. In retaliation, some banks made their remittances in coin; state legislatures were encouraged to enact laws favoring nonpar status; and various nonpar banks took Federal Reserve banks to court.

By January 1921 continued pressure by the Federal Reserve banks forced all but 1,700 banks onto the par list. All banks in nine districts were "par," the only remaining nonpar banks were in the Atlanta, Richmond, and St. Louis Federal Reserve districts. (All banks in the Minneapolis district were par.) With the core of opposition in the South, southern bankers formed a National and State Bankers Protective Association, an organization which provided the impetus for much subsequent litigation.

Many legal ground rules were established in the 1920s. One of many was that the Federal Reserve banks were under no obligation to enforce par clearance on nonmember banks. Also, a section of the 1917 amendment that prohibited Federal Reserve banks from paying exchange either on checks which they themselves held or which they were handling as agents for others was clarified by the courts.

As a result of the litigation and from action by state legislatures as a reaction against the pres-

**Chart 4 — Percentage classification of commercial banks, Ninth district, 1935-65**




sure exerted by Federal Reserve banks, by 1928 approximately 4,000 commercial banks in the nation were again nonpar. The proponents for par clearance had been forced to retreat, and the exchange issue lay dormant for more than a decade.

### State legislation

During the 1940s state legislatures were active on the par clearance front. Iowa in 1943 became the first state to enact a law prohibiting exchange charges — and thus became the first state to require par clearance of checks. Nebraska followed in 1945, and Wisconsin in 1949. In Montana and Michigan voluntary abolition of exchange charges was effected through the state bankers' association. In each of these states par banks outnumbered their nonpar brethren and effectively countered nonpar opposition.

Legislation to prohibit charges was attempted four times in Minnesota between 1945 and 1957, but the bills never emerged from legislative committee. In North Dakota, a "par clearance committee" in 1943 discussed the possibilities of a voluntary par banking resolution with representatives of the North Dakota Bankers Association, but no resolution was forthcoming. At least three efforts to gain passage of laws requiring par clearance were unsuccessfully made in each of the Dakotas in the late 1940s.

### For and against

From legislative committee hearings and from articles in banking periodicals, the arguments for and against nonpar banking seem to reduce themselves into three major classifications.

The major argument for nonpar clearance is the one that says that the small bank needs the income in order to exist in a small town. A small bank is a local service institution, say the nonpar people, and its profit if any, is derived mainly from service charges — of which exchange is one.

A second argument is that a bank should be compensated for sending money to a payee out of town. Remitting for a check for the benefit of the holder and at his request is a service to the holder for which he should pay reasonable compensation, say nonpar bankers.

A third argument centers about a traditional attitude of the small town businessman — that of keeping business "home-owned" and keeping the chain companies out. "Let the mail order houses pay for running our banks," say the nonpar proponents. "Mail order houses would not have to pay exchange if they maintained an office in the town where the bank is located. These out-of-state firms should be the ones which pay: they compete with local businessmen who pay taxes."

Those who favor par banking counter by stating that exchange charges are not really needed for a bank to stay in business. In the states where par legislation has been enacted, they cite as example, not one bank closed because of it.

Also, say the par proponents, checks of nonpar banks complicate the nationwide check collection system. In an area where both par and nonpar checks are handled, clerical handling costs for checks are higher because of the necessity for separate sorting and for allocation of charges.

Nonpar banking weakens the prestige of banking in general, is another argument commonly advanced by the par clearance proponents. Most nonpar bankers do not make the reasons for exchange clear to customers, and the charging of exchange is neither understood nor approved by them. Any practice that does not carry the approval of the customers is hazardous to the goodwill of the banking system, the argument states.

Supporters of par banking emphasize that inasmuch as check settlements are made by draft or authorization to charge, any expense involved on the part of the nonpar bank is clerical and no charge for transfer of funds is justified.

### Who bears the cost?

Bankers, both par and nonpar, agree that the handling of checks is an expense. Estimates suggest that it costs approximately $3.3 billion each year to handle the 60 million daily checks that must find their way into any of 70 million accounts in the country.[3] The bulk of this cost, between 80 and 90 per cent, is borne by commercial banks in order to attract as much demand deposit (checking account) money as possible. Banks pay no interest on these funds, most of which can be invested in interest-earning assets.

As previously indicated, par banks, to recover part of the cost of handling checking accounts, charge the customer who writes the check and who actually gains the convenience of payment by check;[4] nonpar banks require any nonresident payee of the check who does not have an account at the bank to assume the cost. A notable exception is the U.S. Government which refuses to absorb exchange. Generally the writers of checks

[3]George W. Mitchell, Member, Board of Governors of the Federal Reserve System, "Effects of Automation on the Structure and Functioning of Banking." Address to American Economic Association, New York, December 28, 1965.

[4]The systems used vary widely but generally the service charge consists of a flat fee for maintenance of the account plus a charge for each check written. In most cases an earnings credit is allowed based on balances maintained.

on nonpar banks do not increase a check's face value to cover the exchange, so the direct expense of handling nonpar checks is most often borne by merchants who find it impracticable to maintain accounts at every nonpar banking point where they might have customers. Such costs, naturally, cannot be absorbed: they must be added to operating costs which in turn are reflected in the selling price of products sold. The ultimate bearer of the charge is the consumer.

### Decline from the parochial posture

Today many nonpar bankers will privately acknowledge that they are outside the mainstream of American banking; but they will defend their right to an extra source of income as long as it is legal to do so. But elimination of nonpar banking by legislation or by banker association regulation is unlikely in any state where the number of nonpar bankers exceeds the number of par bankers. The Board of Governors of the Federal Reserve System has from time to time recommended to Congress that it enact a law to preclude banks from deducting exchange charges from checks they receive through the mails — the latest such recommendation is set forth in the Board's 1965 *Annual Report* (see below). In the past, however, Congress has been unenthusiastic.

What is more likely is that the number of nonpar banks will decrease as current social and economic trends continue to change the face of rural America. The growth of urban centers at the expense of small towns; the increasing credit demands of agriculture as farm units grow larger; the evolution of banking itself in all its phases from hardware to credit mechanisms — these are a few of the considerations that are forcing a reexamination by each banker of his banking practices.

But social and economic trends are not the only forces inducing bankers — both nonpar and par — to reflect. Also of concern is the image of their industry in times when lawmakers and regulatory agencies are quickly responsive to shifts in public attitudes. Each banking practice is under scrutiny, and each must prove itself viable.

### Legislative recommendation to Congress by the Board of Governors

In some areas of the United States a substantial number of banks impose so-called "exchange charges" for paying checks that are presented for payment through the mails. Such "nonpar banks" exact the exchange charges by deducting, typically, one-tenth of 1 per cent from the face amount of the check.

Deposits in checking accounts constitute the bulk of our country's money supply. Checks and currency are the essential lubricant of our economic machine, and efficient operation requires that checks and currency be interchangeable at their face value. In the Board's opinion, under today's highly developed system of check collections there is no sound reason for any bank to pay less than the face amount of checks drawn upon it, even though that practice provides a source of revenue to the drawee bank. The expense incurred by that bank in performing this service should be borne by the bank's customer — the depositor who drew the check — rather than by the payee or endorsee. This is the practice followed by most banks.

The Board recommends enactment of legislation that would require all insured banks to pay at "par" all checks drawn upon them — that is, without deduction of an exchange charge.

If such legislation is not enacted, the Board of Governors recommends that, at the very least, provisions of the Federal Reserve Act and the Federal Deposit Insurance Act with respect to the payment of interest on deposits by member and non-member insured banks be amended to state expressly that absorption of exchange charges by such banks constitutes a payment of interest for the purpose of such provisions. Such an amendment would resolve a long-standing difference of opinion between the Board of Governors and the Federal Deposit Insurance Corporation and would enable competing member and non-member banks to operate on the same basis in this respect.

—Fifty-second **Annual Report** of the Board of Governors of the Federal Reserve System (1965).

# Sharp growth in time and savings deposits follows interest rate boost

In early December 1965 the Board of Governors of the Federal Reserve System liberalized the maximum interest rates that member banks might pay on time and savings deposits. The move was taken to allow member banks to compete more effectively for funds that they could use to meet the mounting credit demands arising from a step-up in government spending for defense needs and a continued rise in private spending for plant and equipment.[1]

The liberalization of the regulation governing interest rates — Regulation Q — left unchanged at 4 per cent the ceiling rate on savings deposits but increased to 5½ per cent the top rate that member banks might pay on time deposits with a maturity of 30 days or more. Prior to the change, member banks were restricted to rates of not more than 4 per cent on 30- to 90-day time deposits and 4½ per cent on deposits of longer maturity.

Shortly after the amendments to Regulation Q became effective the Board of Governors initiated a survey to determine the structure of interest-bearing deposits at member banks and whether the greater latitude afforded by the amendments was eliciting a response among member banks. Questionnaires were mailed to all members requesting information on interest rates paid prior to the December 6 rate liberalization and on new rates either in effect or planned for the immediate future on savings deposits and time certificates of deposit issued to individuals, partnerships, and corporations.[2] In addition, each member was asked to supply information on selected characteristics of their time certificates of deposit, including the minimum-size deposit on which interest would be paid, the availability of an automatic renewal feature at maturity, and the shortest and longest certificate maturity offered to depositors.

Replies to the questionnaire were received in late December from all Ninth district members — a total of 495 banks. Subsequently, several members, who had stated on their returned questionnaire that they had neither made nor planned a change in deposit rates, notified the Federal Reserve Bank of Minneapolis of an alteration in their rate structure. The notifications received through the end of January were used to amend the initial response forms. Notifications received since January have not been processed.

### Savings deposits

As noted, the December change in Regulation Q did not increase the maximum rate — 4 per cent — that members may pay on savings deposits. The returned questionnaires indicate, however, that 86 members, somewhat less than 20 per cent of all member banks, lifted the rate paid on funds deposited and held one year in a savings account. As may be observed from Table 1, 60 of the banks making a change moved to 4 per cent per annum, bringing to 83 the number of banks in the highest rate category. Of the other banks initiating a change in rates to depositors, 15 increased their rate to 3.5 per cent, 9 advanced to 3.0 per cent, and 2 lifted their rate to 2.5 per cent.

The number of banks making an upward rate adjustment to attract additional funds was relatively heavy among the district's larger banks — those having $10 million or more in total deposits on June 30, 1965. Although these larger banks constitute only 28 per cent of total district mem-

[1] A fuller discussion of the policy actions taken by the Federal Reserve System is contained in the Federal Reserve Bulletin, December, 1965, pp. 1667-92.

[2] Member banks were also questioned on their time deposits open account — a type of deposit exemplified by the Christmas club account. The information provided by member banks on such deposits is not considered in this article.

TABLE 1 — RATES PAID BY NINTH DISTRICT MEMBER BANKS ON SAVINGS DEPOSITS OF ONE YEAR

| Before December change in Reg. Q | | Rate paid after December change in Reg. Q (Per cent per annum) | | | | | |
|---|---|---|---|---|---|---|---|
| Rate | Number of Banks | Under 2.0 | 2.0 | 2.5 | 3.0 | 3.5 | 4.0 |
| Under 2.0 | 34 | 34 | — | — | — | — | — |
| 2.0 | 89 | — | 76 | 2 | 9 | — | 2 |
| 2.5 | 9 | | | 9 | — | — | — |
| 3.0 | 316 | | | | 246 | 15 | 55 |
| 3.5 | 24* | | | | | 21* | 3 |
| 4.0 | 23 | | | | | | 23 |
| Total | 495 | 34 | 76 | 11 | 255 | 36* | 83 |

*Includes one bank paying 3.25 per cent.
SOURCE: Research Department, Federal Reserve Bank of Minneapolis.

bership, they accounted for approximately one-half of the 86 rate increases. Before the Board's early December policy action, only 6 per cent of member banks with $10 to $25 million in total deposits, and 14 per cent of those with $25 million and over were paying more than 3 per cent per annum. After the change, 31 per cent of the $10 to $25 million banks and 54 per cent of $25 million and over banks were paying more than 3 per cent. In the smaller size categories, the shift in rate structure was less significant.

### Time certificates of deposit

Banks questioned in the December survey were also asked to supply information about their time certificates of deposit, a deposit category that has shown rapid growth in recent years.[3] Questions were directed specifically to the types of certificates offered, their principal characteristics, and rates of interest paid.

The replies of member banks indicate that at the turn of the year the savings certificate was the dominant form of certificate: a total of 411 banks, representing over 80 per cent of all district members, offered this type of certificate. The returned questionnaires also indicate that of the banks offering a savings certificate at year-end:

1 Approximately 75 per cent offered only a savings certificate while the remaining 25 per cent offered it in combination with some other class of certificate;
2 Slightly better than 95 per cent offered certificates that were automatically renewable at date of maturity;
3 About 83 per cent offered certificates in amounts of $100 or less while all district members offered certificates in amounts of $1,000 or less.

The fact that most certificates were automatically renewable and generally available in small amounts is consistent with the description often given in the financial press that savings certificates are designed primarily to attract small amounts of funds from individuals rather than from governmental units or business firms.

Other types of certificates about which member banks were questioned were found to be far less important in the Ninth Federal Reserve district than the savings certificate. Savings bonds were offered by three banks, non-negotiable certificates other than savings certificates and bonds by 103 banks, and negotiable certificates by the same number — 103 banks.

Savings bonds, offered by three banks located in Wisconsin, were available in amounts of $100 or less with maturities ranging from 3 to 60 months. None of the banks provided a bond that was automatically renewable at maturity.

Non-negotiable certificates other than savings certificates or bonds were generally available in small amounts — 79 per cent of the banks who offered non-negotiable certficates made them available in amounts of $100 or less while only 3 per cent required a deposit of $1,000 or more. In addition, 38 per cent of the issuing banks provided certificates that were automatically renewable.

[3]A time certificate of deposit, representing funds deposited to the credit of any individual or organization, is evidenced by a written instrument which states, among other things, that the funds can only be withdrawn on a specified maturity date, at the expiration of a stated period, or upon notice in writing given prior to the date of intended withdrawal. Most commonly, certificates have a specified maturity date which, by regulation, is never less than 30 days after date of deposit. Funds held in a savings account, by contrast, may ordinarily be withdrawn at any time; a bank may require notice in writing before an intended withdrawal, but this right is seldom exercised.

**TABLE 2 — MAXIMUM RATES PAID BY NINTH DISTRICT MEMBER BANKS ON FUNDS DEPOSITED AND HELD ONE YEAR**

| Before December change in Reg. Q | | Rate paid after December change in Reg. Q (Per cent per annum) | | | | |
|---|---|---|---|---|---|---|
| Rate | Number of Banks | 3.5 or less | 4.0 | 4.25 | 4.5 | Over 4.5 |
| 3.5 or Less | 13 | 9 | 3 | — | 1 | — |
| 4.0 | 459 | | 326 | 4 | 126 | 3 |
| 4.25 | 8 | | | 3 | 4 | 1 |
| 4.5 | 15 | | | | 12 | 3 |
| Total | 495 | 9 | 329 | 7 | 143 | 7 |

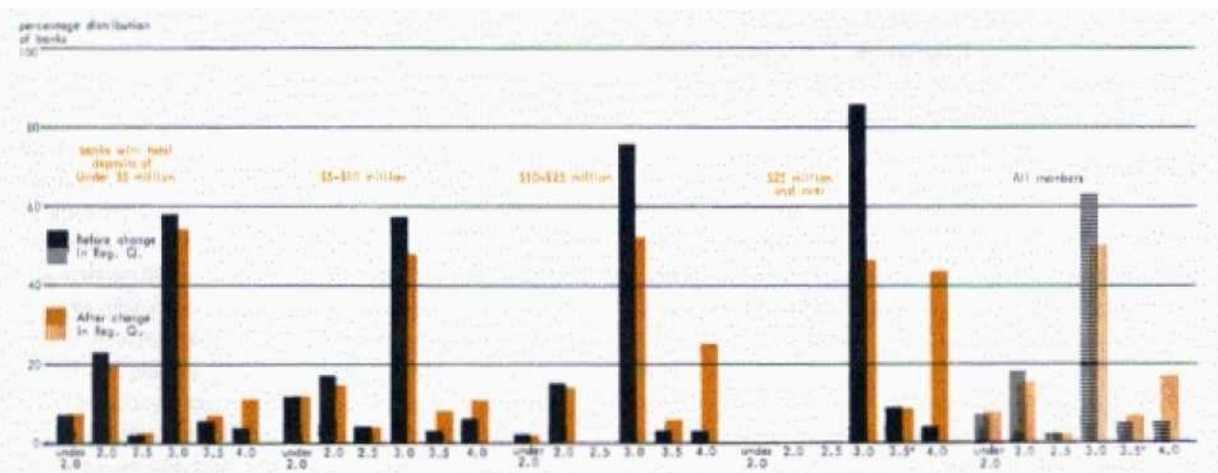
NOTE: All banks paying between 4.1 and 4.4 per cent were recorded as paying 4.25 per cent.
SOURCE: Research Department, Federal Reserve Bank of Minneapolis.

Among the banks offering negotiable certificates only 12 per cent provided automatically renewable certificates. In addition, the number who offered small denomination certificates was relatively less significant — 72 per cent provided certficates in amounts of $100 or less while 12 per cent required a deposit of $1,000 or more.

The number of banks who responded to the December change in Regulation Q by increasing their rates on certificates of deposit was substantially greater than the number who adjusted their rates on savings deposits. The summary information contained in Table 2 was obtained by taking from the returned questionnaires the maximum rate paid before and after the December change in Regulation Q on funds deposited and held for one year. In those cases where a bank did not indicate a rate for a one-year certificate, the rate for the next shortest maturity was taken. The results of this compilation show that 145 member banks, representing 29 per cent of district membership, increased their rates on one-year deposits. The vast majority of these increases were from 4 per cent to 4.5 per cent. Only seven banks moved above 4.5 per cent with five of the seven increases on negotiable certificates offered by banks in the Twin Cities.

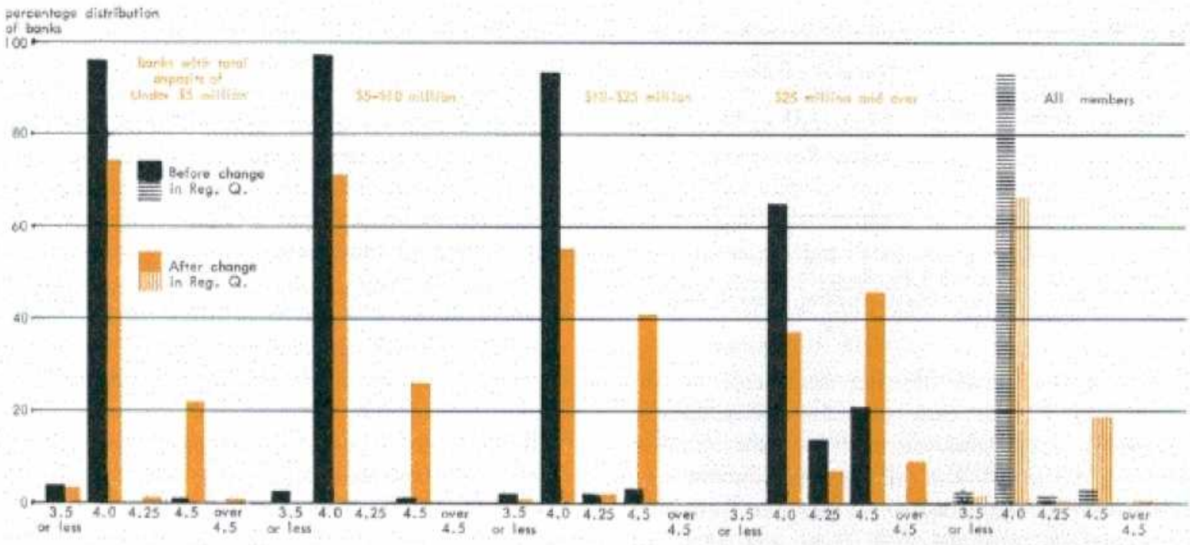
Rate increases on time certificates were not as heavily concentrated among the larger banks in the district as was the case for rate increases on savings deposits. Of the rate increases made by district banks, 36 per cent were made by banks with under $5 million in total deposits, 23 per cent by banks with $5 to $10 million in total deposits, and 41 per cent by members with $10 million and over in total deposits.

**Chart 1 — Per annum rates paid by Ninth district member banks on savings deposits**




NOTE: Size groupings are based on June 30, 1965 data for total deposits; included are demand as well as time and savings deposits. *Includes one bank paying 3.25 per cent.
SOURCE: Research Department, Federal Reserve Bank of Minneapolis.

## Chart 2 — Maximum per annum rates paid by Ninth district member banks on time certificates of deposit




NOTE: Size groupings are based on June 30, 1965 data.
SOURCE: Research Department, Federal Reserve Bank of Minneapolis.

The impact of these changes on the rate structure within the district was not as evenly distributed as the percentages might suggest. The information in Chart 2 indicates substantial variation from one size classification to the next in the proportion of banks paying 4.5 per cent or more after the change in Regulation Q. In general, the larger the size category, the larger the proportion of banks paying the highest rates.

### Summary

The change in Regulation Q, which became effective December 6, raised the maximum rate that member banks might pay on time deposits other than savings to 5½ per cent. This policy move was taken to provide member banks with greater flexibility in their efforts to attract new funds. Immediately following the December action, a fairly substantial number of Ninth district member banks adjusted their deposit rates: 17 per cent increased the rate paid on one-year savings deposits, the ceiling rate on which had not been changed, and 29 per cent lifted the maximum rate paid on time certificates of one-year. Most of the banks who increased their certificate rate, however, did not move above the previous ceiling of 4.5 per cent; only seven banks, in fact, pushed above this rate. Thus, while additional latitude was given by the December change in Regulation Q, relatively few banks took advantage of the additional flexibility.

The inflow of new deposits since the first of the year suggests that the higher interest rates have proved effective. Both in absolute and percentage terms, the increase at Ninth district member banks in outstanding time and savings deposits during the first three months of 1966 was greater than during almost all comparable periods of recent years. The exception is 1962 (Table 3). In the first part of that year higher rates on savings deposits were put into effect by an estimated 31 per cent of district members and increased rates on time deposits by a whopping 93 per cent of all members after the ceiling on one-year time and

TABLE 3 — INCREASE IN TIME AND SAVINGS DEPOSITS AT NINTH DISTRICT MEMBER BANKS, FIRST THREE MONTHS, 1960-1966

| Year | (millions of dollars) Amount | Per cent |
|---|---|---|
| 1966 | $159 | 5.0 |
| 1965 | 109 | 3.9 |
| 1964 | 90 | 3.6 |
| 1963 | 81 | 3.6 |
| 1962 | 167 | 9.3 |
| 1961 | 54 | 3.3 |
| 1960 | 8 | 0.5 |

NOTE: Calculations are based on daily averages of outstanding deposits in the last weeks of December and March.

SOURCE: Federal Reserve Bank of Minneapolis.

savings deposits was lifted from 3 to 4 per cent effective January 1. Leaving 1962 aside, deposit growth during the first quarter of 1966 may be termed relatively sharp.

The higher first quarter inflow provided district member banks with substantial new resources with which to meet expanded customer demands for loan accommodation. Will the inflow of deposits continue? No firm answer can be given. But, if the first quarter inflow is maintained during the remainder of the year, district member banks should be able to fill many of the new demands made upon them for loan accommodation.

# Current conditions . . .

At the beginning of the new crop season, field preparation and seeding throughout the Ninth district were rated somewhat late although better than a year earlier. Generally cold temperatures and too much moisture in the Red River Valley during late April combined to delay spring field operations and to retard pasture and range development. Warm weather during May is needed to push most row crops off to a good start.

The over-all economy of the district appears to have achieved substantial progress during the first quarter of 1966. Industrial production, as measured by the area's production man-hour series and industrial use of electric power, suggest better than a 9 per cent annual growth rate; consumer spending, as measured by retail sales, reached a new high; and total civilian employment moved forward at about a 2.4 per cent annual rate.

Construction activity, as measured by employment, moved ahead at about a 10 per cent annual rate of growth even though the value of new construction contracts during the first quarter declined somewhat. At the same time both the number and value of new building permits expanded. The increase in permits was heavily weighted by a 20 per cent increase in housing units.

Indications of the strong labor demand are shown by a further lengthening in the work week in manufacturing and by the current tremendous amount of help wanted advertising. Still another factor pointing to strong demand is the relatively low level of the unemployment rate — 3.4 per cent seasonally adjusted during the first quarter.

Annual data on personal income recently released by the Department of Commerce show that district (i.e. the four full states) income advanced at a faster rate than in the nation during 1965. Total personal income in the district advanced to a level of nearly $14 billion in 1965, or 9 per cent above the 1964 level compared with a growth of 7 per cent for the entire nation. Of the district states, only Montana, with a growth of 6 per cent, registered a gain lower than the national average. South Dakota led the district with a gain of 10 per cent and was also among the top eight states in terms of year-to-year percentage gains in total personal income.

As for average *per capita* personal income in 1965, all of the district states were below the national level of $2,724. Minnesota, at $2,625, had the highest per capita income of the district states, and South Dakota the lowest, at $2,055.

*Business Week* estimates for the first two months of 1966 show that district personal income is continuing to grow at a rapid rate. During the first two months, two of the district states, South Dakota and Montana, had increases of at least 10 per cent above the same period in 1965. Minnesota nearly matched the national growth of 7.6 per cent, and personal income in North Dakota advanced by 8.6 per cent above the year-earlier level.

*The following selected topics describe particular aspects of the district's current economic scene:*

## Credit continues rapid expansion

After registering solid advances during the final three months of 1965, credit at district member banks in the first quarter of 1966 continued to expand at a rapid pace. Loans during the period rose $123 million, three times as large as the average gain during similar periods in the previous five years and about one-fourth larger than the loan advance recorded during the first three months of 1965. Investments, the other component of bank credit, declined by a relatively small $14 million. The net of the increase in loans and decline in investments yielded a rise in total credit for the initial three months of 1966 of about $109 million. By way of comparison, credit expansion in the similar 1965 period amounted to only $36 million while, on the average, over the 5-year period from 1961 to 1965 there was only a slight increase in credit as the advance in loans was almost entirely offset by the contraction in investments.

Participation in the vigorous first quarter credit expansion was widespread among district banks. At country banks loan growth ($37 million) was about as expected for the period based on seasonal patterns, but the drop-off in investments ($16 million) was less-than-seasonal in nature. At city banks the rise in loans ($86 million) was markedly higher than the normal growth for the first quarter while the increase in investments ($2 million) represented a contraseasonal movement to the moderate downturns ordinarily recorded during the first part of the year.

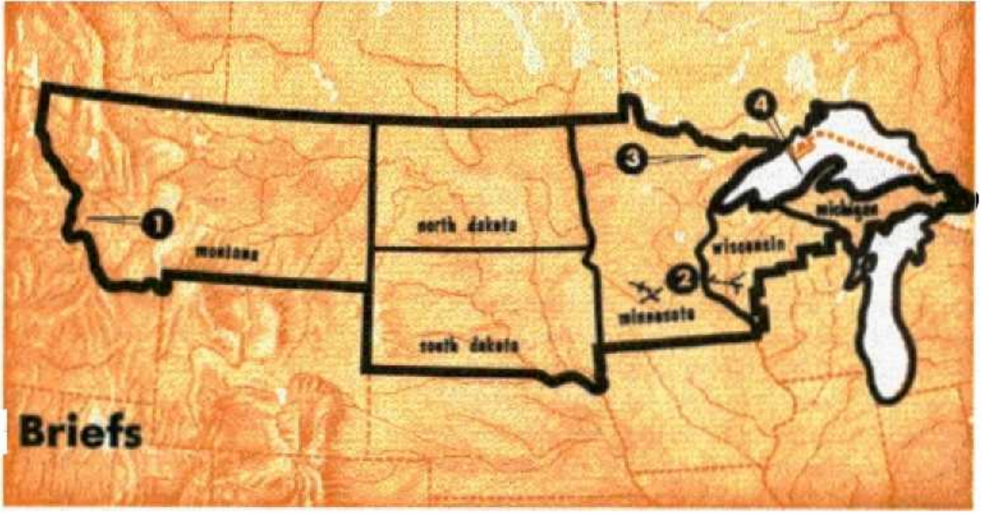
The sharp upturn in city bank loans was supported almost entirely by increases in the business loan category. There was very little change in the level of real estate loans or of consumer instalment loans.

The seasonal drain in deposits to which district banks ordinarily are subjected in the early part of the year was less pronounced in the first three months of 1966. Demand deposits fell by $230 million during the quarter, about average for the period. Time deposits, on the other hand, rose $160 million, 50 per cent greater than the average rise in time deposits over similar periods in the last five years. Total deposits, as a result, declined by a relatively modest $70 million.

Both city and country banks suffered demand deposit outflows in the first quarter of 1966; but, in each case, the outflow was of a seasonal nature. The above-seasonal inflows of time and savings deposits benefited city and country banks alike, but the bulk of the growth occurred at country banks. One factor which may have contributed to the expansion of time and savings deposits was the December 1965 change in Regulation Q which raised the maximum rate banks are permitted to pay on time deposits (excluding savings deposits). (See related article beginning on p. 9 of this issue of *Monthly Review.*)

**Statistical review available**

Copies of the **1965 Annual Statistical Review,** presenting data for principal statistical series relating to the Ninth Federal Reserve district, will be available June 1 from the Research department of this bank.




# Economic Briefs

## 1. Anaconda to reopen zinc plant

The Anaconda Company has announced plans to reopen its electrolytic zinc plant at Anaconda, Montana which has been shut down since January 1961. The company will import zinc concentrates from Canada for processing. The reopening plans call for additional ore roasting facilities as well as four electrolytic treatment units. The plant will begin receiving imported concentrates this summer.

## 2. Gas company extends service

Northern Natural Gas Company is extending service to 131 communities in Nebraska, Iowa, Minnesota, and Wisconsin. The $20 million project calls for 813 miles of branchline and 27 miles of main line. Among the communities to be served in Minnesota will be Harmony, Marshall, and Redwood Falls; in Wisconsin, Frederic and Cumberland. Project completion is scheduled by September 1.

## 3. Pioneer mine to close

Plans to close the Pioneer underground mine at Ely, Minnesota have been announced by U.S. Steel Corporation. The action, effective April 1, 1967, is being taken because of "uneconomical utilization of the kinds of ores produced from the property." The mine, opened in 1898, is the only remaining active mine on the Vermilion iron range. The 500 employees will be offered either employment at other U.S. Steel facilities or pension benefits.

## 4. Copper-ore find announced

A major copper-ore discovery in the Keweenaw peninsula area of Upper Michigan has been reported by Calumet & Hecla, Incorporated. The company has retained an engineering firm to study the feasibility of developing and mining the deposit. An early report by the company estimated the ore body at over 35 million tons and grading in excess of 1½ per cent.