The structure of the Federal Reserve has often been described as having the simple yet classic architecture of a three-legged stool, much like the ladders used to harvest and prune apple trees in the orchards of New England. Just as the ladder is well suited to its task, the Federal Reserve's three main areas of responsibility provide the support for a growing economy and a stable banking system.

In carrying out its responsibilities, the greatest resource of the Federal Reserve Bank of Boston is its people. We are pleased to picture a few members of the staff in this report.
The year 1994 saw a resurgence of New England’s traditions of innovation and ingenuity. With the economy on a solid growth path, the foundations of a rejuvenated region have been laid. At the Boston Fed, we too were able to focus our energies on building for the future. As you turn the following pages, you will see that over the past year, a combination of economic, financial, technological, and legislative developments was shaping New England’s future while having a profound impact on how we do our jobs at the Federal Reserve Bank of Boston.

The economy has been at a particularly fascinating juncture, highlighting the need for continued careful economic analysis as we consider the Bank’s role in the formulation of monetary policy. We saw steady growth in the region’s economy—growth that, while not spectacular, is in retrospect more healthy and sustainable than that which we experienced in the 1980s.

Improved banking conditions in New England offered us the opportunity to ready ourselves for the new era of interstate banking. We enhanced our supervisory and research expertise in mutual funds, derivative instruments, and the capital markets activities of District financial institutions. Technological change and the need to continually improve the financial services we provide to our constituents resulted in consolidation of some of our operations and improvements in others. We carried on our work with community groups, the business community, banks, and other regulators to ensure a continued healthy environment for local economic development. Changes around the world also called us into service, as we provided technical assistance to the central banks of Poland, Albania, and Russia to help them develop safe and sound banking systems.

We said farewell to a number of our staff and officers as they elected to take early retirement under the program the Bank offered last year. Their hard work and wise counsel will be missed as we move forward. At year-end, we took the opportunity to reorganize the Bank to focus more attention on the markets we serve and the formulation of policy and strategic directions. With the resulting shift in job assignments and the onset of the Central Artery construction project literally at our front door, our landscape has changed markedly, both internally and externally.

As the Boston Fed’s new president, I consider it a privilege to continue the strong tradition of public purpose that has characterized the Federal Reserve Bank of Boston. With the assistance of the fine officers and staff of the Bank, our dedicated board of directors, the members of our advisory groups, and the ingenuity that has been the hallmark of New England, I am confident that we will continue to play our part in achieving the overriding central bank goals of bringing about economic growth and financial stability.
In 1994, the Federal Reserve initiated the first tightening in monetary policy since early 1989. The decision to raise interest rates occurred in the face of concerns that wage and price pressures could be building as the three-year-old economic expansion picked up speed and labor markets tightened. In a series of steps, the Federal Open Market Committee (FOMC) raised the federal funds rate from 3 percent at the start of the year to 5-1/2 percent at year-end. Each rate increase was executed after extensive deliberation in which all Federal Reserve Banks participated.

At the Boston Reserve Bank, we brought to the deliberations information conveying a mixed picture of the New England economy. Our research staff reported evidence of an economy still recovering from the ravages of the last recession and continuing to undergo significant structural change, but, at the same time, beginning to show some labor market tightness. Looking at the national as well as the regional data, we saw indications that the unemployment rate could be falling below the rate consistent with stable inflation. We could see a potential need to curb inflationary forces by slowing the growth in demand to a rate consistent with the growth of capacity.

Statistics portray the solid strength of the U.S. economy in 1994. Real Gross Domestic Product (GDP) grew by over 4 percent, compared with about 3 percent in 1993. More-confident firms added almost three million workers to their payrolls. Most sectors of the economy expanded moderately during the first half of the year. Modest gains in final sales were augmented considerably by inventory accumulation, which accounted for about one-half of first-half real GDP growth. For a time, there was concern that an undesired inventory overhang could force production cutbacks in the second half. However, the inventory buildup proved necessary to meet the robust demand that materialized in the third and fourth quarters.

Interest-sensitive spending — on housing, autos, and other consumer durable goods, particularly furniture and household equipment — showed continued strength even after the first round of interest rate hikes. In
addition, many of the nation’s major trading partners began to recover from their downturns earlier than expected, giving U.S. net exports more of a boost than initially anticipated. In the face of this continuing strength, additional rate hikes were approved. Altogether, over the course of 1994, the federal funds rate was raised a total of 250 basis points.

The relationship between the monetary aggregates and the economy proved no more reliable in 1994 than in recent years. Despite strong real growth and relatively low interest rates throughout the year, the broader monetary aggregates, M2 and M3, grew quite slowly, remaining in the bottom third of the Federal Reserve’s target ranges for 1994.

The economy’s clear strength notwithstanding, inflation remained well behaved throughout 1994. Whether the volatile food and energy components of the Consumer Price Index (CPI) are included or not, inflation averaged under 3 percent for the year overall. Prices of crude and intermediate materials registered sizable advances, but these were not passed through into final goods prices.

At year-end, the U.S. unemployment rate stood at 5.4 percent, below most conventional estimates of the rate consistent with stable inflation. The Federal Reserve Board’s measure of industrial capacity utilization stood at 85.4, the highest level since 1979, corroborating the tightness reflected in the labor market data.

During the closing months of 1994, there were a few signs that the tighter monetary policy could be having an impact on the economy. Retail sales eased and consumers began to rein in expenditures, spending a smaller fraction of their disposable income in the fourth quarter. Policymakers continued watching the economy closely to see if a “soft landing” had been engineered.

With the changes in economic conditions, research staff at the Boston Fed spent substantially more time on monetary policy issues in 1994. More frequent and more detailed briefings on current economic conditions were provided for directors and for the new president in preparation for FOMC meetings. Additional in-depth discussions of major policy issues were conducted. Because key
Lauren Fim, Senior Research Assistant, and Stephen K. McNee, Vice President and Economist, Open Economy Macroeconomic Research Group.
statistical indicators at times gave confusing signals, steps were taken to augment the anecdotal information collected for the System's informal survey of current economic conditions. To enhance this source, the "Beige Book," the Bank expanded its contacts in the manufacturing, retailing, and real estate sectors and, for the first time, established contacts at personnel supply agencies.

The annual economic conference of the Federal Reserve Bank of Boston, held in June, proved timely. Titled "Goals, Guidelines, and Constraints Facing Monetary Policymakers," the conference addressed broad questions about the conduct of monetary policy, such as how efficiently U.S. policy has balanced the goals of price stability and full employment.

The Bank's published research on monetary policy also had immediate relevance. One article examined the relationship between inflation and unemployment, finding little evidence for the popular belief that structural changes have changed the NAIRU (non-accelerating-inflation rate of unemployment) — the lowest unemployment rate consistent with stable inflation.

At the end of the year, Boston Fed research staff joined their counterparts Systemwide in watching to see if monetary policy had braked the economy sufficiently to quell inflationary forces.

**Regional Economy**

The First District's economy continued to recover in 1994 in a steady but unremarkable fashion. Most indicators show the improvement that occurred. On an annual basis, consumer confidence, help-wanted advertising, and retail sales all reached post-recession highs. Higher personal income, coupled with relatively slow population growth and low inflation, meant that real income per capita rose. Nonresidential construction contracts were up significantly from 1993, and the housing sector saw building permits and existing home sales at their highest levels since the recession ended.

Labor market data paint a more complete and more mixed picture. While the country as a whole had long since regained all the jobs lost during the most recent recession, by the end of 1994 New England was only about one-third of the way back to its 1989 employment peak. The pace of job growth in the region during 1994 was only about two-thirds of the national rate.

Consistent with this ongoing job recovery, regional labor markets tightened in 1994. Over the course of the year, New England's unemployment rate registered a sizable decline, roughly comparable to the national decline,
and ended the year near the national rate.

Research staff at the Boston Fed have given attention to the region's lag in job recovery and the reasons for it. Structural changes in the job market, including changes attributable to cutbacks in defense spending, are an important factor. Nationwide, increased global competition, differential productivity gains, and changes in domestic spending patterns have retarded employment at goods producers and made service-producing industries the leading source of new jobs. The impact of this shift has been especially pronounced in New England. In 1994, services industries accounted for about half of the net new jobs in New England. Meanwhile, New England manufacturers cut jobs for the tenth consecutive year, although the pace of the job losses slowed.

The slow pace of the region's recovery can also be traced to the real estate boom-bust cycle of the late 1980s and early 1990s. Driven by both fundamental and speculative factors, New England real estate prices skyrocketed in the mid-1980s. When the pace of the real estate activity eventually proved unsustainable, New England was left with a glut of residential and commercial real estate. The glut and accompanying financial difficulties not only deepened the recession in New England, but also prevented construction from playing its normal role in fueling the recovery.

Overall, New England's economic performance in 1994 was a marked improvement from the recent past. The region continued to benefit from the strength of the national recovery and, because of the importance of export markets to the regional economy, from the recovery of trading partners like Canada and Europe.

Research conducted by the Boston Fed in 1994 sheds new light on important aspects of the regional economy. One study examines the labor market adjustments that occurred during New England's long recession, highlighting the role that self-employment played in taking up some of the slack. Another examines the competitiveness of Massachusetts' tax structure. It shows that Massachusetts compares favorably according to the tax burden that should matter most: the extent to which taxes depress the long-run rate of return on business investment. In a third study, a cooperative effort with the Massachusetts Department...
of Revenue, research staff developed indices of coincident indicators for New England and the six states. The indices show that the region's recovery and those of the individual states began much earlier than previously thought: with March 1991 considered the starting point for the national recovery, growth within the region is shown to have resumed at various points ranging from February 1991 to April 1992.

In line with the regional recovery, the financial condition of New England's banks continued to improve in 1994. Higher capital ratios, reduced loan loss provisions, and declining nonperforming loans allowed most institutions to say that the problems of the past were largely behind them.

In an effort to maintain their strength and build their future competitiveness, a number of the District's banks stepped up their involvement in nontraditional activities in 1994. Some offered their customers mutual funds for the first time, and many became more involved in complex financial transactions, including derivatives. The Bank enhanced its expertise in these areas as well. Research staff organized interdisciplinary seminars for Bank personnel on bank mutual funds, the securities custody business, and derivative instruments.

Nonbank financial institutions, including insurance companies and mutual fund companies, also commanded the Bank's attention. New England has a high concentration of nonbank financial companies, and their influence on the economy, role in the provision of financial services, and impact on the payments system are significant. These institutions both compete with banks and use specialized services provided by banks. In 1994, an interdisciplinary team, headed by a research officer, explored ways the Bank might adjust to changes in payments technology and in the structure of financial markets.

The future pace of recovery in New England will depend mainly on three factors: the ability of manufacturers to adapt to more competitive markets, the ability of services industries to function as engines of growth, and the continued expansion of the national economy. With continued progress and strength in these three areas, the region's climb back to 1989 employment levels will continue at a reasonable pace. Research staff will continue to monitor developments in these areas and to suggest policy changes as appropriate.
Christopher Mayer, Economist, and Andrew Gleason, Senior Research Assistant, Regional Economy, Research Group. The Research Library is open to the public.
The changing structure of the financial services industry prompted new activities for the Bank in 1994, setting the stage for major challenges in the years ahead. New England's banks returned to sound financial health only to see their competitive environment altered by the enactment of interstate banking at the national level. At the same time, the evolution in the development and delivery of financial services pushed relentlessly ahead.

New England's banks showed impressive vitality and strength in 1994. Bank capital levels reached historic highs, with measures of asset quality and earnings comparing favorably to pre-recession levels of the late 1980s. The improving economy spawned a recovery in credit, with bank lending attaining its highest level in three years. Many institutions reported their strongest financial performance in nearly 10 years.

The region's large number of nonbank financial companies, including mutual fund companies, insurance companies, and asset-management firms, have grown rapidly in recent years. In addition to being major providers of financial services, these firms are major users of specialized banking services, including global custody, securities lending, and short-term funding. In 1994, the Bank gave close attention to the growing involvement of banks in providing these specialized services, which may entail capital markets activities, including complex trading strategies and derivative instruments. The Bank developed specific examination, training, and analytical techniques to assess the risks — credit, operational, and interest rate — associated with providing these services.

The Interstate Banking and Branching Efficiency Act, passed in September, gives a new boost to the trend toward consolidation within the banking industry. Over the five years from the end of 1989 through the end of 1994, the number of commercial and savings banks in New England declined from 630 to 454, a drop of 28 percent. The Boston Fed worked toward achieving the enhanced coordination among state and federal supervisory staffs that will be necessary to maintain efficient and effective supervision as...
consolidation proceeds. Bank research staff also continued studying the effects of interstate banking on credit availability in the region. Special attention was given to a key concern, the availability of credit to small- and medium-sized firms.

With federal financial regulators seeking to revise Community Reinvestment Act (CRA) rules, the CRA was much in the spotlight in 1994. Staff of the Boston Fed are convinced that safe and sound lending that meets the needs of low- and moderate-income communities not only benefits the communities, but also can be profitable. Bank staff have long encouraged banks to apply the same strategic business planning to lending in low-income markets that they employ in other lines of business.

Because credit markets evolve with the technology that serves them, the volume of interbank transactions has increased every year since the early 1970s. With this growth has come an increase in bank daylight overdrafts that raises the level of payments system risk. The Federal Reserve, as the final guarantor of FedWire transfers, has been engaged in a long-term effort to minimize this risk. In 1994, the System took two steps to reduce the overall level of interbank risk in the payments area: the implementation of daylight overdraft pricing and increased efforts to minimize daylight and overnight overdrafts.

The Bank often initiates interagency efforts, believing that interagency cooperation is both productive and cost-effective. Interagency projects of 1994 include a series of joint examinations of the District's more complex holding companies and a series of directors' training seminars. In addition, the Boston Fed assisted the Federal Bureau of Investigation and U.S. attorneys in prosecuting two major cases of bank fraud.

In 1994, the Bank engaged in a wide range of supervisory activities, all with a common goal—to foster a regional banking system that is sound and capable of carrying out its pivotal function in the New England economy. Important progress was made on many fronts. Aided by an improving economy, the region's banks continued to move beyond the problems of the past; overall, they entered 1995 as strong and profitable institutions, continuing to increase their lending to support the region's economic recovery.
Paula Spencer, Examiner
John G. Hall, Assistant Examiner and Carol Hogarty, Examiner
Examination Department, Bank Supervision and Credit Group.
Since its inception in 1914, the Federal Reserve has been a major agent of change in the U.S. payments system. Technological, economic, and legislative developments in the United States and around the world have demanded that the Fed constantly plan, develop, and implement strategies to ensure the kind of safe and efficient payments system that the United States and the world have come to expect.

Improving the infrastructure for the nation’s financial system while preserving its stability and reliability is no small task. To enhance our ability to address this task, in 1994 the Federal Reserve implemented a major restructuring of our national financial services management. This began with initiatives in which the Bank’s President and First Vice President played key roles. These initiatives were directed at developing a vision for the future U.S. payments system and the role of the Reserve Banks in realizing that vision.

In the restructuring, the Boston Reserve Bank was chosen to manage planning for retail payments products, including check collection, the automated clearinghouse, and other forms of high-volume business and consumer payments. The Bank’s assignment is to move the nation toward a more fully electronic payments system, replacing paper checks wherever possible. Input from the banking industry and major payments system participants will be essential in the planning process and in the implementation of changes. A more fully electronic payments system will not only enhance the regular conduct of business, but also will help ensure the global competitiveness of our financial services sector well into the future.

While providing leadership for the longer term, the Boston Reserve Bank also went ahead in 1994 with a number of shorter-term, local initiatives. Check sorters in all three First
District processing offices—Boston, Lewiston, and Windsor Locks—were replaced and reconfigured. Enhancements to check processing hardware and software systems will provide capacity for new electronic and image-based check services. The Bank also installed a new generation of currency processing equipment containing state-of-the-art technology for counterfeit detection and identification of currency that is unfit for recirculation.

The Bank consolidated its mainframe data processing and became the first Reserve Bank to complete implementation of a new data communications network. These changes are part of an ongoing plan to reduce the number of Federal Reserve data centers in the nation from 12 to three, provide nearly uninterruptible service to customers, and enhance disaster recovery capabilities.

An acknowledged leader in research and development efforts for check imaging, the Bank conducted, on behalf of the System, an extensive analysis of vendor proposals for the high speed capture and archival storage of government-check digitized images. Using the first check-image system of its kind, throughout 1994 the Bank processed an average of 1.5 million Treasury checks per month, including social security checks and tax refund checks. The images provided are far superior to microfilm, and the system will greatly increase the efficiency of Treasury check storage and retrieval.

Boston Fed financial services staff were gratified by the results of a comprehensive customer satisfaction survey conducted early in 1994, which indicated high levels of customer satisfaction across a wide range of Bank services. Nearly every survey measure showed improvement over prior years.

The survey results are welcome, but the Bank would like to do even better. We have embraced the set of management tools and techniques known as Total Quality Management, or TQM. Continuous improvement is the basic tenet of TQM; hearing and heeding the “voice of the customer” is an important TQM principle. Through TQM and related efforts to focus greater attention on better meeting customer needs, the Bank expects in 1995 to enhance further its leadership role in bringing high-quality, state-of-the-art services to the institutions of New England.
June A. Cotton and
Ignatius Holland (foreground) and Rob
Llewellyn (background),
Check Processing Clerks,
Brisbane Check Department,
Retail Payments Division,
Payments and Business
Strategy Group.
Economic growth in New England continues to march to the beat of a different drum—to be held back, more than growth nationally, by such factors as a changing mix of jobs, accelerating global economic integration, and residual effects of the mid-1980s real estate boom-bust. To address growth prospects for the region, the Federal Reserve Bank of Boston has identified two areas—workforce education and community economic development—where the Bank’s involvement can make a difference. A workforce educated to meet changing business needs is essential to long-term growth, as is the capacity for healthy economic activity at the local level. In 1994, the Bank focused greater attention on these two areas.

**EDUCATION.** Public-private partnerships linking schools and the workplace have been shown to be very effective in giving young people the skills they need to enter the workforce successfully and remain productively employed. In 1994, the Federal Reserve Bank of Boston worked with the Boston Private Industry Council to support a pioneer partnership program serving Boston high school students. Called Project ProTech, the program combines work-based classroom learning with work experience to prepare students for careers in specific fields. Students visit participating employer sites and eventually hold part-time jobs at participating employers.

Project ProTech has proven surprisingly successful. New federal legislation, the School-To-Work Opportunities Act, is substantially based on the program. With enhanced funding, Project ProTech is being expanded to serve as many as 3,000 juniors and seniors in high school by the year 2000 and to include new industries in addition to health care and financial services, the initial two. The Boston Fed will continue to support the program as a participating employer and in overseeing and monitoring the expanded effort.

In addition to Project ProTech, the Bank maintained its partnerships with South Boston High School, Oliver Wendell Holmes School, and Dearborn Middle School. Bank staff also served on a committee organized by the
Massachusetts state treasurer’s office to develop a new program, “Savings Makes ‘Cents,’” designed to teach elementary school students basic economic principles and the importance of savings.

These local activities were complemented by the Bank’s longstanding economic education program, which reached more than 10,000 people throughout New England. Through lectures, tours, classroom sessions, and panel discussions, as well as the distribution of publications and videotapes, students, educators, and the general public were given practical information on money, banking, and the Federal Reserve System. The Bank also developed a new program to be used System-wide to educate the public about the risks associated with the purchase of mutual funds and other uninsured bank products.

**Community Development.**

Public-private partnerships are important not just in the educational field, but also in community economic development. In 1994, the Bank’s community development work focused heavily on promoting community development partnerships—expanding their reach, participants, goals, resources, and accomplishments.

The true engines for community development in New England—especially in Massachusetts—are often community development corporations (CDCs)—locally-based organizations governed by a neighborhood board of directors who hire professional staff. CDCs improve communities by creating affordable housing, meeting human services needs, and creating and maintaining jobs. Because CDCs are so effective, the Bank often works with them and tries to promote their influence.

Bank management took a leadership role in community development issues in 1994. We visited community development corporations and met with bankers, community leaders, and development professionals, seeking to build support for existing initiatives, encourage new activities, and involve new participants, such as private firms and foundations, in the development process. We encouraged lenders to recognize the potential of low-income areas and underserved communities.

At various times during the year, the Bank offered training sessions for bankers and community development professionals in the mechanics of consortia lending, multilayered funding arrangements, and other financing techniques relevant to community development lending. A number of informational meetings were sponsored to encourage the formation of community development initiatives.

The Bank expects to expand its community development and educational outreach efforts in 1995 and beyond. An educated workforce and healthy communities are critical resources, and the Bank is committed to enhancing these resources for New England.
Officers

December 31, 1994

Cathy E. Minehan
President and
Chief Executive Officer

Paul M. Connolly
First Vice President and
Chief Operating Officer

William N. McDonough
Executive Vice President and
General Counsel

Lynn E. Browne
Senior Vice President and
Director of Research

Thomas E. Cimino, Jr.
Senior Vice President

Walter T. Sullivan
Senior Vice President

Robert M. Brady
Vice President

Norman S. Fieldse
Vice President and Economist

James R. Fitzgerald
Vice President

Mary E. Fosterelli
Vice President

Thomas Gagnon
Vice President

Gerold J. Giaccie
Vice President

Sarah G. Green
Vice President

John R.H. Kimball
Vice President and Associate
General Counsel

Richard W. Kopcke
Vice President and Economist

Robert K. LaRocca
Vice President

James E. Mahoney
Vice President and Secretary

Roland H. Marx, Jr.
Vice President and General Auditor

Stephen K. McNees
Vice President and Economist

Ronald V. O’Connell
Vice President

Eric S. Rosengren
Vice President and Economist

E. Philip A. Simpson, Jr.
Vice President

William J. Spring
Vice President

Stephen G. Trebino
Vice President

Curtis L. Turner
Vice President

Robert Augusta, Jr.
Assistant Vice President

Katharine L. Bradbury
Assistant Vice President and Economist

Richard M. Burns
Assistant Vice President

Cynthia A. Conley
Assistant Vice President and
Assistant General Counsel

Marshall D’Avanzo
Assistant Vice President

William J. DeLorie
Assistant Vice President

Rena M. DeSisto
Assistant Vice President and
Assistant Secretary

Amarin R. Derball
Assistant Vice President

Claire M. Desjardins
Assistant Vice President

Brian L. Donovan
Assistant Vice President

Jonathan S. Fine
Assistant Vice President

Jeffrey C. Fuhrer
Assistant Vice President and
Economist

Peter F. Genevich
Assistant Vice President

Joan M. Gibbons
Assistant Vice President

Katharine Gibson
Assistant Vice President

June A. Gombeaux
Assistant Vice President

Dexter S. Holt
Assistant Vice President

Linda K. Kopec
Assistant Vice President

Linda J. Mahon
Assistant Vice President

James McFadden
Assistant Vice President

David K. Park
Assistant Vice President

Edward A. Reams
Assistant Vice President

Krista M. Shields
Assistant Vice President

Geoffrey M.B. Tontell
Assistant Vice President and
Economist

Kristine Van Amsterdam
Assistant Vice President

Richard C. Walker, III
Assistant Vice President

Marilyn E. Wedeo
Assistant Vice President

John W. Wescott
Assistant Vice President

Robert M. White
Assistant Vice President

Steven M. Whitney
Assistant Vice President

Anna M. Wong
Assistant Vice President and
Assistant General Auditor

twenty-one

Board of Directors

Jerome H. Grossman, M.D.
Chairman and Chief Executive Officer
New England Medical Center

Warren B. Rudman, Esq.
Deputy Chairman
Sheehan Phinney Bass + Green

Joan T. Belt
Chairman
New England Electric System

Stephen L. Brown
Chairman and Chief Executive Officer
John Hancock Mutual Life Insurance Company

John E. Flynn
Executive Director
The Quality Connection

Edward H. Ladd
Chairman
Stamford Tyler & Wood, Inc.

David A. Page
President
The Ocean National Bank

Robert M. Silva
President
The Citizens National Bank

Ira Stephanian
Chairman and Chief Executive Officer
Bank of Boston Corporations

New England

Angelo P. Pizzagalli
Chairman
Pizzagalli Construction Company

Ray W. Allen
Allenbrook Farms

Bruce D. Clov
President and Chief Executive Officer
Horizon Banks, Inc.

Pamela Crandall
Chairman and Chief Executive Officer
Adams Line Oil & Trace Manufacturing

William J. Cunningham
Commonwealth Group

Albert B. Gleilman, Esq.

Charles Grigsby
Director
City of Boston, Office of Budget Management

Louis Harvey
President
Dillier Financial Services

Chester E. Horner
Executive Vice President
Toms of Maine, Inc.

Mitchell E. Kertzman
Chief Executive Officer
Procorporation Corporation

Donald Leef
Vice President and Chief Financial Officer
Doda USA Corporation

James C. Smith
President and Chief Executive Officer
First Federal Bank, FSB

Carol Wallace
President and Chief Executive Officer
Cooper Instrument Corporation

John Wonack
President
JJS Services, Inc.
### Statement of Condition

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1994</th>
<th>December 31, 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold Certificate Account</td>
<td>$553,000,000</td>
<td>$660,000,000</td>
</tr>
<tr>
<td>Special Drawing Rights Certificate Account</td>
<td>$111,000,000</td>
<td>$111,000,000</td>
</tr>
<tr>
<td>Coin</td>
<td>14,870,139</td>
<td>10,005,362</td>
</tr>
<tr>
<td>Loans and Securities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans to Depository Institutions</td>
<td>$5,750,000</td>
<td>$4,200,000</td>
</tr>
<tr>
<td>Federal Agency Obligations Bought Outright</td>
<td>$190,376,114</td>
<td>$273,708,722</td>
</tr>
<tr>
<td>U.S. Government Securities—System Account</td>
<td>$19,082,041,609</td>
<td>$19,591,883,305</td>
</tr>
<tr>
<td>Total Loans and Securities</td>
<td>$19,278,167,723</td>
<td>$19,869,792,025</td>
</tr>
<tr>
<td>Items in Process of Collection</td>
<td>$293,173,596</td>
<td>$353,327,593</td>
</tr>
<tr>
<td>Bank Premises (Net)</td>
<td>$93,337,983</td>
<td>$90,945,976</td>
</tr>
<tr>
<td>Other Assets</td>
<td>1,249,247,626</td>
<td>1,252,607,077</td>
</tr>
<tr>
<td>Interdistrict Settlement Account</td>
<td>$(2,202,479,852)</td>
<td>$(2,194,680,076)</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$19,790,517,215</td>
<td>$20,552,995,957</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal Reserve Notes (Net)</td>
<td>$17,747,015,737</td>
<td>$17,254,384,035</td>
</tr>
<tr>
<td>Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depository Institutions</td>
<td>$1,215,936,378</td>
<td>$2,555,061,116</td>
</tr>
<tr>
<td>Foreign</td>
<td>5,098,909</td>
<td>4,934,500</td>
</tr>
<tr>
<td>Other</td>
<td>31,366,186</td>
<td>14,746,390</td>
</tr>
<tr>
<td><strong>Total Deposits</strong></td>
<td>1,250,401,474</td>
<td>2,574,742,006</td>
</tr>
<tr>
<td>Deferred Credit Items</td>
<td>283,603,491</td>
<td>325,892,392</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>200,425,814</td>
<td>161,988,624</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>$19,511,444,615</td>
<td>$20,307,003,957</td>
</tr>
<tr>
<td><strong>Capital Account</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Paid In</td>
<td>$139,436,359</td>
<td>$122,996,000</td>
</tr>
<tr>
<td>Surplus</td>
<td>129,436,359</td>
<td>122,996,000</td>
</tr>
<tr>
<td><strong>Total Capital Accounts</strong></td>
<td>$278,872,709</td>
<td>$245,992,000</td>
</tr>
<tr>
<td><strong>Total Liabilities and Capital Accounts</strong></td>
<td>$19,790,517,215</td>
<td>$20,552,995,957</td>
</tr>
</tbody>
</table>
### Statement of Earnings and Expenses

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1994</th>
<th>December 31, 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Earnings:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances to Depository Institutions</td>
<td>$120,337</td>
<td>$75,142</td>
</tr>
<tr>
<td>Invested Foreign Currency</td>
<td>32,311,828</td>
<td>44,484,956</td>
</tr>
<tr>
<td>U.S. Government Securities and Agency</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obligations—System Account</td>
<td>1,035,627,770</td>
<td>1,014,558,922</td>
</tr>
<tr>
<td>Income from Services</td>
<td>39,895,530</td>
<td>43,728,635</td>
</tr>
<tr>
<td>Penalties on Deficiencies in Required Balances</td>
<td>22,644</td>
<td>31,122</td>
</tr>
<tr>
<td>Penalties on Overnight Overdrafts</td>
<td>5,442</td>
<td>12,510</td>
</tr>
<tr>
<td>Penalties on Daylight Overdrafts</td>
<td>90,629</td>
<td>-0-</td>
</tr>
<tr>
<td>Treasury Securities Transfer Fees</td>
<td>319,295</td>
<td>288,064</td>
</tr>
<tr>
<td><strong>Total Current Earnings</strong></td>
<td>1,108,395,276</td>
<td>1,103,179,331</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Expenses</td>
<td>94,032,256</td>
<td>91,242,540</td>
</tr>
<tr>
<td>Cost of Earnings Credit</td>
<td>14,492,606</td>
<td>11,330,964</td>
</tr>
<tr>
<td><strong>Current Net Earnings</strong></td>
<td>999,868,414</td>
<td>1,000,605,827</td>
</tr>
<tr>
<td><strong>Additions to Current Net Earnings:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Profit on Sale of U.S. Government Securities</td>
<td>(1,237,875)</td>
<td>2,562,418</td>
</tr>
<tr>
<td>Net Profit on Foreign Exchange Transactions</td>
<td>87,608,162</td>
<td>9,425,225</td>
</tr>
<tr>
<td>All Other</td>
<td>11,532</td>
<td>1,895</td>
</tr>
<tr>
<td><strong>Total Additions</strong></td>
<td>86,381,619</td>
<td>11,789,446</td>
</tr>
<tr>
<td><strong>Deductions from Current Net Earnings:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of Unreimbursed Treasury Services</td>
<td>1,582,808</td>
<td>1,157,577</td>
</tr>
<tr>
<td>Accumulated Post Retirement Benefit Obligation</td>
<td>-0-</td>
<td>32,948,374</td>
</tr>
<tr>
<td>All Other</td>
<td>-0-</td>
<td>30,865</td>
</tr>
<tr>
<td><strong>Total Deductions</strong></td>
<td>1,582,808</td>
<td>34,156,816</td>
</tr>
<tr>
<td><strong>Net Addition (Deduction) to Net Earnings</strong></td>
<td>84,798,811</td>
<td>(22,547,370)</td>
</tr>
<tr>
<td><strong>Assessments by the Board:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board Expenditures</td>
<td>5,354,800</td>
<td>5,006,300</td>
</tr>
<tr>
<td>Federal Reserve Currency Cost</td>
<td>18,471,633</td>
<td>20,988,078</td>
</tr>
<tr>
<td><strong>Net Earnings Before Payments to U.S. Treasury</strong></td>
<td>$1,060,860,791</td>
<td>$952,264,079</td>
</tr>
<tr>
<td><strong>Distribution of Net Earnings</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends Paid</td>
<td>$7,849,562</td>
<td>$7,076,855</td>
</tr>
<tr>
<td>Payments to U.S. Treasury</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Interest on Federal Reserve Notes)</td>
<td>1,036,570,880</td>
<td>930,501,974</td>
</tr>
<tr>
<td>Transferred to Surplus</td>
<td>16,490,350</td>
<td>14,685,250</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,060,860,791</td>
<td>$952,264,079</td>
</tr>
</tbody>
</table>

*twenty three*
<table>
<thead>
<tr>
<th>Services to Depository Institutions</th>
<th>Calendar Year 1994</th>
<th></th>
<th>Calendar Year 1995</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Wire Transfer of Funds</td>
<td>32,696 transfers</td>
<td>$73.0 billion</td>
<td>30,795 transfers</td>
<td>$59.5 billion</td>
</tr>
<tr>
<td>Automated Clearing House</td>
<td>718,192 items</td>
<td>$1.8 billion</td>
<td>631,964 items</td>
<td>$1.7 billion</td>
</tr>
<tr>
<td>Commercial ACH Items</td>
<td>605,074 items</td>
<td>$1.6 billion</td>
<td>524,620 items</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>Government ACH Items</td>
<td>115,118 items</td>
<td>$0.2 billion</td>
<td>107,344 items</td>
<td>$0.2 billion</td>
</tr>
</tbody>
</table>

Check Processing (Commercial)

| Total Volume                      | 4.1 million checks | $2.6 billion    | 5.1 million checks | $3.2 billion    |
| Processed Volume                  | 3.0 million checks | $2.1 billion    | 3.4 million checks | $2.6 billion    |
| Fine Sort Volume                  | 1.0 million checks | $0.4 billion    | 1.7 million checks | $0.6 billion    |
| Processed Returns                 | 42,936 daily average items | $0.04 billion | 45,307 daily average items | $0.04 billion |
| Government Volume                 | 92,701 daily average items | $0.09 billion | 95,466 daily average items | $0.09 billion |
| Adjustment Process                | 775 daily average items | 796 daily average items |

Cash Operations

| Cash Shipped                      | 6.4 million notes | $82.6 million   | 6.2 million notes | $77.8 million   |
| Cash Received                     | 5.8 million notes | $72.4 million   | 5.8 million notes | $69.5 million   |

Services to U.S. Treasury

| Electronic Book Entry Securities  | 5,797 transfers   | $70.2 billion   | 5,626 transfers   | $79.6 billion   |
| Savings Bonds Issued*             | 10,699 bonds      | $2.0 million    | 16,225 bonds      | $3.6 million    |

*Payroll bond processing was moved to Federal Reserve Bank of New York at Buffalo as of July 1994.
"The lessons of the 80's have made me a staunch defender of the course monetary policy has been following. I believe the focus on containing inflation begun in the early part of that decade has resulted in longer periods of cyclical economic growth, lower interest rates at cycle peaks, and, at the same time, lower unemployment rates at cycle troughs . . . It has laid the groundwork for the United States' regaining its position as one of, if not the, most productive and competitive world economies. That, I think, is the very definition of success for a central bank."
