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Appendix
to the statement
of
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before the
Subcommittee on International Exchange and Payments
of the
Joint Economic Committee

January 15, 1969

A PROGRESS REPORT ON THE FEDERAL
RESERVE FOREIGN CREDIT RESTRAINT
PROGRAMS

The Program for Banks, 1965 - 1969

In February 1965 the President requested the voluntary cooperation of U.S. financial institutions and non-financial corporations in solving the problem of the persistent deficit in the U.S. balance of payments. The Board of Governors was asked to administer a program for financial institutions, and on March 3, 1965, issued guidelines for banks and nonbank financial institutions.

The major objective of the program for banks was to reduce, but not to eliminate the banks' foreign lending. This was to be done without endangering other important national objectives, such as the financing of exports of U.S. goods and services, and meeting the credit needs of the developing countries.

The guidelines issued on March 3, 1965, requested the banks to hold loans and other foreign assets covered by the program to 105 per cent of the amount of credits outstanding on the base date of December 31, 1964. Since the amount of "covered" assets approximated \$10 billion, this formula would have permitted an increase of about \$500 million in 1965.

While the program applied to all banks, only banks with total foreign assets of \$500,000 or more were requested to report to the Federal Reserve Banks. The number of reporting banks has varied closely around 150 since the beginning of the program.

During 1965 the reporting banks increased their holdings of covered assets by \$168 million, as compared with an increase in total foreign assets of \$2.5 billion in 1964. At the end of the year, the banks were \$321 million below the target ceiling effective on that date.

In December 1965 the Board announced revised guidelines for banks for 1966 which increased the target ceiling to 109 per cent of the end-1964 base, or by about \$430 million. The room for additional expansion, the Board said, was allowed because the Board believed that the additional leeway would be used only to meet priority credit requirements and because it wished to make certain that such requirements could be met. Because the additional leeway was added to an existing leeway of more than \$300 million, the Board requested that the banks use the additional ceiling provided at a rate of not more than 1 per cent of the base figures per quarter during 1966; i.e., the target ceiling was set at 106, 107, 108, and 109 per cent by quarters.

The guidelines for 1966 also contained the first provisions to reduce the inequities inherent in a program that is based upon a particular point in time. Banks with bases between \$500,000 and \$5 million were permitted to adopt ceilings of base plus \$450,000 (\$225,000 in each calendar half-year) even though in most cases that amount exceeded 109 per cent of their end-1964 base.

Bank holdings of covered assets declined by \$156 million during 1966, bringing the total down to about the amount outstanding on the base date. The leeway available on December 31, 1966, was \$911 million.

The bank program for 1967, announced in December 1966, was essentially unchanged from the 1966 program. The ceiling remained at 109 per cent of the December 1964 base. Since the banks had a large leeway available at the time the program was announced (\$1.2 billion as of October 31, 1966) the banks again were asked to phase any increase in their foreign lending during 1967, this time at a rate of not more than 20 per cent of the leeway on October 31, 1967, in each quarter, cumulative, beginning with the fourth quarter of 1966.

The provision for banks with small bases was modified by raising the maximum base for these "special" ceilings to \$10 million, and the amount of the ceiling to base plus \$900,000.

The first step in the direction of a geographical focus, other than the priority for developing countries, was taken in 1967 when the banks were asked to use no more than 10 per cent of their available leeway to increase nonexport credits to developed countries. The related reporting requirement was dropped on February 2, 1967, because the banks found it difficult to identify export credits, particularly in the short maturities. However, the banks were asked to continue to conform as closely as possible to the spirit of the request.

Bank foreign assets covered by the program increased by \$370 million in 1967, but the banks ended the year with a net leeway for further expansion of \$1.2 million, half of which reflected an increase in the ceiling under the revised guidelines for 1968 described below.

Revised guidelines for banks for 1968 were issued by the Board in November 1967, to be effective as of the date of issue. The

ceiling was in general retained at 109 per cent of the end-1964 base. However, in a major move to overcome the inequitable effects of the program already referred to, the guidelines provided that banks whose foreign assets on October 31, 1967, were \$500,000 or more could take as a ceiling for 1968 their 1967 ceilings or 2 per cent of total assets as of December 31, 1966, whichever figure was larger. The amount by which the ceiling calculated on this basis exceeded the 1967 ceiling was to be used only for priority credits.

This provision added about \$600 million to the aggregate ceiling. Again, the size of the leeway available led to a request by the Board that any expansion of foreign lending during the last quarter of 1967 and in 1968 be limited to not more than 20 per cent of the leeway, cumulative, in each calendar quarter, beginning with the fourth quarter of 1967.

The geographical emphasis introduced into the 1967 program was given sharper focus by a provision in the guidelines which requested that banks not increase nonexport credits to developed countries of continental Western Europe above the amount outstanding on October 31, 1967. These countries were singled out because to a large extent their balance of payments surpluses corresponded to our deficit, and because they were in the best position to meet their own credit needs.

A reappraisal of the U.S. balance of payments results for 1967 in December of that year led to the announcement by the President on January 1, 1968, of a more restrictive balance-of-payments program. The bank program announced in November 1967 was replaced by revised

guidelines which for the first time requested an outright reduction in the level of foreign assets outstanding (in the amount of \$400 million) as compared with the earlier objective of restraining the rate of increase in such assets. The reduction was accomplished by reducing the ceiling to 103 per cent of the end-1964 base or, for the banks electing the "2 per cent" calculation, to the 1967 ceiling plus one-third of the difference between that amount and 2 per cent of total assets as of December 31, 1966. As was true in the earlier guidelines for 1968, any amount over the 1967 ceiling was to be used only for priority credits. These measures immediately reduced the ceiling for 1968 by \$960 million.

The guidelines provided that the ceiling would be further reduced during 1968 by measures relating to bank foreign lending to developed countries of continental Western Europe. The banks were requested to make no new term loans to those countries (including renewals of term loans outstanding) except to finance U.S. exports, and to reduce their ceilings on each reporting date by the amount of repayments received during the preceding month of such loans outstanding on December 31, 1967. The banks also were asked to reduce their ceilings over the year by 40 per cent of the amount of short-term credits to developed countries of continental Western Europe outstanding on December 31, 1967. The reduction in the ceiling was to take place at 10 percentage points in each quarter; the banks were expected to reduce their short-term credits outstanding to those countries at about the same rate.

There was one major change in the January 1, 1968, guidelines during the year. On March 1, 1968, because of a difficult financial situation that had developed in that country early in the year, Canada was exempted from all of the U.S. balance-of-payments programs. Changes in foreign assets held by financial institutions in Canada after February 29, 1968, were excluded from the target ceilings.

There are data on the performance of the reporting banks under the January 1, 1968, guidelines only through November 30, 1968. On that date the banks had reduced their holdings of covered assets by \$673 million below the level outstanding on December 31, 1967, or by \$273 million more than the objective for the year. The banks on November 30, 1968, actually were \$300 million below the 1964 base figure and had a net leeway for further expansion of \$581 million.

On December 23, 1968, the President accepted recommendations of the Cabinet Committee on the Balance of Payments that the balance-of-payments programs be carried forward in 1969 in substantially the same form as those for 1968. On the same date the Board announced revised guidelines for financial institutions which essentially were unchanged from 1968. The target ceiling for banks remains the same as that provided for in the January 1, 1968, guidelines. The provisions relating to treatment of term loans outstanding to developed countries of continental Western Europe are retained, and are expected to result in a further reduction in the ceiling by \$100 to \$200 million during 1969. Short-term credits to those countries are to be held at

the level requested for 1968, that is, 60 per cent of the amount outstanding on December 31, 1967.

The bank guidelines for 1969 contain one change, largely technical in nature. Under the 1968 guidelines equity investments by banks in developed countries of continental Western Europe were treated in the same way as term loans; that is, the banks were requested not to make such investments. Under the guidelines for 1969, banks may make equity investments in developed countries of continental Western Europe within their overall ceiling.

Finally, the bank guidelines from the beginning have provided that banks with no previous experience in foreign lending may request from their Federal Reserve banks special ceilings for the purpose of making priority loans or investments. Thirty-seven special ceilings have been granted since 1965 in an aggregate amount of \$69 million.

Program for Nonbank Financial Institutions, 1965 - 1969

Since the Board had only limited information on the extent to which nonbank financial institutions were engaged in foreign lending and investment, the program announced in February 1965 included tentative guidelines for such institutions. The guidelines were comparable to those for banks, but with allowances for differences in methods of operation. The guidelines suggested that liquid funds held abroad, other than minimum working balances, should be limited to the end-1964 level and reduced, in a gradual and orderly manner, to the December 31, 1963, level. Loans and investments with maturities of five years or less were to be held to 105 per cent of the amount of such loans and invest-

ments outstanding on December 31, 1964. The priorities suggested in the bank guidelines also were suggested to nonbank financial institutions.

First reports under the tentative guidelines revealed an unexpectedly large amount of foreign assets held by nonbank financial institutions - \$12 billion, or about the same amount as total foreign claims held by banks. Revised guidelines were issued in June 1965; the principal change was to expand the coverage of the 105 per cent ceiling to loans and investments with maturities up to ten years and to suggest that substantial restraint be exercised in acquiring long-term assets (those whose maturities placed them outside the guideline ceiling) in developed countries other than Canada, Japan, and the United Kingdom. On December 31, 1965, long-term investments for which a ceiling was not suggested accounted for almost 90 per cent of total foreign investments held by nonbank financial institutions.

During the first year of the program, the reporting nonbank financial institutions increased total holdings of foreign assets by about \$700 million - from \$12.2 billion on December 31, 1964, to \$12.9 billion on December 31, 1965. However, foreign assets for which a target ceiling was suggested by the guidelines declined from \$1.7 billion to \$1.5 billion during the same period.

The guidelines for nonbank financial institutions were revised in December 1965, again with the idea of conforming them as closely as possible to the bank guidelines. The target ceiling for loans and investments with maturities of ten years or less was increased to 109 per cent of the end-1964 base; the increase was to be

used at a rate of 1 per cent of the base figure in each quarter. Again no ceiling was suggested for long-term loans and investments in the priority categories. However, lending institutions were requested to limit the total of credits and investments in developed countries other than Canada and Japan to 105 per cent of the total of such assets held on September 30, 1965. Within the ceiling, nonbank financial institutions also were asked to avoid any increase in long-term investments in the developed countries of continental Western Europe.

Total foreign assets held by the nonbank financial institutions showed almost no change during 1966. Long-term investments in Canada rose by about \$400 million, but holdings of most other assets declined.

The guidelines for 1967, which became effective in the fourth quarter of 1966, simplified the nonbank program by combining assets covered under separate guidelines in the earlier programs into one category of "covered" assets. Covered assets included liquid funds and loans and investments with maturities of ten years or less, and long-term and equity investments in developed countries other than Canada and Japan (except equity securities acquired after September 30, 1965 in U.S. markets from U.S. investors). Covered assets as thus defined totaled \$1.9 billion on December 31, 1966, as compared with a total of \$2.4 billion for the same types of assets on December 31, 1965.

The 1967 guidelines asked nonbank financial institutions to hold the totals of these covered assets to 105 per cent of the adjusted

base figure, (essentially holdings of covered assets on September 30, 1966). The priorities for export credits and credits to developing countries were continued. In addition, lending institutions were asked to limit nonexport loans and investments to developed countries of continental Western Europe to the fullest extent practicable, and in any event to a level not to exceed the amount of such assets held on September 30, 1966.

Nonbank financial institutions reporting at the end of 1967 increased their holdings of total foreign assets by \$910 million during the year; of this amount \$585 million represented increases in long-term credits and equity investments in Canada and Japan. Covered assets remained relatively unchanged at \$1.9 billion; however, adjustments to the base date figures reduced the ceiling by about \$130 million, leaving the lending institutions in the aggregate over the target ceiling by \$94 million at the end of 1967.

Initial guidelines for 1968 issued in November 1967 increased the target ceiling for covered assets to 109 per cent of adjusted base date holdings. Reporting requirements were eased by providing that financial institutions holding covered assets of \$500,000 or more, or total foreign assets of \$5 million or more were expected to report. Previously, lending institutions with total foreign assets of \$500,000 or more had been requested to report. The new provision reduced the number of reporters from about 570 to 340 institutions. The group of institutions exempted from reporting held only nominal amounts of covered assets and about \$400 million of noncovered assets.

The restrictive program announced on January 1, 1968, reduced the ceiling for covered assets to 95 per cent of adjusted base date holdings (now defined as covered assets held on December 31, 1967). Lending institutions were asked to reduce holdings of liquid funds abroad to zero during 1968, except for minimum working balances. Institutions were expected to refrain from making new investments to developed countries of continental Western Europe, in either debt or equity form, except to finance U.S. exports.

As of March 1, 1968, all Canadian loans and investments formerly subject to the ceiling (money market instruments and short- and medium-term credits) were excluded from the ceiling and from the definition of covered assets.

Performance of the nonbank financial institutions as a group under the January 1, 1968, guidelines has been satisfactory. The guidelines had requested a reduction in covered assets of at least \$100 million. On September 30, 1968, (latest data available) covered assets had been reduced by \$192 million from the December 31, 1967, level.

Total holdings of foreign assets of reporting nonbank financial institutions increased by almost \$350 million during the first three quarters of 1968 to \$14.1 billion. Almost the entire amount of the increase reflected increased investments in Canada.

The importance of Canadian assets in the portfolios of nonbank financial institutions is emphasized by the fact that Canadian investments on September 30, 1968, both short- and long-term, accounted for 70 per cent of total foreign assets held by nonbank financial institutions and 80 per cent of the assets not covered by the guidelines.

Guidelines for nonbank financial institutions issued on December 23, 1968, continued the ceiling for covered assets at 95 per cent of adjusted base date holdings for 1969. Lending institutions that had not succeeded in reaching this ceiling during 1968 are requested to increase their efforts to do so.

STATISTICAL NOTE

Bank holdings of short- and long-term claims on foreigners are published by the Treasury Department and the Federal Reserve on the basis of data collected from the banks on Treasury Department foreign exchange reporting forms. These data are not comparable with the data reported to the Federal Reserve Banks under the foreign credit restraint program, since some institutions and accounts covered by the Treasury Department forms are not included in the foreign credit restraint program, and vice versa. For example, U.S. agencies and branches of foreign banks report to the Treasury Department but not to the Federal Reserve under the program. Foreign assets reported by banks to the Treasury but not covered by Federal Reserve guidelines include foreign assets held for account of customers, loans guaranteed or participated in by the Export-Import Bank (and, since December 23, 1968, by the Department of Defense), and, since February 29, 1968, loans to residents of Canada. Assets reported to the Federal Reserve and not to the Treasury Department include foreign long-term securities held for own account and investments in foreign subsidiaries and branches.

Foreign Credits of United States Banks
(dollar amounts in millions)

	1964	1965	1966	1967	1968				
	<u>Dec.</u>	<u>Dec.</u>	<u>Dec.</u>	<u>Dec.</u>	<u>March</u>	<u>June</u>	<u>Sept.</u>	<u>Oct.</u>	<u>Nov.</u>
Number of reporting banks	154	161	148	151	153	153	154	157	153
Target ceiling	---	9,973	10,407	11,069	9,984	9,886	9,785	9,784	9,773
Total foreign credits subject to ceiling <u>1/</u>	9,484	9,652	9,496	9,865	9,396	9,203	9,156	9,249	9,192
Change from previous date	---	+168	-156	+369	-469	-193	-47	+93	-57
Net leeway for further expansion	---	321	911	1,204	588	683	629	535	581
Total foreign credits held for own account <u>2/</u>	9,719	9,958	9,844	10,202	9,731	9,721	9,649	9,761	9,711
Change from previous date	---	+239	-114	+358	-471	-10	-72	+112	-50

1/ Total foreign assets reported on Treasury Foreign Exchange Forms B-2 and B-3 minus (1) amounts held for accounts of customers, (2) loans guaranteed or participated in by the Export-Import Bank or insured by the FCIA, and (3) beginning March 1, 1968, changes after February 29, 1968, in claims on residents of Canada held for own account; plus foreign assets held for own account but not reported on Forms B-2 and B-3.

2/ Total foreign assets reported on Treasury Foreign Exchange Forms B-2 and B-3 plus foreign assets not reported on those forms, minus amounts held for account of customers.

FOREIGN ASSETS OF U.S. NONBANK FINANCIAL INSTITUTIONS AND NONPROFIT ORGANIZATIONS

(Dollars in Millions)

	Holdings End of Sept. 1968	Change from June 1968		Change from Dec. 1967	
		Dollars	Per Cent	Dollars	Per Cent
<u>ASSETS SUBJECT TO GUIDELINE</u>					
Deposits & money market instr., foreign countries except Canada	26	-7	-21.1	-30	-54.1
Short & intermed. credits, foreign countries except Canada <u>1/</u>	258	-9	-3.5	-37	-12.7
Long-term investments, "other" developed countries <u>2/</u> :					
Investment in financial businesses <u>3/</u>	97	4	4.1	-4	-4.4
Investment in nonfinancial businesses <u>3/</u>	6	*	6.8	-3	-32.9
Long-term bonds and credits	634	-9	-1.4	-25	-3.8
Stocks <u>4/</u>	<u>463</u>	<u>-17</u>	<u>-3.5</u>	<u>-92</u>	<u>-16.6</u>
TOTAL holdings of assets subject to guideline	1,483	-37	-2.5	-192	-11.5
Adjusted base-date holdings <u>5/</u>	1,604	-9	-0.6	n.a.	n.a.
Target ceiling <u>6/</u>	1,524	-9	-0.6	n.a.	n.a.
<u>ASSETS NOT SUBJECT TO GUIDELINE</u>					
Investments in Canada:					
Deposits and money market instruments	93	-31	-25.3	-22	-19.0
Short- and intermediate-term credits <u>1/</u>	151	9	6.3	16	12.3
Investment in financial businesses <u>3/</u>	590	-4	-0.7	13	2.3
Investment in nonfinancial businesses <u>3/</u>	44	*	0.6	1	2.2
Long-term bonds and credits	7,943	93	1.2	365	4.8
Stocks	<u>1,335</u>	4	0.3	-46	-3.3
Bonds of international institutions, all maturities	<u>1,042</u>	33	3.2	63	6.5
Long-term investments in the developing countries and in Japan:					
Investment in financial businesses <u>3/</u>	25	*	-0.5	12	98.9
Investment in nonfinancial businesses <u>3/</u>	9	1	17.1	2	32.3
Long-term bonds and credits	824	11	1.3	80	10.7
Stocks	231	9	4.3	9	4.2
Stocks, "other" developed countries <u>7/</u>	<u>338</u>	<u>1</u>	<u>0.4</u>	<u>44</u>	<u>14.9</u>
TOTAL holdings of assets not subject to guideline	12,624	125	1.0	538	4.5
Memo: Total holdings of all foreign assets	14,107	88	0.6	346	2.5

1/ Bonds and credits with final maturities of 10 years or less at date of acquisition. 2/ Developed countries other than Canada and Japan. 3/ Net investment in foreign branches, subsidiaries or affiliates in which the U.S. institution has an ownership interest of 10 per cent or more. 4/ Except those acquired after Sept. 30, 1965 in U.S. markets from U.S. investors. 5/ December 31, 1967 holdings of assets subject to guideline, less carrying value of equities included therein but since sold, plus proceeds of such sales to foreigners. 6/ Adjusted base-date holdings, times 95 per cent. 7/ If acquired after Sept. 30, 1965 in U.S. markets from U.S. investors. * Less than \$500,000.
n.a. Not applicable.