FEDERAL RESERVE BANK OF NEW YORK

ANNUAL REPORT 1977

FEDERAL RESERVE BANK OF NEW YORK

February 28, 1978

To the Member Banks in the
Second Federal Reserve District

I am pleased to present our sixty-third Annual Report, reviewing major economic and financial developments and this Bank's operations in 1977.

The Report itself amply reviews economic and financial developments over the year. In reading that record, one cannot help but be struck by the complexity of the challenges that must be met locally, nationally, and internationally--challenges that will continue to require the full attention of this Bank, as well as others, in the period ahead.

It seems to me apparent that many of the particular problems touched upon in the Report--ranging over unemployment, sluggish investment, and the instability of the dollar exchange markets--have one common thread: they are greatly complicated by, and partly attributable to, the inflationary pressures characteristic of the world economy. The Federal Reserve System and central banks everywhere, with their responsibilities for controlling money and credit, must play a key role in resolving that problem. By its nature, however, the problem can be dealt with effectively only to the extent all elements in the community--Government, labor, and business--appreciate the magnitude of the effort and are willing to play their part.

Meanwhile, we want to conduct with sureness and efficiency our own operations--ranging from the effective handling of domestic and foreign open market operations totaling hundreds of billions of dollars in the course of a year to the clearance of several million checks a day. Organizational changes within the Bank, shifts of key officers, and fine cooperation by our staff have helped us meet those responsibilities with a reduction in personnel to the lowest level since 1969, a marked increase in productivity, and the smallest increase in total costs in a decade. We look forward to extending that pattern in 1978 while maintaining our level of services even as volume increases.

I must, however, report disappointment over the progress that has been made in 1977 in dealing with the chronic problem of the burdens of Federal Reserve membership, a matter that can be effectively resolved only by legislation. Until that matter is resolved, it will remain among the first priorities for the Federal Reserve generally, and for me personally.

In approaching both our operations and our policies, we place great value on our relationships with member banks and others in the financial community. We will continue to look to that reservoir of energy, talent, and resourcefulness in our work.

Paul A Volcker

PAUL A. VOLCKER
President

Federal Reserve Bank

of New York

SIXTY-THIRD ANNUAL REPORT

For the Year

Ended

December 31, 1977

Second Federal Reserve District

Contents:

Sixty-third Annual Report
Federal Reserve Bank of New York

THE UNITED STATES AND WORLD ECONOMY

Growth in the Industrial World

The United States economy continued to expand vigorously in 1977. Elsewhere in the industrial world, the year began auspiciously enough but economic growth faltered in the spring and summer. As demand sagged, unemployment increased in most industrial nations. Even in the United States, where the overall rate of unemployment fell substantially, joblessness remained a serious problem for some segments of the labor force. Despite a continuing margin of unused resources, only limited progress was made against inflation in the industrial world. While price increases did moderate in a number of countries during the second half of the year, strong underlying cost pressures persisted.

CONTRASTS IN GROWTH. In 1977 the United States economy again played a leading role in the world's economic expansion. Overcoming the disruptive effects of an unusually severe winter in the eastern half of the nation, economic activity surged ahead in the early months of the year under the impetus of strong consumer buying and restocking of business inventories. Later, these forces weakened, but rapid increases in Federal Government spending and residential construction supported continued growth. Toward the year-end, consumer expenditures strengthened anew and construction of single-family dwellings climbed to record levels. Over the four quarters of 1977, real gross national product in the United States was estimated to have grown 5.7 percent, up from the preceding year's 4.7 percent advance and well above the economy's longer run growth potential. Strong gains in employment reduced the unemployment rate to 6.6 percent in the final quarter of 1977 from 7.8 percent a year earlier. Unemployment might have dropped further except for unusually fast growth in the labor force, which largely reflected continued rapid increases in the participation of women and young people.

In contrast to the vigorous expansion in the United States, economic growth elsewhere in the industrial world was sluggish last year. The outcome was particularly disappointing, since a rather strong recovery early in the year had raised hopes of a sustained expansion of the world economy. But the recovery in Europe faded in the spring and summer when consumer buying slowed and investment spending remained slack. The weakening of the European economies was followed by a leveling-off of economic activity in Japan, whose recovery depended heavily upon exports to other industrial nations. In Canada, economic growth resumed in the second half of the year after a setback in the spring. Unemployment rates rose in most large industrial countries abroad during 1977, in many cases to the highest levels since World War II. In Europe, as in the United States, joblessness was especially acute among younger people.

Two intertwined problems—rapid inflation and relatively slow growth of investment in productive capital—contributed to the persistently high levels of unemployment throughout the industrial world. Progress against inflation was spotty last year. Indeed, virtually no progress was discernible in the United States. The underlying rate of inflation is probably best seen in consumer prices of items other than food, which rose 6.3 percent over the course of 1977, practically the same as the preceding year's increase. The acceleration in the overall consumer price index—a rise of 6.8 percent during 1977, compared with 4.8 percent the year before—resulted from substantial increases in food prices after a year of virtual stability. The bulk of the increases occurred in the first half of the year, partly because of unusually severe winter weather and drought at home as well as sharply higher prices of coffee and some other imported foods. During the latter half of the year, food prices rose only modestly further.

Cost pressures intensified last year. While increases in compensation in the United States eased slightly from 1976, productivity gains slowed much more. As a consequence, unit labor costs in the private business sector rose 6.1 percent in 1977, up from 4.7 percent the year before.

Price developments continued to show wide divergence abroad. Among the major industrial countries, consumer prices increased from the end of 1976 until late in 1977 at annual rates ranging from about 4 percent in Germany to more than 16 percent in Italy. Rates of price increases generally slowed somewhat after midyear, partly in response to the weakening of demand conditions but also reflecting currency appreciations. Wage increases appear to have moderated slightly last year in most large countries, but as in the United States unit labor costs probably rose faster because of slower growth in productivity. In the United Kingdom, wage increases picked up somewhat during the second half of the year following relaxation of a two-year program of voluntary pay restraint buttressed by tax incentives and other measures, but most settlements remained close to the guideline.

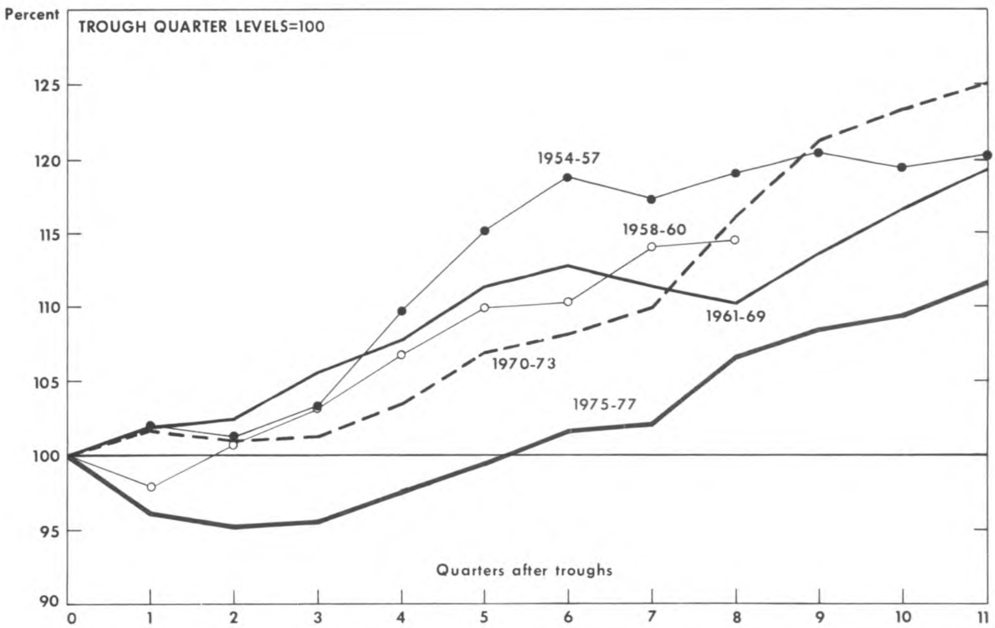
LAGGING CAPITAL INVESTMENT. The recovery of business fixed investment from the 1973-75 recession has been considerably slower than in previous postwar expansions. Chart 1 illustrates the United States case, which typifies the experience of Western Europe and Japan as well. Among the major industrial countries, only in Canada does real business capital spending appear to have recovered to pre-recession peak levels. To some extent, lagging capital investment results from relatively low rates of utilization of existing capacity. There is little incentive to augment facilities already underutilized. Insofar as demand grows faster than productive facilities, the resultant absorption of existing capacity should eventually stimulate increased capital spending. It is likely, however, that various structural changes—such as the marked increase in energy prices since 1973—have rendered some productive facilities economically obsolete. Hence, statistical measures probably exaggerate the amount of economic capacity and understate rates of capacity utilization.

Two basic reasons for the weakness of capital investment are poor profitability and apprehension about the ability of government to cope with a wide variety of problems. That anxiety has many causes, the import of which varies among countries. In the United States, doubts concerning public policies—particularly those relating to taxes, energy, and environmental protection—seem to impede investment decisions. In some other countries, deep-seated political and social problems have further compounded the uncertainty.

In virtually all of the industrial nations, however, profitability is a matter of serious concern. In the inflationary period of the past decade, nominal profits have generally overstated true "economic profits" as a result of accounting procedures that failed to adjust income adequately for increases in the replacement cost of capital assets and inventories used in production. Inasmuch as corporate tax liability in most countries is still tied to nominal profits rather than economic profits, price inflation increases the real burden of taxation.

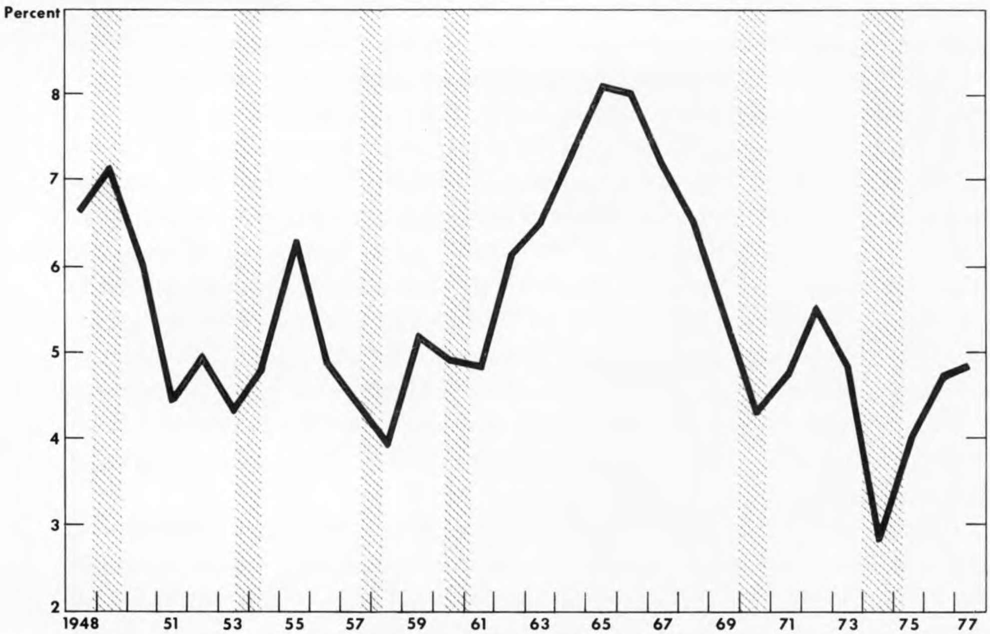
Partly because of the interaction of inflation and taxes, nonfinancial corporations in the United States turned increasingly to the debt markets to finance new investment outlays since the midsixties. But even when the net interest payments of these corporations are added to aftertax profits, this measure of total income on capital looks very weak, compared with the cost of replacing existing capital assets. The ratio of capital income to the replacement value of nonfinancial

Chart 1. REAL BUSINESS FIXED INVESTMENT IN RECENT RECOVERIES IN THE UNITED STATES



The recoveries shown are the periods following the recession troughs dated by the National Bureau of Economic Research as the second quarter of 1954, the second quarter of 1958, the first quarter of 1961, the fourth quarter of 1970, and the first quarter of 1975, respectively. The 1958-60 recovery ended after eight quarters. All data are seasonally adjusted.

Chart 2. **RATE OF RETURN ON CORPORATE ASSETS IN THE UNITED STATES**



The rate of return is defined as total capital income of nonfinancial corporations divided by the total replacement cost of their reproducible assets. Total capital income consists of economic profits (adjusted for replacement-cost valuation of inventories and fixed assets used in production), net of corporate income taxes, plus net interest payments and minus the purchasing power loss on currency, demand deposits, and net trade credit.

Shaded areas represent periods of recession, as defined by the National Bureau of Economic Research.

corporate assets represents the rate of return on corporate capital. As shown in Chart 2, this measure has deteriorated markedly since the midsixties, despite some recovery since the low point in 1974.

THE BURDEN OF INFLATION. Throughout the industrial world, the fear of resurgent inflation—and the public policies it might call forth—have clouded the outlook and contributed to the weakness in the investment climate. The erosion of private capital through taxation of artificial profits generated by inflation impairs incentives to invest. By depressing equity values, moreover, the effects of inflation increase the cost of raising capital and make new investments relatively unattractive, compared with acquisition of existing assets.

The roots of inflation lie deep in the social and economic makeup of the nations of the world; the ultimate source is probably to be found in the persistent tendency for aspirations to outrun the economy's capacity to satisfy them. The worldwide inflation of the 1970's initially arose largely out of excessive aggregate demand. But inflation persisted long after demand pressures abated in the deep and prolonged recession of 1973-75, partly because of downward inflexibility in wage and price setting. Any shock that changes relative prices—the quintupling of world oil prices since late 1973 being the most dramatic example—tends to ratchet the whole price structure upward. Continuing adjustments, as aggrieved parties attempt to restore their former positions, serve to aggravate and spread inflationary pressures.

Inflation can hardly be sustained for long without monetary nourishment. But once the behavior of the various claimants to national income has been conditioned by the legacy of rising price levels, inflation cannot be eradicated quickly and painlessly simply by cutting back monetary growth. Neither wages nor prices of most goods and services are very sensitive to demand conditions in the short run, because they are influenced heavily by inflationary expectations that respond only slowly to changing conditions. Hence, even an abrupt slowdown of monetary growth would probably have little near-term impact on the price level.

For inflation to be overcome, however, inflationary expectations must be dampened, and that requires a credible program gradually to reduce monetary growth to a rate compatible with overall price stability. But more than monetary moderation is needed. Less rigidity in wage and price setting and modification of governmental policies that exert upward pressure on prices are necessary also. In the United States, costs of production were boosted significantly at the beginning of 1978 by sizable increases in payroll taxes; even larger hikes in such taxes to finance social security benefits have been legislated to take place in coming years. Similarly, the step-up in the minimum wage in January, and annual increases scheduled to take effect over the next three years, will augment costs, particularly in the relatively low-wage service and trade sectors. Cutbacks in grain acreage and higher price supports for certain crops, which were announced late last year, will further increase the cost of living. Various regulatory restraints on competition inhibit downward price adjustments. Concessions to pressures for protection from import competition—for products ranging from sugar to steel in the United States—will help perpetuate inflation. Indeed, a worldwide drift toward protectionism poses a grave threat to prosperity and price stability throughout the world.

Another clear need is relief from excessive taxation of income from capital. Enactment of a tax package such as proposed by President Carter on January 21, 1978, would be a step in the right direction. In addition to reductions in personal income taxes and various other measures, the President proposed reducing the corporate income tax rate eventually to 44 percent from 48 percent, making permanent the 10 percent investment tax credit against outlays for equipment and extending that credit to investments in manufacturing and utility structures. Such a program would help to stimulate capital spending, but more fundamental tax reform is needed to correct the bias in our tax system against saving and investment.

TOWARD FULL EMPLOYMENT. It is far better to begin moving toward an environment conducive to capital investment when there are still ample unused resources available, rather than wait until production is straining available capacity. To defer action until virtually all capacity becomes fully utilized is to risk a renewed upsurge of virulent inflation, as occurred in the years 1973-74. Healthy capital spending is needed now to boost the world economy by expanding incomes and increasing demand for consumer as well as producer goods. Renewed strength in the capital goods sector may be the best way of creating the jobs required to reduce the high level of unemployment that persists in most nations.

For the longer term, expansion of productive facilities will help to temper the inflationary pressures that accompany rising aspirations. It is needed, moreover, to absorb expanding labor forces into productive employment. Of course, unemployment will not be solved by capital investment alone; the work force must possess the skills to use the capital stock as well as the incentives to take advantage of job opportunities as they are created. In the long run, the private sector must provide the jobs for an expanding work force, but governments can do much to ameliorate transitional problems. Temporary public employment programs may have a role to play in many countries, especially programs that emphasize job training, basic education, and cultivation of sound work habits. Private employment of marginal workers might be facilitated by means of wage supplements or subsidies to firms employing such workers. If programs such as these are to prove effective, they should be complemented by modifications in the government policies that interfere with efficient use of labor resources. Unemployment compensation and minimum wages must be structured so that they do not encourage unduly prolonged periods of idleness or prevent the employment of the young and the unskilled.

Ultimately, restoration of full employment and prosperity is inextricably tied to restoration of reasonable price stability. There is no permanent "trade-off" between inflation and unemployment. On the contrary, the dislocations created by inflation are among the main obstacles to the capital formation needed to promote full employment. Tax reform can help stimulate capital investment. Sustained moderation in monetary growth can alter inflationary expectations and make return to price stability an achievable goal. But the achievement of that goal might be agonizingly slow if wage and price decisions continue to build in expectations of future inflation. What is needed is a means of breaking that cycle. It is the basic appeal of incomes policies that they might provide a means of doing so. The various schemes that have been proposed or tried around the world often have not been effective over time, and they all have serious drawbacks in terms of equity, in distortions to the allocation of resources, or in administrative complexity. Furthermore, an approach that is appropriate to one country might not be adaptable to others with different economic or social structures. Nevertheless, there may be lessons all nations can learn from those experiments with incomes policies. Especially interesting is the British experience in combining tax cuts with voluntary wage restraint. No such policies, however, can take the place of monetary and fiscal moderation—the *sine qua non* of price stability.

Payments Imbalances and Exchange Rates

The disparities in rates of growth and inflation experienced by major countries were reflected in the payments imbalances that continued to disturb the world economy during 1977. In some areas, to be sure, progress toward restoring international equilibrium was recorded during the year, but elsewhere disequilibria became more pronounced, as the current account position of Japan moved into large surplus while that of the United States shifted into a record deficit.

Prominent among those achieving better balance were Britain and Italy which eliminated the very large current account deficits that they had run in the midseventies (Chart 3). France's deficit was substantially reduced. At the same time, vigorous adjustment efforts among some of the nonoil developing countries, both to expand exports and to curb imports, helped reduce their collective current account deficit to more manageable proportions. On the other hand, progress toward better balance among the surplus countries was unsatisfactory. True, the aggregate current account surplus of the major oil-exporting countries was apparently reduced by several billion dollars from the estimated $38 billion to $40 billion of 1976. However, the surpluses of Germany and Switzerland remained about unchanged. More disturbing, Japan's surplus tripled to about $11 billion. Reflecting the stagnation of the economy since spring, the volume of Japan's imports was 1 percent lower in July-December than a year earlier while its export volume was up 6 percent.

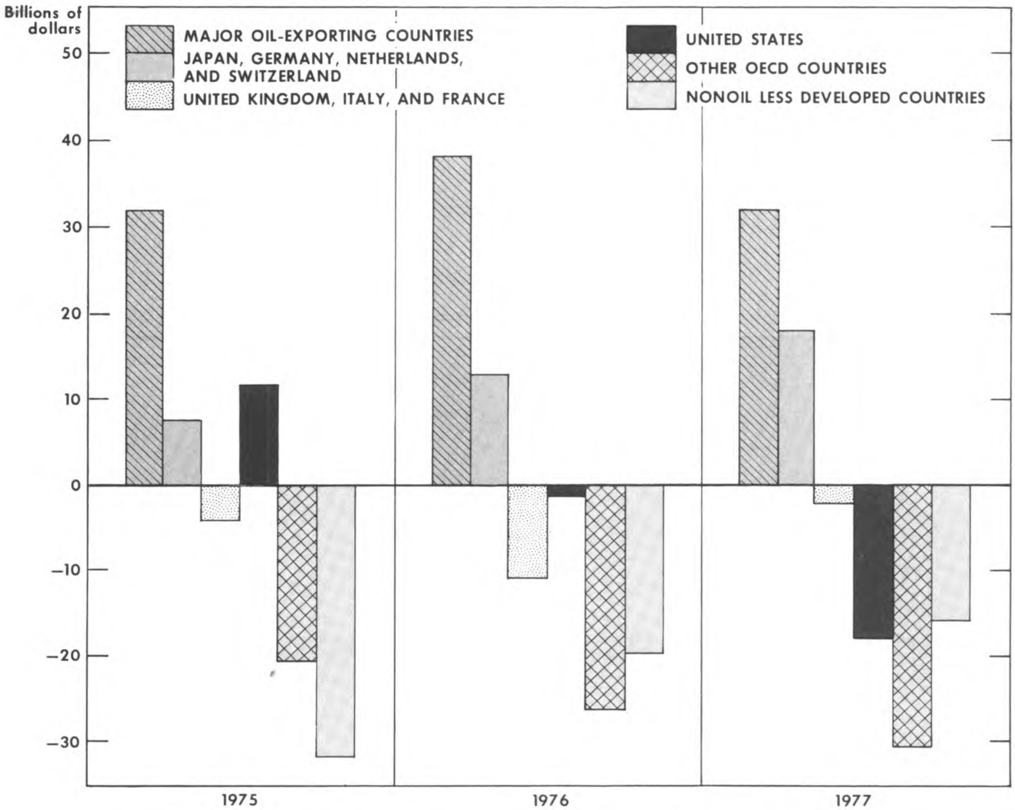
The improvement in the external positions of Britain, France, Italy, and the nonoil developing countries, as well as the huge rise in Japan's surplus, was accompanied by deterioration elsewhere. The current account deficit of the smaller OECD (Organization for Economic Cooperation and Development) countries,[1] which had already been uncomfortably large in the midseventies, widened further last year. But the major shift came in the position of the United States. A 5 percent rise in our exports over the previous year was surpassed by a 22 percent advance in imports which expanded across the board. While imports of industrial supplies, consumer goods, and food climbed substantially, none of these categories rose as fast as petroleum which surged by almost one third to $45 billion. The resulting $22 billion increase in our merchandise trade deficit played a positive role in strengthening the positions

[1] *The other OECD grouping consists of Australia, Austria, Belgium, Canada, Denmark, Finland, Greece, Iceland, Ireland, New Zealand, Norway, Portugal, Spain, Sweden, and Turkey.*

of the nonoil developing and weaker industrial countries. However, it also contributed to the huge rise in Japan's surplus. All in all, even though our surplus on investment income rose substantially, the United States current account deficit grew to $19 billion in 1977 from $1.4 billion the year before.

These shifts in current account positions—accompanied as they were by

Chart 3. CURRENT ACCOUNT BALANCES, 1975-77

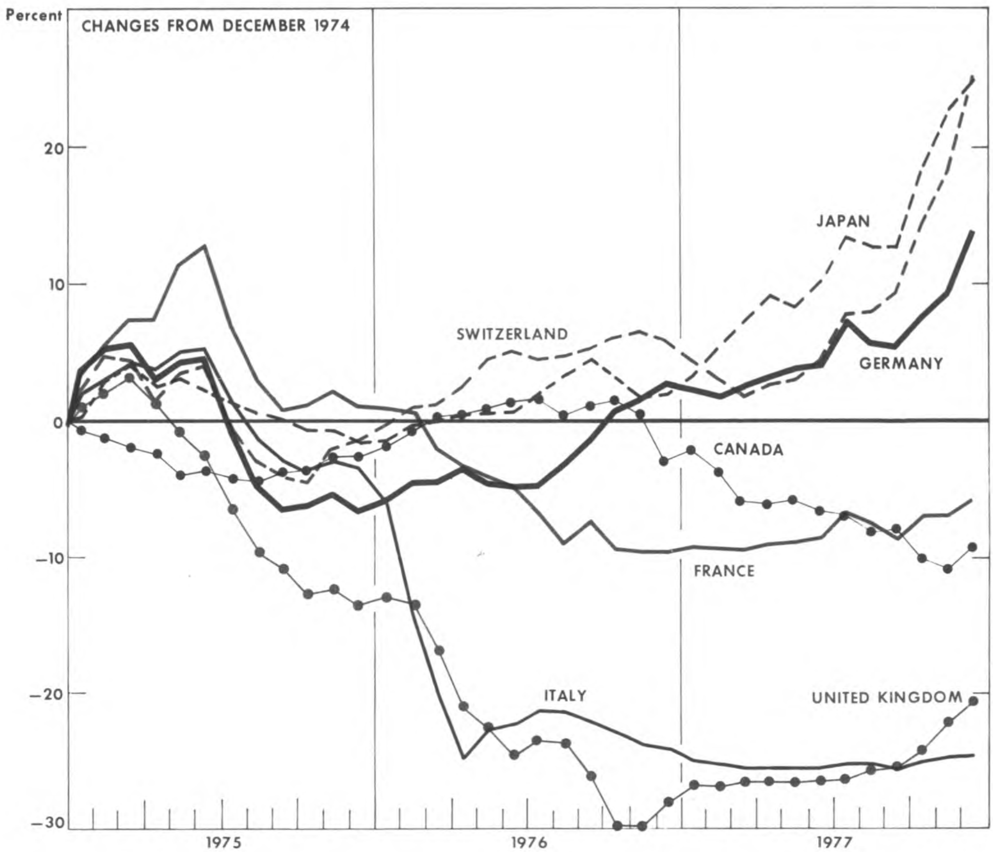


Current account balances include goods, services, and private and government transfers. The other OECD grouping consists of Australia, Austria, Belgium, Canada, Denmark, Finland, Greece, Iceland, Ireland, New Zealand, Norway, Portugal, Spain, Sweden, and Turkey. All 1977 figures are preliminary estimates.

changes in exchange rate expectations and in relative monetary conditions—significantly affected the financial markets. Particularly notable was the change in the character of United States capital transactions. In 1976, the outflow of United States private capital, which contributed so much to the financing of the international imbalance, was largely offset by inflows from foreign private investors and, in almost equal parts, from the monetary authorities of OPEC (Organization of Petroleum Exporting Countries) and of other countries. In 1977, the relative strength of the United States economy and rising interest rates here acted—together with various special factors—sharply to curtail the recorded outflow of American capital. Although United States direct investment abroad remained about the same, private investors decreased their purchases of foreign securities, while the rise in United States bank claims on foreigners that had characterized the midseventies was substantially reduced. Meanwhile, recorded foreign capital flows were apparently influenced more by uncertainties about the outlook for the dollar than by the relative strength of the United States economy. Consequently, inflows to the United States from OPEC members and private foreign investors dropped below those of 1976. Furthermore, unrecorded transactions, as captured in the statistical discrepancy, shifted from large inflows in 1976 and in the first half of last year to a large outflow during July-December 1977. In contrast, dollar assets taken up by the monetary authorities of the major industrial countries—intent on cushioning the appreciation of their currencies—rose, in some cases, massively.

These changes in trade and payments flows were reflected in, and to some extent were exacerbated by, developments in the exchange markets. As the press reported increases in the surpluses and deficits of key countries, delays in the enactment of United States energy legislation, official statements on exchange policy, and myriad other developments, exchange rates sometimes moved rapidly and trading occasionally became disorderly. Such periods of confusion and, more importantly, the absence until the year-end of policy measures designed to deal with deteriorating market conditions caused modifications in expectations about future exchange rates. This in turn led to shifts both in the leads and lags in payments and in the choices that investors made regarding the currency composition of their portfolios. Consequently, surplus countries such as Germany, Japan, and Switzerland saw their currencies rise sharply in terms of the dollar (Chart 4). The currencies of Britain, France, and Italy were also higher against the dollar at the end of the year than at the beginning. In several cases, the appreciation might have been even larger and would surely have come sooner

Chart 4. **EXCHANGE RATE CHANGES AGAINST THE UNITED STATES DOLLAR, 1975-77**



Exchange rate data are monthly averages of noon offered rates in New York.

but for heavy intervention by foreign monetary authorities. Such intervention doubtless supported the dollar but, from the perspective of monetary authorities abroad, it served primarily to resist the erosion of international competitive positions; in countries whose currencies had previously been under pressure, intervention last year also served to rebuild depleted foreign currency reserves.

Elsewhere, countries whose current account deficits rose during 1977 or were already large saw their exchange rates decline. Over the year, the Canadian dollar depreciated 7 percent against the United States currency. Also noteworthy were devaluations of the currencies of Portugal, Spain, and Turkey as well as the withdrawal of Sweden from the European currency arrangement.

In the Euro-markets, foreign branches of United States banks continued to play a pivotal role in, and to bear heavy responsibility for, financing the international imbalance. Even so, lending by these branches to official and private nonbank entities slackened somewhat from the high rate of the previous year, thus paralleling the smaller rise in loans outstanding to such borrowers by United States head offices. While the record is open to further improvement, last year did see heightened awareness among commercial banks of the importance of carefully assessing the payments prospects of borrowing countries. (See section on Banking Supervision below.) In addition to making their own assessments, banks seemed to give more weight than previously to the willingness of such countries to adopt programs to strengthen their balances of payments as a condition for drawing on the International Monetary Fund (IMF).

The more sluggish recovery abroad than in the United States had repercussions not only on trade and financial flows but also on commercial policy. In several countries, including the United States, vociferous demands arose for restrictions on rising imports from industrial countries whose domestic markets were weak as well as from developing countries attempting to strengthen their external positions. For the most part, governments resisted such demands. Indeed, some progress was made in multilateral negotiations toward further reductions in trade barriers. Yet, some industrial countries instituted restrictive measures against various imports and so-called voluntary restraint agreements proliferated. At the year-end, the full impact of these actions was still unclear but it was apparent that, at least temporarily, the process of dismantling protectionism had been interrupted.

ENERGY POLICY. The United States plays and must continue to play a major role in dealing with the international imbalance. With other strong industrial countries growing relatively slowly, the improvement in the external positions of many countries abroad has been heavily dependent both on the relatively rapid recovery of the United States and on the maintenance of open markets here. However, although the United States has helped significantly in strengthening the external positions of many oil-consuming countries abroad, it has been laggard in doing its own part to reduce the imbalance with OPEC. The United States merchandise trade deficit with OPEC accounted for about one third of the oil-exporting countries' surplus in 1977. As a share of total United States imports, oil ballooned from only 12 percent in 1973, before the increase in oil prices, to no less than 30 percent last year. Yet, by the end of 1977, the United States had announced only temporary measures to expand domestic oil production while a comprehensive energy program, designed to reduce the country's dependence on imported oil over the longer term, was still awaiting enactment. The need for such a program remains clear. Whereas the major European countries, Canada, and Japan were using significantly less oil per unit of real GNP in 1977 than they did four years earlier, the amount utilized by the United States was down only slightly.

The Administration's energy program is an attempt to overcome this lag. Under that program, the rise in United States oil imports would be curbed, the target being a cut in projected imports of 4.5 million barrels daily by 1985, an amount that would save some $23 billion annually at 1977 prices. Whether this goal could or should be attained more quickly is debatable, but the need for the United States to reduce its dependence on imported oil is beyond dispute.

THE POSITION OF THE DOLLAR. Adoption of an effective energy policy would brighten the long-term balance-of-payments prospects of the United States. In transactions with nations outside OPEC, this country's fundamental position remains strong. Apart from oil, the deterioration in its current account balance occurred largely because the economy grew more rapidly than those of most of its major trading partners. United States exports were generally maintaining their competitive position in foreign markets. Nevertheless, the dollar depreciated at an accelerating pace in late December and the first few days of 1978. With the depreciation feeding on itself, exchange market conditions showed characteristics of growing disorder.

In these circumstances, the United States authorities took action reflecting their concern over the balance-of-payments and the dollar situation. Reaffirming the determination of the United States to reduce its dependence on imported oil, the President on December 21 expressed confidence that the Congress would take early action on the Administration's energy program. To relieve, in the interim, pressure on the trade position, the President announced measures to boost domestic oil production and to support the international competitiveness of American products through an expansion of export credit facilities. He also reemphasized the Administration's intention, in consultation with foreign monetary authorities, to continue intervening to the extent necessary to counter disorderly conditions in the exchange markets. Implementing this policy, the United States monetary authorities announced, after the turn of the year, that existing reciprocal credit arrangements between the Federal Reserve and foreign central banks had been reinforced by an additional swap arrangement between the Treasury's Exchange Stabilization Fund and the Deutsche Bundesbank. In the early days of the new year, these expanded facilities were being actively employed, in cooperation with central banks abroad, to check speculation and reestablish order in the foreign exchange markets. Supporting these measures, the directors of this Bank, as well as those of the Federal Reserve Bank of Chicago, increased the discount rates by ½ percent on January 6. The Board of Governors promptly approved these increases and other Reserve Banks soon followed suit.

Long before these measures were announced, international disturbances stimulated renewed discussion of the appropriate role of the monetary authorities in exchange rate management. Few question that changes in exchange rates should reflect shifts in underlying economic relations among trading countries and should therefore play a continuing role in the adjustment process. Rather, the points at issue are whether these underlying changes have been reflected in the actual movements of rates and whether more active intervention, especially on the part of the United States authorities, might foster more satisfactory exchange rate behavior.

Although the appropriate stance of the monetary authorities in the exchange markets remains open to debate, several things are clear. Official efforts to improve the functioning of the international monetary system must rely heavily on signals from the market about the appropriate structure of currency relations. The problem here, of course, is to distinguish between signals that underlying conditions have changed and seasonal, speculative, and other transitory influences. It is also clear that, when underlying conditions do change, the authorities can choose among several instruments, of which exchange rate policy is only one. Above all, it is clear that intervention is a tool that, employed in certain circumstances, can promote orderly exchange markets but it is a limited tool. In the end, exchange stability must rest on effective economic policies to attain the more basic objectives of steady growth, reduced inflation, and appropriate international adjustment.

STRENGTHENING THE LINK BETWEEN FINANCE AND ADJUSTMENT. While the debate on how to attain these various objectives went on, the problem of assuring appropriate financing for the international imbalance remained pressing. Although many countries abroad have made gratifying progress in redressing their external positions, the payments deficits of some others still reflect the absence of effective stabilization policies. Clearly, financing to handle such deficits is appropriate only in conjunction with the adoption of effective measures for adjustment.

Yet, assuring a close link between finance and adjustment remained one of the major unsolved problems of 1977. The difficulty arose because the private markets, which continued to provide the bulk of financing, are not by themselves always in a position to influence the policies of the borrowing countries. At the same time, the resources of the IMF, which can influence the policies of member countries, have not expanded as fast as the world economy. Since 1969, when the last increase in Fund quotas was initiated, world imports have quadrupled while payments imbalances have more than tripled. The danger is that the Fund's ability to foster international adjustment will atrophy without appropriate increases in its financing capabilities. Accordingly, the Board of Governors of the Fund approved as long ago as March 1976 a one-third increase in IMF quotas; the Fund's executive directors also approved in August 1977 the establishment of the Witteveen facility that would, temporarily, further augment that institution's medium-term lending capacity. Together, the two measures would provide some $17 billion equivalent in additional usable resources, roughly one half of total existing quotas. However, as the year ended, neither measure had become effective because legislative ratification had not been obtained in the requisite number of member countries including, as regards the Witteveen facility, the United States. For similar reasons, enlarged resources could also usefully be made available to the World Bank group of institutions which has extensive experience in providing long-term financing for development purposes. A substantial proportion of such additional resources would appropriately be contributed by the industrial and oil-producing countries whose external positions are strong.

FEDERAL RESERVE POLICIES

Monetary Policy

Confronted with high unemployment and rapid inflation as a legacy of earlier years in the 1970's, the Federal Reserve System sought in 1977 to promote financial conditions that would encourage economic expansion while helping to curb inflationary pressures.

In formulating its broad policy approach, the Federal Open Market Committee (FOMC) continued to focus explicitly on long-term objectives for monetary growth. Each quarter, projected growth ranges over one-year horizons for several monetary aggregates were adopted and announced publicly, a practice initiated in 1975 following a Congressional resolution supporting the concept. Spokesmen for the System at that time indicated its desire to lower monetary expansion over the long run to levels consistent with general price stability. They also emphasized that this approach would have to be gradual to sustain the recovery during a period when the inflationary momentum in the economy remained strong. This same strategy was maintained throughout 1977 and, indeed, reaffirmed on several occasions when the FOMC announced further reductions in its one-year ranges for growth of the aggregates.

Monetary expansion, however, proved to be unexpectedly rapid during the year. Growth of the narrowly defined money stock (M_1) accelerated sharply beginning in the spring and continued at a pace above the FOMC's longer run ranges into the fall. The expansion of the broader monetary aggregates—while more in line with the FOMC's objectives—also remained at fairly high rates over this period. At the same time, private credit demands picked up strongly, especially business demands for short-term credit which had been unusually weak in the earlier part of the recovery.

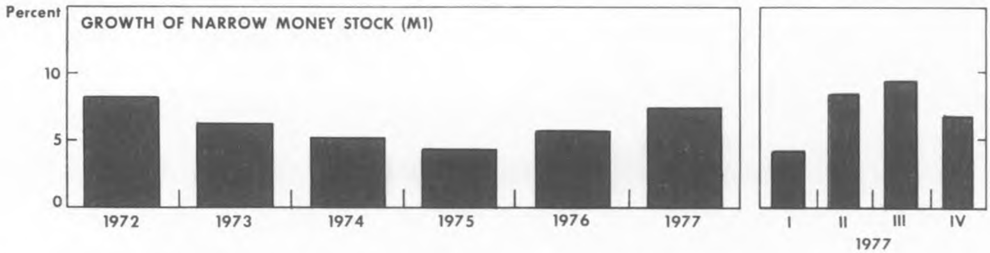
The monetary overruns created a serious dilemma for the Federal Reserve. They came at a time when the economic expansion appeared to be slowing somewhat, when inflation was no longer showing signs of continuing moderation, and when uncertainty over the future course of the economy had increased. The FOMC recognized that completely accommodating the rising demands for money and credit could aggravate the problem of inflation, a development which would eventually undermine the recovery. At the same time, however, it felt that an attempt to offset or even to halt the overruns too quickly might result in strong money market pressures out of keeping with economic conditions. In dealing with this situation, therefore, the FOMC adopted a middle course—one aimed at restraining monetary growth, but not so aggressively as to prevent or entirely offset the overshoots from earlier projections.

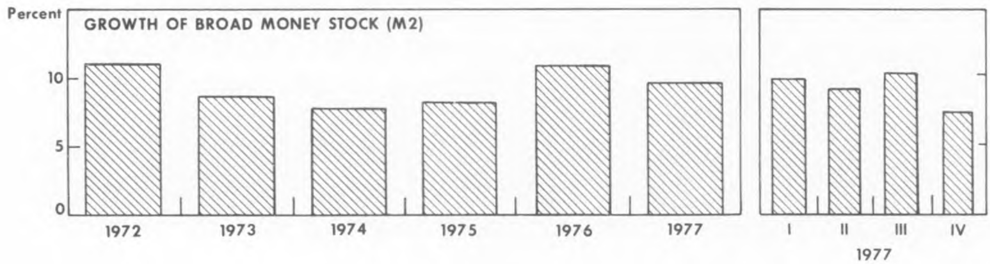
Other considerations also led the System to proceed cautiously. For one, monetary growth was extremely erratic during 1977. M_1, for example, surged in each of the opening months of the second, third, and fourth quarters. At the time, it was not clear whether such steep increases reflected only temporary phenomena that would soon be reversed or whether they indicated a trend. While growth was sluggish after each bulge, as it often is, this time the extent of the slowdowns was not nearly enough to offset the previous gains.

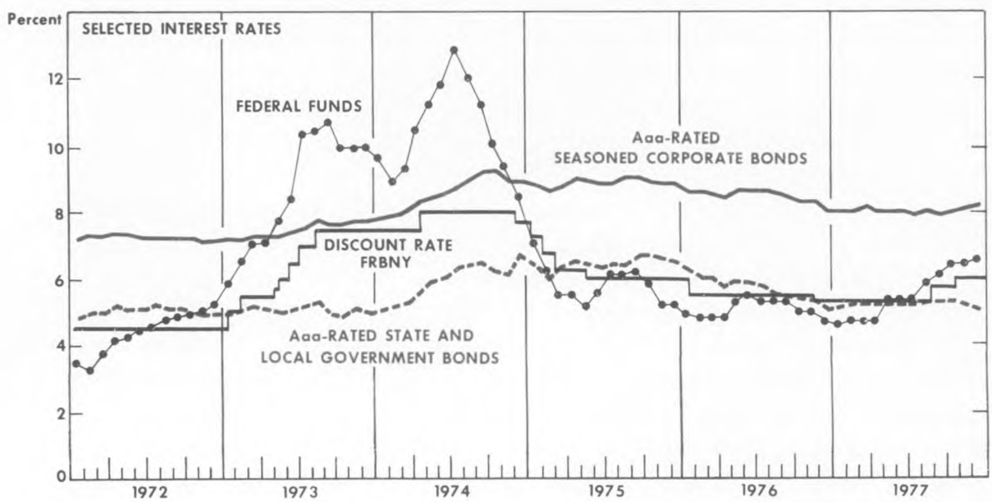
Adding to the problem of interpreting the significance of the behavior of M_1 was uncertainty over the monetary effects of a number of recent financial innovations and regulatory changes. These developments—most notably the rapid growth of NOW (negotiable order of withdrawal) accounts in New England and changes in regulations that allow state and local governments and businesses to hold savings deposits at commercial banks—had apparently retarded the expansion of M_1 in 1975 and 1976, as the public switched part of its transaction balances, normally held in demand deposit accounts, to income-earning assets. Partly reflecting these developments, the velocity of M_1—the ratio of GNP to M_1—had risen at a much faster pace over the 1975-76 period than at comparable stages in earlier postwar recoveries. In formulating its projections of M_1 growth for 1977, the FOMC had expected M_1 velocity to continue rising sharply during the year. Instead, beginning in the second quarter the growth of M_1 velocity returned to a more historical pattern, as it appeared that the public's economizing of demand deposit balances had at least temporarily slowed.

Faced with these uncertainties over the durability and significance of the acceleration of monetary growth and concerns over the strength of the economic recovery, the System acted with caution and moderation. In response to initial indications of rapid monetary expansion, the System began to supply reserves less generously in the spring. When monetary growth continued above the FOMC's longer run objectives through the summer and fall, the System did not fully accommodate the associated increase in demands for reserves. The Federal funds rate, which had fluctuated within a range of 4⅝ to 4¾ percent from December 1976 to March 1977, moved up to around 6½ percent by mid-October and then hovered close to that level over the remainder of the year (Chart 5). Rates on most other short-term market instruments also advanced by

Chart 5. MONEY AND INTEREST RATES







The money stock growth rates are computed from daily-average seasonally adjusted levels in the final quarter of the preceding period and the final quarter of the period covered. Quarterly figures for 1977 are expressed at annual rates. Rates for Federal funds and yields on corporate bonds are monthly averages of daily figures. Yields on state and local government bonds are monthly averages of Thursday quotations.

about 1½ to 2 percentage points over the March-October period and then edged upward over the final two months. Even with the increases that occurred in 1977, most short-term interest rates closed the year not much above their levels at the start of the economic recovery in the spring of 1975. In contrast, short-term rates had risen substantially over comparable periods of previous upswings in economic activity.

The advance in short-term market rates in 1977 had by August brought them to levels considerably above the Federal Reserve discount rate for the first time in nearly three years. The result was a surge in member bank borrowing from the discount window to its highest levels since 1974. To bring the discount rate into closer alignment with other short-term interest rates, as well as to signal concern over the growth of the money stock, this Bank initiated increases in the discount rate in the summer and fall. The Board of Governors of the Federal Reserve System approved actions by this Bank and other Federal Reserve Banks raising the discount rate by ½ percentage point to 5¾ percent beginning in late August and then to 6 percent in late October.

SHORT-AND LONG-TERM INTEREST RATES DIVERGE. While rates on short-term instruments moved up in 1977, yields in the capital markets were comparatively stable until the final months of the year. Yields on highly rated corporate securities, as measured by Moody's Aaa bond yield index, for example, fluctuated narrowly around the 8 percent level over most of 1977, after falling rather steadily in 1976. Concerns over the rapid depreciation of the dollar in the foreign exchange markets and expectations that the new year would bring further increases in private credit demands and enlarged Treasury borrowing brought the index up to 8.30 percent by the end of the year. Still, this was about 40 basis points below its level at the start of the economic recovery. Yields on long-term Government bonds behaved in a roughly similar fashion, but strong purchases of tax-exempt issues by commercial banks, fire and casualty insurance companies, and individuals led to declines toward the year-end in yields on highly rated municipal securities.

In the meantime, as the economic expansion continued, investors became increasingly confident in the ability of firms and municipalities to service their debt obligations. In addition, the municipal market was buoyed by court decisions protecting sources of revenue earmarked for bond repayment and prohibiting state legislatures from violating convenants on outstanding issues. These developments resulted in further sizable drops in yields on lesser rated corporate and municipal securities. As a result, spreads between relatively low- and high-rated issues in both sectors continued to fall throughout most of 1977 and by the year-end were close to their pre-recession levels.

The general stability of long-term yields in 1977, and indeed throughout the current economic recovery, stemmed from several factors. Perhaps the most important was the absence of an acceleration in the rate of inflation, which had so often occurred in previous economic upswings. The fact that inflation did not accelerate in the current economic expansion probably served to moderate the inflation premium built into the structure of long-term yields. The Federal Reserve's responses to rapid monetary expansion in 1977 and its announcements of further reductions in its monetary growth ranges evidently also played an important role in dampening inflationary expectations and thus helped moderate the upward pressures on yields that typically develop during recovery periods.

MONEY STOCK GROWTH IN 1977. Growth of the monetary aggregates finally began to slow, as the year drew to a close. Nevertheless, the expansion of the aggregates for the year as a whole was high relative to the FOMC's projections. Measured from the fourth quarter of 1976 to the fourth quarter of 1977, M_1 advanced by 7.4 percent (Chart 5), above the 4½ to 6½ percent range announced for that period. Growth rates of the broader aggregates were close to the upper bounds of their respective ranges, with M_2 increasing by 9.6 percent and M_3 by 11.6 percent.

The relatively high rates of growth of the monetary aggregates in 1977 did not signal any change in the System's long-run strategy of gradually reducing monetary expansion to noninflationary levels. In fact, the FOMC underscored its determination by announcing further reductions in its one-year growth ranges for the aggregates extending into 1978. In a series of steps during the year, the FOMC reduced both the upper and the lower bounds of the M_2 and M_3 ranges by 1 percentage point. At the close of the year, the range for M_2 over the four quarters ending in the third quarter of 1978 stood at 6½ to 9 percent, while the range for M_3 was 8 to 10½ percent. By comparison, the initial ranges adopted for these aggregates when the FOMC first began specifying them for annual periods in the spring of 1975 had been 8½ to 10½ percent and 10 to 12 percent, respectively.

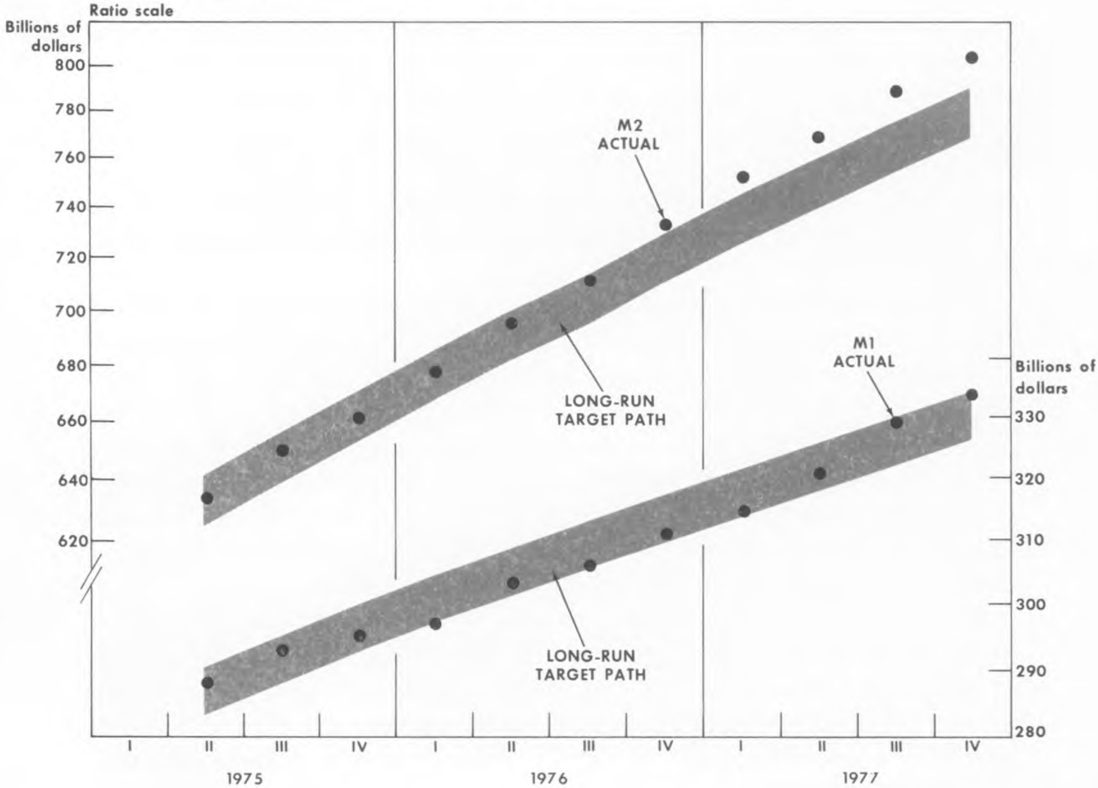
In view of the uncertainties surrounding the behavior of M_1, the FOMC made only one small change during the year in its projected long-run growth. At the July FOMC meeting, the lower bound of the M_1 range was reduced by ½ percentage point, resulting in a projected expansion of 4 to 6½ percent. The initial annual range for M_1 growth had been 5 to 7½ percent.

AGGREGATE TARGETS: A LONGER RUN PERSPECTIVE. The projections for yearly growth of the monetary aggregates adopted by the FOMC since 1975 have reflected its efforts to strive for a moderate course—one that would sustain the economic recovery and provide for a gradual reduction in the rate of inflation. At times, monetary expansion has been rapid relative to the FOMC's longer run objectives, while on other occasions growth has fallen short. The procedure of updating the monetary targets each quarter and using the level of the actual money stock in the previous quarter as the base for setting the succeeding target provides for flexibility and is readily understood. But the procedure raises the potential problem that short-run deviations from monetary objectives can cumulate in one direction without formally violating the stated targets. Actually, however, such deviations have tended to be offsetting for M_1 over the period as a whole, although overruns have been apparent for the broader monetary aggregates. On balance, the overall path of monetary expansion since 1975 has been fairly close to the FOMC's longer run objectives (Chart 6).

The practice of setting aggregate targets, however, raises many technical as well as fundamental issues. The technical considerations include just which aggregates should be targeted, what relative weights they should receive, and how they should be controlled, through short-run control of interest rates or of reserves. It also raises the question of the circumstances under which monetary targets should be modified or even temporarily given a back seat to domestic or international financial considerations. More fundamentally, there is the issue of what levels of monetary growth are compatible with satisfactory economic performance and further progress in bringing down inflation.

Resolving these issues with existing knowledge continues to be a matter of difficult judgment and a source of much current debate. But that debate should not obscure the basic importance of maintaining the procedure of targeting monetary aggregates in the present inflationary environment. Reducing monetary expansion over the long run to more moderate levels is a necessary condition for restoring general price stability and sustaining balanced growth. While monetary

Chart 6. MONEY STOCK LEVELS RELATIVE TO THE FEDERAL OPEN MARKET COMMITTEE'S LONG-RUN PROJECTIONS



The long-run target paths are constructed by extending a trend line (not shown) for each monetary aggregate from its actual value in the second quarter of 1975 at rates equal to the midpoints of the one-year ranges adopted each quarter by the FOMC. The shaded areas shown are drawn parallel to each trend line with the upper and lower bounds 1¼ percentage points above and below it. This reflects the FOMC's practice of expressing its one-year projections as ranges, which have averaged about 2½ percentage points in width.

policy alone cannot accomplish these goals, aggregate targeting, however imprecise and imperfect, can help provide the monetary framework in which they can be achieved.

Banking Supervision

The nation's banking and financial system had emerged from the severe financial turbulence of 1974 and 1975 without an undermining of its foundation of stability, and in 1976 made a good recovery from the difficulties caused by rampant inflation and a serious recession. While the recovery attested to the substantial resilience of the nation's financial system, the nature and dimensions of the strains imposed on banking institutions suggested it would be in the public interest to strengthen supervision of the nation's banks and bank holding companies.

The Federal Reserve, therefore, reviewed a number of measures to improve its supervisory capabilities, and in 1977 implemented several new initiatives and broadened or strengthened a number of existing programs. These steps were taken to promote sound banking and to improve the Federal Reserve's ability to deal with any future pressures that might impinge on the nation's financial system. It was expected that further safeguarding the nation's banking institutions would contribute to more effective monetary policy, which operates on and through the banking system. The Federal Reserve Bank of New York participated actively in the development of many of these programs.

The new supervisory initiatives placed major emphasis on improvements in on-site examinations of the offices and subsidiaries of member banks and bank holding companies, and on more effective utilization of information reported between scheduled examinations. Also, during the year, the Federal Reserve Bank of New York helped launch a new program to develop uniform examination information pertaining to large business loans extended by commercial banks in concert with other banks. This Bank established a nationwide, computerized file of "shared national credits", for use by the Federal bank regulatory authorities, which will eliminate the need for a separate supervisory evaluation of a shared credit held by each participating bank.

Throughout the Federal Reserve System, the training and proficiency of field examination staffs were reappraised and strengthened where necessary and measures were taken to promote increased efficiency. During the year, for example, this Bank introduced a new "compacted" examination for state member banks in this District having an established record of largely trouble-free operations. The new procedure has freed staff resources for broadening and strengthening supervision where most needed.

As part of the general review of programs and measures to improve its ability to supervise and evaluate risk exposure at banking organizations, the Federal Reserve focused during the year on the "country risk" aspects of foreign lending by United States commercial banks. Such lending has grown rapidly in recent years, as a result both of the external borrowing requirements of countries experiencing external payments imbalances and of the rapid growth of international banking. A committee of high-ranking officials of the Federal Reserve System was appointed to conduct a study of foreign lending by major United States banks. Its purpose was to review commercial bank techniques for monitoring and controlling foreign credits and to develop improved Federal Reserve procedures for assessing the foreign exposure of specific banks as part of the examinations process. The primary emphasis of this improved approach is to encourage adequate internal risk management and to identify potentially troublesome concentrations of foreign loans at individual banks. This approach should improve substantially the Federal Reserve's ability to evaluate the impact, if any, of country risk exposure on a bank's financial condition.

In more specialized fields, the Bank expanded its inspection programs dealing with bank internal audit and control functions and loans to insiders, and implemented new programs covering stock transfer agents and municipal securities dealers. This Bank also played an important role in Federal Reserve implementation of computerized techniques to analyze more effectively the financial information reported by banking organizations.

To help meet its new responsibilities in the enforcement of consumer protection laws and regulations and to promote a wider understanding of those requirements, this Bank initiated as part of a Systemwide effort a two-pronged program developed by the Federal Reserve Board to ensure compliance by member banks with the consumer protection laws. One phase of this program provides extensive educational and consultation services to member banks. The educational effort is coupled with special consumer compliance examinations to uncover any violations of consumer protection laws and to remedy promptly these violations.

THE SECOND DISTRICT

Economic Developments

The Second District began showing some signs of renewed vitality last year, although the District's recovery continued to lag behind the nation's economic expansion. At the same time, a measure of stability returned to the fiscal affairs of New York State and to those of its municipalities and agencies that had experienced financing problems during the previous two years. Indeed, such fiscally distressed cities as Yonkers and Buffalo regained access to the credit market. Among the overall positive developments in the District were an expansion in private employment, an increase in construction activity, and a relative moderation in the rate of price increases. These improvements were especially noteworthy since they occurred despite steel plant layoffs, agricultural losses due to severe fall weather conditions, and a two-month dockworkers' strike against containerized shipping.

New York City, however, did not fully share in the gradual economic and financial recovery that characterized much of the District. The provisions of the Federal Seasonal Loan Act of 1975, which established a $2.3 billion line of credit to New York City through June 1978, called upon the city to try to satisfy its borrowing needs in the public marketplace. Accordingly, in November, New York City attempted to reenter the credit market. Although the notes that the city proposed to sell were to be backed by segregated state-aid revenues, they nevertheless received the lowest investment grade rating from Moody's Investors Service and the offering was canceled. While municipal employment has been sharply reduced since mid-1975, accounting and reporting procedures revised, and management reforms and productivity measures introduced, these efforts continued to be outweighed by the remaining areas of uncertainty surrounding the city's financial future. Among the complex issues with which New York City must contend in coming months are the development of a new financial plan to cover the city's short-term and long-term needs, the adoption of a credibly balanced budget for fiscal 1979, the establishment of a review-and-control mechanism to replace the temporary Emergency Financial Control Board, forthcoming negotiations with the municipal unions as the contracts of almost 300,000 workers expire, and the continued phasing-out of current expense items from its capital budget. Compounding these difficulties are questions regarding the levels of future Federal and state aid, and possible new Federal financing assistance.

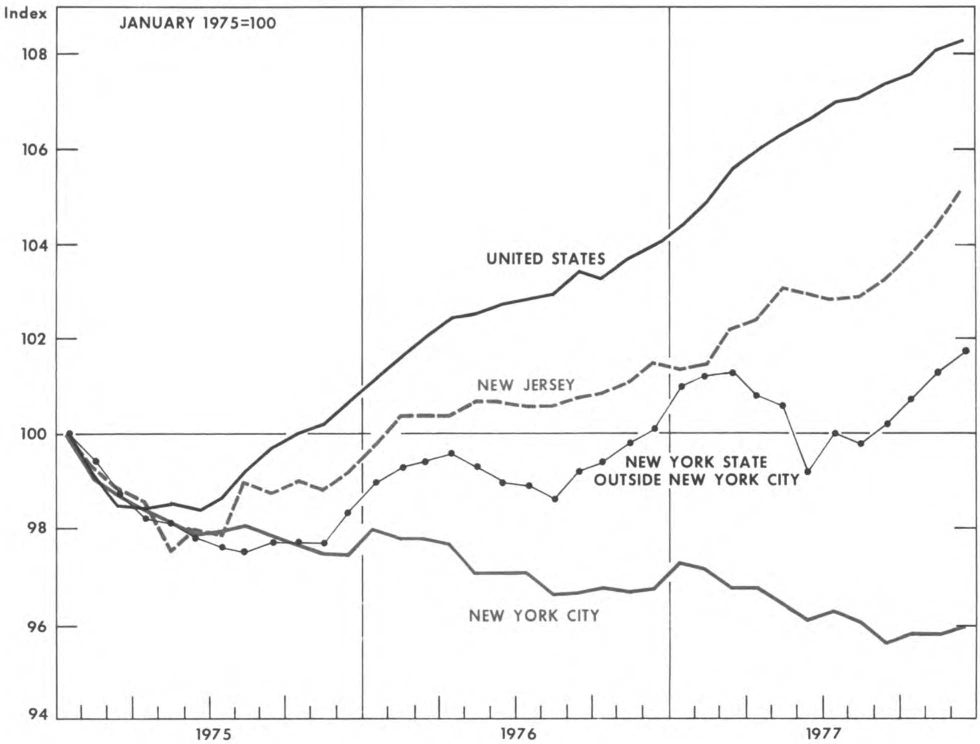
The ongoing fiscal problems of New York City during 1977 were aggravated by the sluggishness in its economy. In contrast to the rest of the District, retail sales activity in the city declined in 1977. Although many of the city's large department stores reported an unexpectedly sharp upturn in year-end sales volume, lagging sales during the year forced at least three major general merchandise chains to close unprofitable branch stores located in New York City. Several large corporation headquarters also moved out of the city. While the destinations of many of these departing firms were nearby counties, such as Fairfield County, Connecticut, others relocated outside the region.

Labor market conditions in New York City were also less favorable than elsewhere in the District. Jobless rates declined in the District as government employment expanded due to Federally funded programs and private job-holding increased moderately. In New York City, too, unemployment rates fell during 1977, but this did not really indicate any basic improvement since the decline stemmed from a drop in the labor force together with the rise in government employment. Private employment continued to edge downward, although at a more moderate rate than was experienced in previous years (Chart 7). Employment in both manufacturing and nonmanufacturing industries decreased.

The lingering weakness in New York City's private sector resulted from a wide range of deep-seated economic problems as well as from the fiscal situation. Frequently mentioned as obstacles to private investment are the high rates and the multiplicity of local and state taxes and charges, the difficulty in attracting middle level management, the inflexible traffic and zoning regulations for the central business district, the often lengthy licensing procedures, and the relatively high energy costs. In addition, the general movements of economic activity and population southward and westward have compounded the economic troubles of the city as well as those of the District.

More recently attention has been given to the extent to which the economic and financial problems plaguing New York City and other urban areas have been aggravated by Federal programs. For instance, serious questions arise over the variety of formulas used to distribute Federal intergovernmental aid, for they seem in fact to discriminate against urban areas such as New York City by ignoring regional cost-of-living differences, by not utilizing current data, or by considering the total population as a factor rather than that portion

Chart 7. **PRIVATE NONFARM PAYROLL EMPLOYMENT**



All data are seasonally adjusted.

of the population that the program aims at. In other instances, national programs may be biased against older urban areas, as in the case of mass transit support which traditionally has favored the funding of new capital projects rather than maintaining and improving existing facilities.

Notwithstanding all these difficulties, 1977 saw a number of developments which are likely to strengthen the city's and therefore the District's economy. Newer Federal formulas for distributing aid, such as those used in revenue sharing and some block grant programs, are generally more helpful to urban areas than the older categorical grants. In attacking such problems as unemployment or substandard housing, these newer formulas tend to incorporate more direct measures of need, such as unemployment rates or age of housing, rather than a proxy, such as personal income.

In New York City, an Economic Recovery Plan was adopted to foster the growth of local business and industry. As a first step in this effort, the city eliminated some business taxes and reduced several others. In contrast to the sharp escalation in the real estate tax rate which has occurred since 1960, the city's attempt to stabilize this rate is noteworthy. New York State, too, in its fiscal 1979 budget proposed sizable cutbacks in both personal and business taxes. Foreign companies, particularly in financial industries, found the region and especially New York City attractive. They became a source of new employment opportunities and gave impetus to the previously lagging rental market. Indeed, the supply of office space in some areas of the city is now inadequate to meet the strong demand. To some extent, this increase is due to the reversal by some companies of their previously announced decisions to leave the city. One of these, a large industrial corporation, now intends to buy the building in which it currently rents space. The planned construction of several new hotels in the city will provide jobs in the coming months for building trades workers, who have suffered from persistently high unemployment. Other spurs to their employment may come from such proposed capital projects as a convention center, new or refurbished mass transit facilities, or the reconstruction of the lower portion of the West Side Highway, if any of these should reach fruition. Also of long-term importance to the District's overall competitive posture is the fact that during 1977 inflation rates continued to be more moderate locally than nationwide.

The actions taken to combat New York City's continuing multitude of fiscal and economic problems are a necessary beginning, but they have not yet been sufficient to restore to the city fiscal independence and private sector stability. In particular, during the final months of fiscal 1978, as the Federal Seasonal Loan Act of 1975 nears expiration, New York City must accelerate its efforts to assure budgetary balance and a stable cash flow without resorting to self-defeating measures for increasing revenues or decreasing vital expenditures. The reestablishment of fiscal integrity remains a key element in retaining the cooperation of the Federal and state governments as well as in reversing the city's economic decline and restoring its access to the credit market.

The Banking Scene

Commercial banks in the Second District, as elsewhere in the nation, began 1977 with a substantial overhang of problem loans that developed in the wake of the inflation and recession and related difficulties of the prior few years. Even as 1977 started, however, the vast majority of banks were making significant progress toward resolving these difficulties. Along with their efforts to restore troubled loans to a more viable status, commercial banks continued to make prudent deductions from operating revenues to provide for the possible future write-off of losses where full recovery of principal might not be possible. These deductions had been rather high in 1976, thus retarding the growth of net earnings at many banks, and they continued to be substantial well into 1977. As the year progressed, however, such deductions from operating revenues seemed to be declining, and for the entire year the aftertax income of practically all the large money center institutions, which account for the great bulk of the Second District's banking assets, showed a significant increase.

The District's member banks experienced relatively moderate growth in total loans and total assets during 1977. At money center banks, the growth of loans at foreign offices was substantially more rapid than at domestic offices; nonetheless, on average, these institutions' ratio of total loans to total domestic and foreign assets (adjusted to exclude collection items) recovered moderately to just under 61 percent by the end of the year. This ratio had reached a peak of 64 percent in 1974. Facing moderate growth of the domestic demand for most types of business credit, the District's money center banks rebuilt their United States Government securities holdings during most of the year. With risk assets (mainly loans) increasing slowly, the ratio of capital to risk assets at the money center banks remained just above 6½ percent during most of 1977, compared with 6.8 percent at the end of 1976.

Most of the smaller member banks throughout the Second District also experienced improved operating results. Many banks, however, especially those in upper New York State metropolitan markets, bore the brunt of new competitive pressures. These pressures stemmed from the entry of state-chartered thrift institutions into the market for nonbusiness checking accounts after the state legislature empowered these institutions to offer this type of account and to extend small personal loans, effective May 1976. To monitor developments in this area, a special quarterly survey of nonbusiness deposits has been conducted by this Bank in cooperation with the New York State Banking Department since the latter part of 1976. The latest survey, as of September 30, 1977, showed that the state's thrift institutions had captured about 5.7 percent of the dollar volume of nonbusiness demand deposits reported by respondents and 15 percent of the total number of these accounts. Despite the rapid growth of nonbusiness demand deposits at thrift institutions in New York State, these institutions' share of all nonbusiness deposits—demand, savings, and time accounts—stayed close to 71.5 percent while their share of the total number of all types of nonbusiness accounts advanced from 49.2 percent in June 1976 to 51.9 percent by September 30, 1977.

The significance of these figures is somewhat blurred by the possibility that some holders of savings and time deposits at thrift institutions may have shifted a portion of their funds into new checking accounts at the same institution. Growth in the dollar volume of existing accounts at commercial banks may have offset shifts to thrift institutions. Nonetheless, other evidence from the survey indicated that respondent thrift institutions offering nonbusiness checking services generally had better experience with respect to both the number and the dollar volume of savings accounts than those institutions that do not offer the service. Further, many commercial banks that sustained losses in the dollar volume and in the number of nonbusiness demand accounts since May 1976 fared worse than other respondents with respect to time and savings accounts.

While it will take some time to develop evidence on the impact of the new thrift competition on bank profits, it appeared from the survey that thrift institutions in New York State have improved their competitive position. Thrift institutions are permitted higher interest ceilings on regular savings and time accounts under Federal law than those permitted commercial banks and, through their new checking powers, more recently have broadened the range of services they can offer the nonbusiness public. Thus, the widened role of New York State thrift institutions brings into focus the continuing problem of equitable regulatory treatment of commercial banks and thrift institutions where both are providing essentially similar services.

THE BANK IN 1977

Operational Highlights

The Bank realized significant gains in operational efficiency and expense control during 1977, as the full impact of managerial innovations made during several previous years became more visible. Productivity increased more than 10 percent in measurable activities, such as check processing and currency handling, and the increase in total expenditures was held to 4 percent, the smallest such rise in more than a decade. The most significant contribution to the productivity gain and the modest increase in expenditures was the Bank's success in managing the size of its work force. Between December 31, 1976 and December 31, 1977, the work force was reduced by more than 6 percent to 4,582 employees, the lowest year-end total since 1969. Mechanization or automation of certain operations, tighter management control over work flows, and improved employee efficiency also contributed to these developments.

The managerial and operational improvements realized in 1977, taken in the context of the continued growth in the volume and complexity of the Bank's operations, underscored the needs of the future as well as the accomplishments of the past. Consistent with this, the Bank took important steps during 1977 to shape its organizational structure and enhance its physical facilities to meet future challenges.

A series of major organizational changes directed at strengthening the Bank's ability to deal with a variety of critical issues was initiated during the year. These changes saw the appointment of a senior vice president and senior adviser with responsibility for issues related to System membership, access and pricing of Federal Reserve services, consumer-related policies and programs, the growth of electronic funds transfer systems, and relations with member banks. The Bank also consolidated responsibility for human resource management, budgeting, planning, and systems development into a newly formed management and planning group, a move intended to assure greater cohesion and more effective coordination of internal resource management.

In addition, in mid-1977, following extensive negotiations, an agreement was reached with the Home Insurance Company to lease fifteen floors, or 310,000 square feet, in its building at 59 Maiden Lane. The agreement provides the basis for a multiyear plan to relocate selected Bank operations in the Home facility by year-end 1980. The new leasehold space provides a convenient, flexible, and cost-effective means of consolidating operations now situated in four separate buildings in the downtown area into a single location convenient to the main building. Employees are scheduled to begin moving into the new premises in 1978; the Bank expects ultimately to accommodate approximately 1,300 employees in this facility.

SERVICING THE PAYMENTS MECHANISM. During 1977, concern over the decline in System membership heightened, partly because the changing characteristics of depository institutions and related changes in the technological and institutional features of the payments mechanism brought the pros and cons of System membership into sharper focus. At midyear the Bank's directors issued a policy statement setting forth general principles providing a basic framework for addressing this and several related problems.

Specifically, the directors said that four major issues should be considered immediately: the burden of required reserves on member banks, the effect of the membership question on the ability of the Federal Reserve to conduct monetary policy, the need for uniform reserve requirements on new forms of customer payment accounts, and equitable provision of Reserve Bank services to members and nonmembers. They noted that, "Once the reserve burden of membership is substantially eliminated, the System should provide services to members and nonmembers on the basis of explicit prices and in a manner . . . consistent with System programs and commitments designed to foster the development of a more efficient payments mechanism".

While it is presently difficult to foresee the pace at which electronic funds transfer systems will evolve or to predict the Federal Reserve's future activities in this area, strides clearly are being made in eliminating paper payment procedures. For example, substantial increases in volume have taken place under the Federal recurring payments program, jointly undertaken by the Treasury and the Federal Reserve to convert certain Government check payments to electronic form. The Bank's Head Office processed about 700,000 monthly entries under this program during 1977, an increase of 28 percent over last year.

Further progress was also made during 1977 toward eliminating the use of definitive securities for Treasury and Government agency debt. As of September 1977, all new issues of United States Treasury bills were available only in book-entry form. At the year-end, some $506 billion, or 93 percent, of all marketable Treasury and agency debt was in book-entry form. Some $38 billion of securities continues to be held in definitive form, primarily by insurance companies, mutual funds, and fiduciaries, organizations currently required by law or regulation to hold securities in definitive form. Efforts are continuing to enact legislation or regulations to permit these institutions to hold Government securities in book-entry form. In December, the Bank also terminated end-of-day physical settlements resulting from transfers of Government securities under the New York Government Securities Clearing Arrangement.

The volume of electronic transfers of securities and Federal funds processed by the Bank's telecommunications system rose by almost 13 percent during 1977. The daily average dollar volume of this traffic reached $96 billion. The daily average volume of transactions processed has been rising at an annual rate of about 22 percent since 1970, when the system was first introduced. During 1977, the Bank undertook and completed a major upgrading of its telecommunications computer facilities to ensure adequate processing capacity through the early 1980's, when a new Federal Reserve communications facility will be opened.

Despite the growing use of electronic forms of payment, the financial system still generates increasing amounts of paper payments, a large portion of which flows through Reserve Banks. During 1977 the volume of conventional checks processed by the Bank rose by 9.7 percent to 1.6 billion items. This growth reflects, to some extent, a continuing shift in the correspondent check collection business from the private sector to the Federal Reserve System. The shift is the result largely of the improved transportation facilities provided through Federal Reserve check clearing services. The Bank's ability to handle this growing volume with increasing efficiency was enhanced by the first full year of operation of the Northeastern New York Regional Check Processing Center at Utica and by the installation of new processing equipment at the Head Office.

During 1977, the Bank was one of three Federal Reserve Banks to participate in a pilot program for testing and evaluating high-speed currency processing equipment. This effort is expected to culminate in a recommendation to buy and use this equipment, which should facilitate further productivity gains.

TRADING DESK ACTIVITY AND BANK OPERATIONS. During 1977, the dollar value of open market transactions in United States Government and agency securities conducted by this Bank for its own account and for the System Open Market Account rose by approximately 38 percent to $1.3 trillion.

Over a three-year period, the volume of these transactions rose nearly fourfold. Most of the transactions are designed to offset the undesirable impact market and other forces have on bank reserves. For example, in 1977, Treasury cash management policies continued to produce frequent and sharp swings in Treasury cash balances at Reserve Banks. These swings resulted in fluctuations in bank reserve positions which, in many instances, had to be offset by open market operations.

Late in the year, however, the President signed into law a new Treasury Tax and Loan Investment Program, which is expected to reduce fluctuations in Treasury cash balances in the future and accordingly to reduce the volume of Trading Desk operations needed to offset fluctuations in reserve balances. Under the program, the Treasury is authorized to invest its cash balances in interest-bearing obligations at those depositories that elect to hold Treasury cash. As part of the program, institutions will also have the option of remitting Federal tax deposit balances directly to the Federal Reserve Banks. At the same time, the Treasury will pay fees to depositories for certain related services.

By the year-end, thirty-six Government securities dealers—an increase of seven over the past two years—were reporting their daily transactions volume and inventories to the Bank. Federal Reserve open market operations are conducted by the Bank with most of the dealers. The Bank closely monitors developments in the dealer market, primarily through statistical and financial reports. It has expanded its surveillance of reporting firms through individual visits. The goal is to gain further insight into market practices and to evaluate the activities of the firms themselves.

The volume of transactions conducted in the domestic securities markets by this Bank on behalf of foreign central banks and monetary authorities continued to increase rapidly in 1977, partly because of the buildup of dollar balances accumulated abroad in the wake of the large United States balance-of-payments deficit. At the year-end, the Bank held in custody for such organizations $75 billion of marketable United States Treasury securities, up about $25 billion.

Activity in the New York foreign exchange market rose sharply in response to several factors. Among these were the influx of foreign banking institutions to the United States market, the growth in lending abroad by United States institutions, and the efforts of United States multinationals to centralize their foreign exchange operations in this country as a response to the increased volatility in foreign exchange rates and expanded international trade and capital flows. The New York Federal Reserve Bank acts on behalf of the Federal Open Market Committee and the United States Treasury in foreign exchange operations. As part of its ongoing effort to expand market contacts and to ensure orderly development for foreign exchange markets in the United States, the Bank undertook a comprehensive study of foreign exchange trading in the New York market during 1977, together with other studies of foreign exchange market structure and current market practices. The Bank is working to establish a foreign exchange advisory group to provide a forum in which issues of mutual concern to market participants might be discussed.

Contacts between central banks in developing and smaller industrialized countries and this Bank have continued to increase. These contacts have generated considerable interest in the workings of financial markets and central bank operations in this country. In October, the Bank sponsored a three-week central banking seminar attended by participants from forty-eight countries. The seminar, which covered a wide range of financial and operations topics, was held principally at this Bank but included brief visits to other financial institutions and the office of the Board of Governors of the Federal Reserve System.

Financial Statements

STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1977 AND 1976 (In dollars)

	1977	1976
Total current earnings	1,702,740,726	1,708,961,080
Net expenses	131.678,202	125,814,553*
Current net earnings	1,571,062,524	1,583,146,527
Additions to current net earnings:		
Profit on sales of United States Government securities and Federal agency obligations (net)	—0—	7,911,034
All other	3,740,033	458,243
Total additions	3,740.033	8,369,277
Deductions from current net earnings:		
Loss on foreign exchange transactions (net)†	37,474,391	6,444,044
Loss on sales of United States Government securities and Federal agency obligations (net)	11,783,645	—0—
All other	659,296	3,827,499
Total deductions	49,917,332	10,271,543
Net deductions	46,177,299	1,902,266
Assessment for the Board of Governors	12,048,600	10,779,100*
Net earnings available for distribution	**1,512,836,625**	**1,570,465,161**
Dividends paid	15.319,899	14,736,448
Payments to United States Treasury (interest on Federal Reserve notes)	1,482,064,726	1,543,777,313
Transferred to surplus	15,452,000	11,951,400
SURPLUS ACCOUNT		
Surplus—beginning of year	251,256,950	239,305,550
Transferred from net earnings for year	15,452,000	11,951,400
Surplus—end of year	**266,708,950**	**251,256,950**

* Effective January 1, 1977, this Bank's "Assessment for the Board of Governors", formerly included in "Net expenses", is shown as a separate deduction from current net earnings; the 1976 figures have been restated to reflect this change.

† Reflects further repayments of System swap commitments outstanding since August 1971. Larger repayments occurred in 1977 following an agreement with the Swiss National Bank, in October 1976, for the orderly repayment over three years of remaining Swiss franc swap drawings. Partially offsetting the losses are modest profits realized from current foreign exchange operations in both years.

STATEMENT OF CONDITION

In dollars

Assets	DEC. 31, 1977	DEC. 31, 1976*
Gold certificate account	3,492,174,498	3,349,952,359
Special Drawing Rights certificate account	313,000,000	300,000,000
Other cash	18,079,848	29,337,794
Total	3,823,254,346	3,679,290,153
Advances	102,800,000	2,875,000
Acceptances:		
Bought outright	†	196,305,703
Held under repurchase agreements	953,597,256	794,831,023
United States Government securities:		
Bought outright‡	23,819,212,000	21,937,483,000
Held under repurchase agreements	1,901,000,000	3,752,800,000
Federal agency obligations:		
Bought outright	1,889,089,015	1,597,951,337
Held under repurchase agreements	451,000,000	278,100,000
Total loans and securities	29,116,698,271	28,560,346,063
Other assets:		
Cash items in process of collection	1,450,436,176	1,831,543,968
Bank premises	9,207,030	17,355,589
Due from Federal Deposit Insurance Corporation§	—0—	650,000,000
All other¶	492,282,697	688,457,188
Total other assets	1,951,925,903	3,187,356,745
Interdistrict settlement account	(1,312,886,283)	(3,763,077,956)
Total Assets	**33,578,992,237**	**31,663,915,005**

* The 1976 figures have been restated to reflect the following accounting changes made effective January 1, 1977: (a) the asset account "Federal Reserve notes of other Banks" has been netted against the liability account "Federal Reserve notes"; (b) the asset accounts "United States notes" and "Other United States currency", which had been included in "Other cash", are now included in "Other assets".

† In March 1977, in accordance with a directive from the Federal Open Market Committee, this Bank discontinued the outright purchases of bankers' acceptances.

‡ Includes securities loaned—fully secured	135,935,000	195,425,000

§ In connection with the closing of Franklin National Bank and paid on October 7, 1977.

¶ Includes assets denominated in foreign currencies.

STATEMENT OF CONDITION

In dollars

Liabilities	DEC. 31, 1977	DEC. 31, 1976
Federal Reserve notes	23,678,138,605	21,331,734,210*
Deposits:		
Member bank reserve accounts	5,783,978,634	4,820,158,559
Due to other Federal Reserve Banks—collected funds	—0—	164,577,396
United States Treasury—general account	1,398,528,731	2,464,102,743
Foreign†	173,647,386	176,558,876
Other	688,984,628	885,675,171
Total deposits	8,045,139,379	8,511,072,745
Other liabilities:		
Deferred availability cash items	990,862,184	1,041,267,832
All other	331,434,169	277,326,318
Total other liabilities	1,322,296,353	1,318,594,150
Total Liabilities	**33,045,574,337**	**31,161,401,105**
Capital Accounts		
Capital paid in	266,708,950	251,256,950
Surplus	266,708,950	251,256,950
Total Capital Accounts	**533,417,900**	**502,513,900**
Total Liabilities and Capital Accounts	**33,578,992,237**	**31,663,915,005**

* This figure has been restated to reflect an accounting change made effective January 1, 1977—the asset account "Federal Reserve notes of other Banks" has been netted against the liability account "Federal Reserve notes".

† After deducting participations of other Federal Reserve Banks amounting to 205,120,800 175,125,100

Changes in Directors and Senior Officers

CHANGES IN DIRECTORS. In a special election of directors held on April 15, 1977, member banks in Group 2 elected Raymond W. Bauer a Class A director. Mr. Bauer, Chairman and President of United Counties Trust Company, Elizabeth, N.J., succeeded Stuart McCarty, who had resigned as a Class A director effective April 1, 1977. Mr. McCarty, Chairman of First-City National Bank of Binghamton, N.Y., and Executive Vice President of Lincoln First Banks Inc., Rochester, N.Y., had served as a Class A director since January 1975. In December 1977, Mr. Bauer was reelected by the member banks in Group 2 to a three-year term as a Class A director beginning January 1, 1978.

Also effective April 15, 1977, member banks in Group 3 elected John R. Mulhearn a Class B director. Mr. Mulhearn, President of the New York Telephone Company, was elected to serve for the unexpired term, ending December 31, 1978, of Jack B. Jackson, who resigned as a Class B director effective February 1, 1977. Mr. Jackson, formerly President of J. C. Penney Co., Inc., New York, N.Y., had served as a Class B director since January 1973.

In June 1977, the Board of Governors of the Federal Reserve System appointed Boris Yavitz a Class C director of the Bank for the term ending December 31, 1979. Mr. Yavitz, Dean of the Graduate School of Business at Columbia University, succeeded Alan Pifer, President of the Carnegie Corporation of New York, whose term had expired. In January 1978, the Board of Governors appointed Mr. Yavitz as *Deputy Chairman* of the board of directors for the year 1978.

In December 1977, member banks in Group 2 reelected William S. Sneath a Class B director for a three-year term beginning January 1, 1978. Mr. Sneath, Chairman of the Board of Union Carbide Corporation, New York, N.Y., has served as a Class B director since August 15, 1973.

Also in December, the Board of Governors reappointed Robert H. Knight a Class C director of this Bank for a three-year term beginning January 1, 1978, and designated him *Chairman* of the the board of directors and *Federal Reserve Agent* for the year 1978. Mr. Knight, a partner in the New York law firm of Shearman & Sterling, had been serving as a Class C director and as *Deputy Chairman* since February 1976. As *Chairman* and *Federal Reserve Agent*, he succeeded Frank R. Milliken, who resigned as a Class C director effective December 31, 1977. Mr. Milliken, President of Kennecott Copper Corporation, New York, N.Y., had been serving as a Class C director since January

1973 (and previously as a Class B director in 1972); he served as *Deputy Chairman* during 1973, 1974, and 1975, and since January 1976 had been serving as *Chairman* and *Federal Reserve Agent.*

Harry J. Taw resigned as a Class A director effective January 3, 1978. Mr. Taw, President of the First National Bank of Cortland, Cortland, N.Y., had served as a Class A director since January 1976.

In February 1978, the Board of Governors appointed Gertrude G. Michelson a Class C director of the Bank. Mrs. Michelson, Senior Vice President of Macy's New York, was appointed to serve for the unexpired term, ending December 31, 1978, of Frank R. Milliken, who resigned as noted above.

Buffalo Branch. In December 1977, the board of directors of this Bank designated Donald R. Nesbitt, Sr., as *Chairman* of the board of directors of the Buffalo Branch for the year 1978. Mr. Nesbitt, who is the owner and operator of Silver Creek Farms, Albion, N.Y., has been a director of the Branch since January 1973 and was Chairman of the Branch Board during 1975. At the same time the board of this Bank appointed William S. Gavitt a director of the Buffalo Branch for a three-year term beginning January 1, 1978. Mr. Gavitt is President of The Lyons National Bank, Lyons, N.Y. On the Branch Board, he succeeded Charles A. Marks, President of Alden State Bank, Alden, N.Y., who had been serving as a Branch director since January 1976. Also in December 1977, the Board of Governors reappointed Paul A. Miller a director of the Buffalo Branch for a three-year term beginning January 1, 1978. Mr. Miller, President of the Rochester Institute of Technology, Rochester, N.Y., has been a director of the Branch since January 1975 and was *Chairman* of the Branch Board during 1977.

CHANGES IN SENIOR OFFICERS. The following changes in the official staff at the level of Vice President and above have been made since January 1977:

Robert L. Cooper, Vice President, retired on May 1, 1977, after completing more than forty-four years of service. Mr. Cooper joined the Bank's staff in 1932 and became an officer in 1960.

Thomas C. Sloane, Senior Vice President, was appointed Senior Vice President and Senior Adviser, effective June 1, 1977. In this position, Mr. Sloane is responsible for advising the Bank's directors and senior management on issues relating to System membership, Federal Reserve services, member bank relations, consumer affairs, and payment systems developments.

Paul B. Henderson, Jr., formerly Vice President, was appointed Senior Vice President effective June 1, 1977, and assigned responsibility for the Operations Group and for a newly established Systems Development Function. At the same time, the Operations Group, which had consisted of the Cash and Collection, Check Processing, and Government Bond and Safekeeping of Securities Functions, was expanded to include a newly structured Data Processing Function, responsible for the operation of the Bank's central computer installations. Geri M. Riegger joined the Bank as a Vice President on June 1, 1977, and was assigned as the officer in charge of the Systems Development Function. Herbert W. Whiteman, Jr., joined the Bank as a Vice President effective July 1, 1977, and was assigned as the officer in charge of the Data Processing Function.

E. Gerald Corrigan, Vice President, was assigned as the officer in charge of the newly established Management and Resource Planning Group effective June 1, 1977. Initially the group consisted of the Personnel Function and a new Planning and Control Function. Effective January 1, 1978, the group was expanded to include the Systems Development Function.

The former Building and Planning Function was restructured and renamed the Building Services Function effective June 1, 1977, responsibility for which was assigned to Robert E. Lloyd, Jr., Vice President.

A. Marshall Puckett, Vice President, formerly the officer in charge of the Accounting Control Function, was assigned to the Bank Supervision Function, effective June 1, 1977, with general supervisory responsibility for analytical work in banking and related financial markets. When Frederick C. Schadrack, Vice President, commenced a leave of absence in August 1977, to serve as Deputy Director of the Division of Banking Supervision and Regulation of the Board of Governors, Mr. Puckett, in addition to his other duties, assumed Mr. Schadrack's responsibilities in the regulation and application areas of the function.

Margaret L. Greene, formerly Assistant Vice President, was appointed Vice President, effective June 1, 1977, and was assigned supervisory responsibility for activities in the Foreign Function relating to foreign exchange operations, under Scott E. Pardee, Vice President.

William H. Braun, Jr., Vice President, was assigned responsibility, effective September 1, 1977, for the development and direction of a program to enhance the overall security of Bank procedures, telecommunications, electronic equipment, written documents, and data. Mr. Braun's responsibility for planning in connection with high-speed, currency-handling equipment was continued.

Whitney R. Irwin, formerly Assistant Vice President, was appointed Vice President, effective September 1, 1977, and was assigned as the officer in charge of the Cash and Collection Function.

Directors of the Federal Reserve Bank of New York

DIRECTORS	*Term expires Dec. 31*	*Class*	*Group*
ELLMORE C. PATTERSON Chairman of the Executive Committee, Morgan Guaranty Trust Company of New York, New York, N.Y.	1979	A	1
RAYMOND W. BAUER Chairman and President, United Counties Trust Company, Elizabeth, N.J.	1980	A	2
VACANCY	1978	A	3
MAURICE F. GRANVILLE Chairman of the Board, Texaco Inc., White Plains, N.Y.	1979	B	1
WILLIAM S. SNEATH Chairman of the Board, Union Carbide Corporation, New York, N.Y.	1980	B	2
JOHN R. MULHEARN President, New York Telephone Company, New York, N.Y.	1978	B	3
ROBERT H. KNIGHT, *Chairman, and Federal Reserve Agent* Partner, Shearman & Sterling, Attorneys, New York, N.Y.	1980	C	
BORIS YAVITZ, *Deputy Chairman* Dean, Graduate School of Business, Columbia University, New York, N.Y.	1979	C	
GERTRUDE G. MICHELSON Senior Vice President, Macy's New York, New York, N.Y.	1978	C	

DIRECTORS—BUFFALO BRANCH

DONALD R. NESBITT, SR., *Chairman* Owner and operator, Silver Creek Farms, Albion, N.Y.	1978
KENT O. PARMINGTON Regional President, Western Region, The Bank of New York, Buffalo, N.Y.	1978
FREDERICK D. BERKELEY Chairman of the Board and President, Graham Manufacturing Co., Inc., Batavia, N.Y.	1979
M. JANE DICKMAN Partner, Touche Ross & Co., Buffalo, N.Y.	1979
WILLIAM B. WEBBER Chairman of the Board, Lincoln First Bank of Rochester, Rochester, N.Y.	1979
WILLIAM S. GAVITT President, The Lyons National Bank, Lyons, N.Y.	1980
PAUL A. MILLER President, Rochester Institute of Technology, Rochester, N.Y.	1980

MEMBER OF FEDERAL ADVISORY COUNCIL—1978

WALTER B. WRISTON Chairman of the Board, Citibank, N.A., New York, N.Y.	1978

Officers of the Federal Reserve Bank of New York

PAUL A. VOLCKER, *President*
THOMAS M. TIMLEN, *First Vice President*
ALAN R. HOLMES, *Executive Vice President*
Foreign; Open Market Operations and Treasury Issues

EDWARD G. GUY, *Senior Vice President and General Counsel*
Legal

PAUL B. HENDERSON, JR., *Senior Vice President*
Operations Group

FRED W. PIDERIT, JR., *Senior Vice President*
Bank Supervision

THOMAS C. SLOANE, *Senior Vice President and Senior Adviser*

PETER D. STERNLIGHT, *Senior Vice President*
Open Market Operations and Treasury Issues

AUDIT

JOHN E. FLANAGAN, *General Auditor*
FRANK C. EISEMAN, *Assistant General Auditor*
WILLIAM M. SCHULTZ, *Assistant General Auditor*
DONALD R. ANDERSON, *Manager, Auditing Department*
GERALD I. ISAACSON, *Manager, Audit Analysis Department*

BANK RELATIONS

THOMAS C. SLOANE, *Senior Vice President and Senior Adviser*
FRANKLIN T. LOVE, *Bank Relations Officer*

BANK SUPERVISION

FRED W. PIDERIT, JR., *Senior Vice President*
RONALD B. GRAY, *Vice President*
A. MARSHALL PUCKETT, *Vice President*
FREDERICK C. SCHADRACK, *Vice President*
LEON KOROBOW, *Assistant Vice President*
BENEDICT RAFANELLO, *Assistant Vice President*
FRED C. HERRIMAN, JR., *Manager, Domestic Banking Applications Department*
ROBERT A. JACOBSEN, *Chief Examiner*
EDWARD F. KIPFSTUHL, *Manager, Consumer Affairs and Bank Regulations Department*
RICHARD W. NELSON, *Manager, Banking Studies Department*
THEODORE N. OPPENHEIMER, *Manager, Foreign Banking Applications Department*
DONALD E. SCHMID, *Manager, Bank Analysis Department*
JOHN M. CASAZZA, *Assistant Chief Examiner*
A. JOHN MAHER, *Assistant Chief Examiner*

BUILDING SERVICES

ROBERT E. LLOYD, JR., *Vice President*
RALPH A. CANN, III, *Assistant Vice President*
A. THOMAS COMBADER, *Buildings Administrator*
MATTHEW C. DREXLER, *Manager, Building Operating Department*

ECONOMIC ADVISER

RICHARD G. DAVIS, *Senior Economic Adviser*

EQUAL OPPORTUNITY

RUTH ANN TYLER, *Equal Opportunity Officer*

FOREIGN

ALAN R. HOLMES, *Executive Vice President*
SCOTT E. PARDEE, *Vice President*
H. DAVID WILLEY, *Vice President*
MARGARET L. GREENE, *Vice President*
ROBERT J. CROWLEY, *Assistant Vice President*
JOHN HOPKINS HEIRES, *Adviser*
IRWIN D. SANDBERG, *Assistant Vice President*
THOMAS C. BARMAN, *Manager, Foreign Department*
GEORGE H. BOSSY, *Manager, Foreign Department*
GEORGE W. RYAN, *Manager, Foreign Department*
PETER R. SKORPIL, *Foreign Exchange Officer*

LEGAL

EDWARD G. GUY, *Senior Vice President and General Counsel*
JAMES H. OLTMAN, *Deputy General Counsel*
ERNEST T. PATRIKIS, *Assistant General Counsel*
DONALD L. BITTKER, *Assistant Counsel*
ROBERT N. DAVENPORT, JR., *Assistant Counsel*

Officers *(Continued)*

JANE L. DETRA, *Assistant Counsel and Assistant Secretary*
LAWRENCE D. FRUCHTMAN, *Assistant Counsel*
MARVIN D. LINDER, *Assistant Counsel*
CLIFFORD N. LIPSCOMB, *Assistant Counsel*
DON N. RINGSMUTH, *Assistant Counsel*

LOANS AND CREDITS

CHESTER B. FELDBERG, *Vice President*
SUZANNE CUTLER, *Assistant Vice President*
EUGENE P. EMOND, *Manager, Credit and Discount Department*

MANAGEMENT AND RESOURCE PLANNING GROUP

E. GERALD CORRIGAN, *Vice President*

PERSONNEL

PHILIP VAN ORMAN, *Assistant Vice President*
JOHN M. EIGHMY, *Manager, Personnel Department*
ROBERTA J. GREEN, *Manager, Personnel Department*

PLANNING AND CONTROL

LOUIS J. BRENDEL, *Adviser*
HENRY S. FUJARSKI, JR., *Assistant Vice President*
STEPHEN G. THIEKE, *Assistant Vice President*
CATHY E. MINEHAN, *Manager, Management Information Department*
ROBERT J. MISCHLER, *Manager, Resource Planning Staff*
JOHN J. STRICK, *Manager, Accounting Department*

SYSTEMS DEVELOPMENT

GERI M. RIEGGER, *Vice President*
HOWARD F. CRUMB, *Adviser*
DENIS L. CONWAY, *Manager, Custom Systems Department*
ISRAEL SENDROVIC, *Manager, Common Systems Department*

OPEN MARKET OPERATIONS AND TREASURY ISSUES

ALAN R. HOLMES, *Executive Vice President*
PETER D. STERNLIGHT, *Senior Vice President*
PAUL MEEK, *Monetary Adviser*
SHEILA L. TSCHINKEL, *Adviser*
JOHN S. HILL, *Senior Economist*
EDWARD J. OZOG, *Manager, Securities Department*
MARY R. CLARKIN, *Securities Trading Officer*
JOAN E. LOVETT, *Securities Trading Officer*

OPERATIONS GROUP

PAUL B. HENDERSON, JR., *Senior Vice President*
KARL L. EGE, *Vice President and Operations Adviser*

CASH AND COLLECTION

WHITNEY R. IRWIN, *Vice President*
JERRY BERKOWITZ, *Operations Analysis Officer*
JOHN CHOWANSKY, *Manager, Cash Department*
JOHN C. HOUHOULIS, *Manager, Cash Custody Department, and Manager, Collection Department*

CHECK PROCESSING

JAMES O. ASTON, *Vice President*
ROBERT C. THOMAN, *Vice President (Utica Office)*
JOSEPH M. O'CONNELL, *Assistant Vice President*
LEONARD I. BENNETTS, *Manager, Jericho Office*
JOSEPH P. BOTTA, *Manager, Check Processing Department*
FRED A. DENESEVICH, *Manager, Cranford Office*
EDWARD H. DENHOFF, *Operations Officer, Utica Office*
JEROME P. PERLONGO, *Manager, Check Adjustment and Return Items Department*
JOHN F. SOBALA, *Operations Analysis Officer*
HENRY F. WIENER, *Manager, Check Processing Department*

DATA PROCESSING

HERBERT W. WHITEMAN, JR., *Vice President*
PETER J. FULLEN, *Manager, Telecommunications Department*
OLEG HOFFMAN, *Manager, Computer Operations Department*
ANGUS J. KENNEDY, *Manager, User Operations Department*
GEORGE LUKOWICZ, *Data Processing Officer*
RALPH C. SCHINDLER, *Data Processing Officer*

GOVERNMENT BOND AND SAFEKEEPING OF SECURITIES

EDWIN R. POWERS, *Vice President*
RICHARD VOLLKOMMER, *Assistant Vice President*
JORGE A. BRATHWAITE, *Manager, Government Bond and Safekeeping Department*
LEON R. HOLMES, *Manager, Security Custody Department*
FRANCIS H. ROHRBACH, *Manager, Savings Bond Department*
STEPHEN P. WEIS, *Manager, Government Bond and Safekeeping Department*

PUBLIC INFORMATION

PETER BAKSTANSKY, *Vice President*
RICHARD H. HOENIG, *Assistant Vice President*
LAWRENCE A. MAYER, *Adviser*

Officers *(Continued)*

RESEARCH AND STATISTICS

PETER FOUSEK, *Vice President and Director of Research*
MICHAEL J. HAMBURGER, *Adviser*
ROGER M. KUBARYCH, *Assistant Vice President*
ANTON S. NISSEN, *Assistant Vice President*
RUDOLF THUNBERG, *Assistant Vice President*
MARCELLE V. ARAK, *Senior Economist*
STEPHEN V. O. CLARKE, *Senior Economist*
EDNA E. EHRLICH, *International Adviser*
FRED J. LEVIN, *Manager, Domestic Research Department*
CHARLES M. LUCAS, *Manager, Statistics Department*

SECRETARY'S OFFICE

TERRENCE J. CHECKI, *Secretary*
JANE L. DETRA, *Assistant Secretary and Assistant Counsel*

SECURITY AND CONTROL

WILLIAM H. BRAUN, JR., *Vice President*
GERALD HAYDEN, *Manager, Security and Control Staff*

SERVICE

FREDERICK L. SMEDLEY, *Vice President*
CECIL A. SHEPHERD, *Assistant Vice President*
LOUIS J. CONROY, *Manager, Records Management and Emergency Planning Department*
RONALD E. LONG, *Manager, Service Department*
FRANK W. LUNDBLAD, JR., *Manager, Protection Department*

OFFICERS—BUFFALO BRANCH

JOHN T. KEANE, *Vice President and Branch Manager*
PETER D. LUCE, *Assistant Vice President and Cashier*

ACCOUNTING; BANK RELATIONS AND PUBLIC INFORMATION; CHECK

ROBERT J. MCDONNELL, *Operations Officer*

BUILDING OPERATING; CASH; PROTECTION

HARRY A. CURTH, JR., *Operations Officer*

COLLECTION, LOANS, AND FISCAL AGENCY; PERSONNEL; SERVICE

GARY S. WEINTRAUB, *Operations Officer*

MANAGEMENT INFORMATION

PETER D. LUCE, *Assistant Vice President and Cashier*

THE SECOND FEDERAL RESERVE DISTRICT