76th Annual Report 1989

Board of Governors of the Federal Reserve System

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Letter of Transmittal

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., May 7, 1990

THE SPEAKER OF
THE HOUSE OF REPRESENTATIVES

Pursuant to the requirements of section 10 of the Federal Reserve Act, I am pleased to submit the Seventy-Sixth Annual Report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 1989.

Sincerely,

Chairman

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Part 1

Monetary Policy and the U.S. Economy in 1989

Introduction

The U.S. economy in 1989 recorded its seventh consecutive year of expansion. Although growth was slower than in either of the preceding two years, it was sufficient to support the creation of 2½ million jobs and to hold the unemployment rate steady at 5¼ percent, the lowest reading since the early 1970s. Inflation remained undesirably high, but the pace was less than many analysts had predicted, with softness in the prices of imported goods helping to offset persistent domestic cost pressures. On the external front, the trade and current account deficits shrank further in 1989.

In 1989, monetary policy was tailored to the changing contours of the economic expansion and to shifting perceptions of the potential for inflation. Early in the year, the economy still was strong, and inflation appeared to be on the rise; to prevent the pressures on wages and prices from building, the Federal Reserve extended the tightening of money market conditions that had begun in early 1988. A rise in market rates of interest relative to those on deposit accounts restrained the growth of the monetary aggregates; additional restraint came in April and May, when unexpectedly large tax payments drained liquid balances. By May, M2 and M3 lay below the lower bounds of the annual target ranges established by the Federal Open Market Committee.

Through the spring, risks of an imminent acceleration in inflation seemed to diminish somewhat. Pressures on industrial capacity began to moderate slightly during this period, commodity prices leveled off, and the dollar strengthened on exchange markets, all of which reinforced signals conveyed by the weakness in the monetary aggregates. In June the FOMC began a series of steps—undertaken with care to avoid excessive inflationary stimulus—that trimmed 1½ percentage points from short-term interest rates by year-end. Longer-term interest rates moved down by a like amount, influenced both by the System's easing and a moderate reduction in inflation expectations.

Growth of M2 rebounded in the second half of 1989 to end the year at about the midpoint of the 1989 target range. Growth of M3, however, remained around the lower end of its range; a contraction of the thrift industry, which was prompted by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, reduced the needs of thrifts to tap M3 sources of funds. The shrinkage of the thrift industry's assets led to a rechanneling of funds in mortgage markets but appeared to have little effect on overall credit availability. In total, growth in the outstanding debt of the nonfinancial sector was only a bit slower in the second half of the year than in the first half, and the level of debt ended the year close to the midpoint of the 1989 monitoring range established by the FOMC.

On the whole, the adjustments that the Federal Reserve undertook in 1989 were more in the nature of a midcourse correction than of a fundamental shift in policy. The basic goals and strategies of the System remained unchanged from those of previous years. The ultimate goal of monetary policy continued to be that of

NOTE. This discussion of economic and financial developments in 1989 is adapted from the *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978* (Board of Governors, February 1990).

ensuring price stability so as to promote the maximum sustainable rate of economic growth. Similarly, the strategy for moving toward that goal still was that of restraining growth in money and aggregate demand by enough to establish a clear downward tilt to the trend of inflation and inflation expectations while avoiding a recession.

Viewed in the context of those longer-run goals and strategies, the performance of the economy in 1989 seemed satisfactory in many broad respects. At the same time, however, the year's events underscored the formidable challenges that still lay ahead if the ultimate goals of price stability and sustained economic growth are to be realized. While inflation in 1989 was no higher than in the previous year, neither was there any progress made toward the goal of reduced inflation over time. Indeed, the underlying rate of inflation held stubbornly around the 4 to 4½ percent mark, about the same range in which it had been in previous years of the expansion. Clearly, seeking gains against inflation while maintaining the expansion would remain a central part of economic strategy into the 1990s.

Another essential part of economic policy as a new decade begins is to move further toward a lowering of federal budget deficits. In that regard, the federal budget deficit in 1989, while smaller than those of the mid-1980s, remained far too large for an economy in the neighborhood of full employment. Such deficits seem almost certain to affect long-run economic performance adversely. In particular, the deficits likely have cut into national saving and investment in recent years and have limited the expansion and upgrading of the stock of productive capital. It is that stock, together with the skills and innovativeness of the labor force, that ultimately will determine the standard of living of the population over the long run. The need for lowered deficits—and perhaps even surpluses—becomes even more compelling when viewed in the context of current demographic trends: saving and investment are needed now to ensure a productive economy that can support a rapidly growing population of retirees two or three decades down the road. International developments also seem to reinforce the case for deficit reduction, as the rebuilding of Eastern European economies is likely to put still greater demands on the limited flow of world saving in the coming decade. ▪

The Economy in 1989

Real gross national product grew 2½ percent over the four quarters of 1989; the rise was 2 percent if adjustment is made for the recovery in farm output from the drought losses of 1988. By either measure, growth was significantly slower than in 1987 and 1988; in those two years, however, the pace of expansion had been unsustainably rapid and had pushed activity to a point at which inflationary strains were beginning to emerge. As growth slowed over the course of 1989, the pressures on resource utilization eased somewhat, particularly in the industrial sector. Nonetheless, the overall unemployment rate remained at 5.3 percent, the lowest reading since 1973; and inflation, as measured by the consumer price index, remained at 4½ percent despite the restraining influence of a dollar that was strong for much of the year.

The deceleration in business activity in 1989 reflected, to some degree, a tightening of monetary conditions; this tightening, which had begun in early 1988 and extended into early 1989, was undertaken with a view toward damping the inflation forces. Partly as a consequence of the tightening, the U.S. dollar appreciated in the foreign exchange markets from early 1988 through mid-1989 and contributed to a slackening of the growth of foreign demand for U.S. products. At the same time, domestic demand also slowed, more for goods than for services.

Producers of goods, facing slower growth of demand in both the domestic and foreign markets, shifted to a lower rate of growth in activity than that of the two previous years. The rise in industrial production was a bit more than 1 percent in 1989; it had been 6½ percent in 1987 and 4½ percent in 1988. Employment in manufacturing, after increasing a total of 90,000 over the first three months of 1989, declined 190,000 over the remainder of the year.

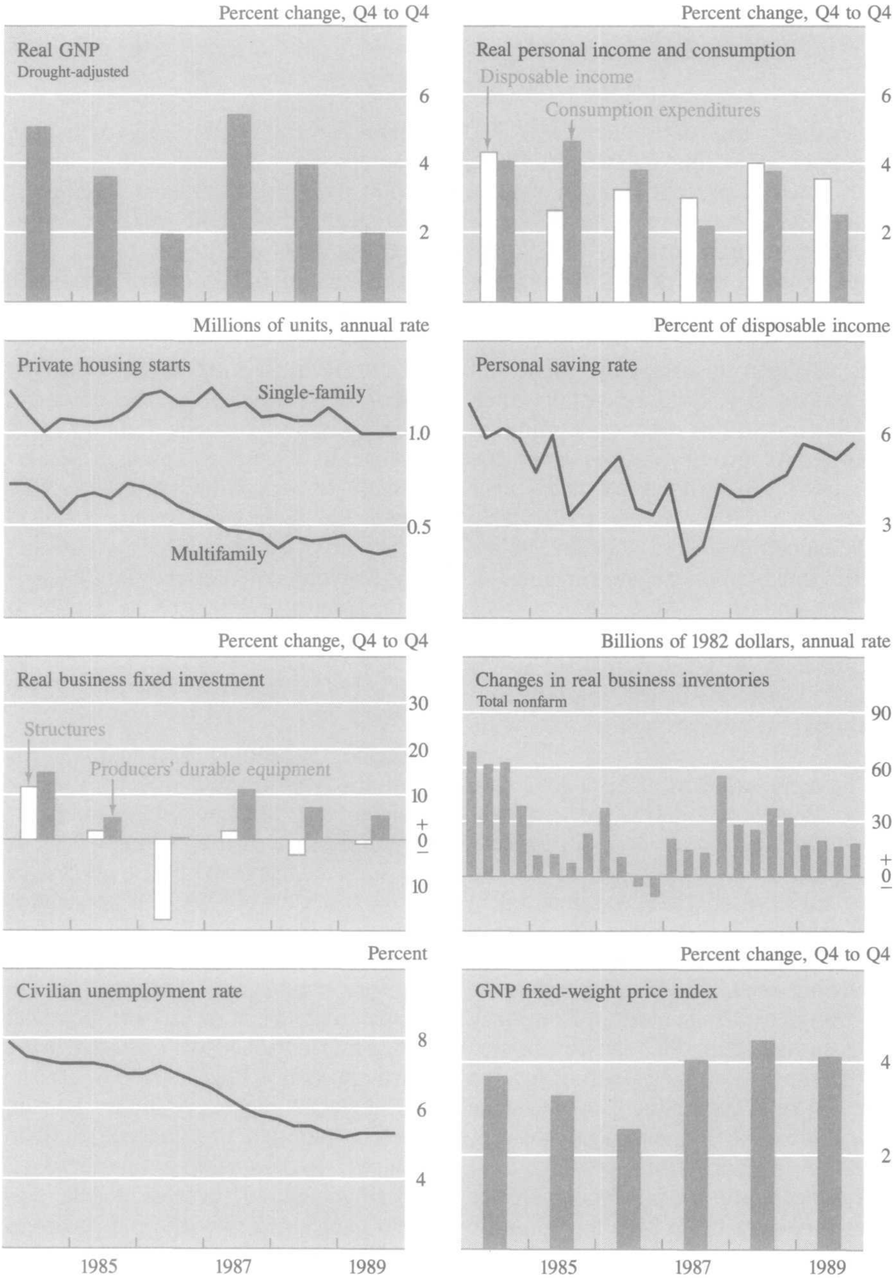
The rate of inflation was about the same in 1989 as it had been in the preceding two years. While the appreciation of the U.S. dollar through the first half of the year helped to hold down the prices of imported goods, the high level of resource utilization continued to exert pressure on wages and prices. In that regard, the moderation in the expansion of real activity during 1989 was a necessary development in establishing an economic environment more conducive to progress over time toward price stability.

The Household Sector

Household spending softened significantly in 1989 as the demand for motor vehicles and housing weakened markedly. Real consumer spending on goods and services increased 2½ percent over the four quarters of 1989, 1¼ percentage points less than in 1988. Growth in real disposable income also slowed last year but, for a second year, outstripped growth in spending; as a result, the personal saving rate increased to 5½ percent in the fourth quarter of 1989.

The slackening in consumer demand was concentrated in goods rather than services. Real spending on durables, which had jumped 8 percent in 1988, was about unchanged over the four quarters of 1989; the sharp slowing mainly reflected a slump in purchases of motor vehicles. Spending on nondurable goods also decelerated, increasing only 1 percent in 1989 after a 2 percent advance in

Indicators of Economic Performance



The data are seasonally adjusted. The unemployment data are from the Department of Labor; the rest are from the Department of Commerce.

1988. By contrast, real consumer spending for services continued to rise rapidly. Among the service categories, outlays for medical care increased 7¼ percent in real terms last year; the sustained rapid growth in these outlays in recent years has raised their share of total consumption expenditures to 11 percent—a larger share than is spent on any major category except food and shelter. Outlays for other services rose 3½ percent in 1989, with sizable increases in a number of categories.

Sluggishness of autombile sales was evident when 1989 began, and it persisted through much of the year. In total, the sales of cars and light trucks fell more than ¾ million units in 1989, to 14½ million. The weakness of sales was most pronounced during the fourth quarter. Third-quarter clearance sales on 1989-model cars had led buyers to advance the timing of their purchases but apparently did not raise overall demand appreciably. Sales thus fell back in the fourth quarter. This decline was exacerbated by a relatively large increase in sticker prices on 1990-model cars; although part of the price increase reflected the inclusion of additional equipment—notably the addition of passive restraint systems to many models—consumers nevertheless reacted adversely. Beyond these influences, longer-run factors appear to have damped the demand for autos and light trucks during 1989; in particular, the robust pace of sales earlier in the expansion seems to have satisfied demand that had been pent up during the recessionary period of the early 1980s. The rebuilding of the motor vehicle stock suggests that future sales may be aligned more closely with pure replacement needs than was the case through much of the 1980s.

Real spending on residential construction fell 7 percent over the four quarters of 1989. Construction was pressured throughout 1989 by the overbuilding that occurred in some locales earlier in the decade. Vacancy rates remained especially high for multifamily rental and condominium units, and the starts of multifamily units fell for the fourth year in a row. In addition, high prices for houses appeared to be restraining demand in some regions in which price increases had been especially large over the course of several years.

Mortgage interest rates declined more than a percentage point, on net, between the spring of 1989 and the end of the year, helping to arrest the contraction in housing activity; however, the response to the easing in rates appears to have been muted somewhat by a reduction in the availability of construction credit, likely reflecting, in part, the tightening of regulatory standards in the thrift industry and the closing of a number of insolvent institutions. Exceptionally cold weather also hampered building late in the year.

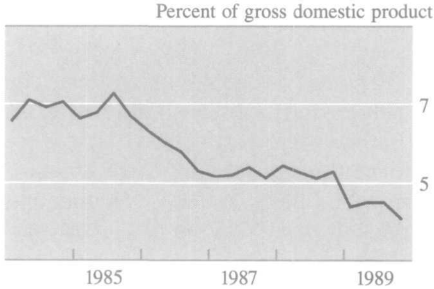
The Business Sector

Business fixed investment, adjusted for inflation, changed little on net during the second half of 1989 after surging at an annual rate of 7¾ percent during the first half. Although competitive pressures forced many firms to continue seeking efficiency gains through capital investment, the deceleration in overall economic growth made the need for capacity expansion less urgent, and shrinking profits reduced the availability of internal finance.

Spending on equipment moved up briskly during the first half of 1989; gains in outlays were particularly notable for information processing equipment—computers, photocopiers, telecommunications devices, and the like. However, in the second half of the year equipment outlays leveled off; growth in the information processing category slowed sharply, and spending in most other categories was either flat or down. Business purchases of motor vehicles, in particular, dropped sharply in the fourth quarter. Spending on aircraft, which had been very strong over the first three quarters of 1989, also was down in the final quarter as the strike at Boeing curbed production and shipments. In an exception to the pattern of second-half softness, outlays for agricultural machinery moved up smartly through year-end, buoyed by the substantial improvement in the financial health of the farm sector over the past few years. Overall, business spending on equipment increased 5¼ percent in real terms over the four quarters of 1989—about 2 percentage points below the pace of 1988.

Business spending for new construction, which had dropped 3½ percent in real terms in 1988, edged down further in 1989. Commercial construction, which includes office buildings, remained especially weak; vacancy rates for office space persisted at high levels in many areas, lowering prospective returns on new investment. Outlays for drilling and mining, which had dropped 20 percent over the four quarters of 1988, moved down further in the first quarter of 1989; later in the year, drilling activity revived in response to a higher level of crude oil prices. The industrial sector was the most notable exception to the overall pattern of weakness in heavy construction: Real outlays for new industrial facilities increased 10 percent in 1989, largely because of construction that had been planned in 1987 and 1988, when capacity in many basic industries tightened substantially and profitability was improving sharply.

Corporate Profits after Taxes



Profits of nonfinancial corporations from domestic operations, with adjustments for inventory valuation and capital consumption.

The slowdown in investment spending during the second half of 1989 likely was exacerbated by the deterioration in corporate cash flow. Before-tax operating profits of nonfinancial corporations dropped 17½ percent from the fourth quarter of 1988 to the fourth quarter of 1989; measured as a share of the value of gross domestic output, the pre-tax profits of nonfinancial corporations averaged 7¾ percent in 1989, the lowest reading since 1982. Fundamentally, this squeeze on profits arose from increased pressures from labor and materials costs at a time when domestic and international markets had become highly competitive and aggregate demand was being restrained.

Inventory investment in the nonfarm business sector totaled $18 billion in real terms in 1989, a slower pace of accumulation than in 1988. Some of the buildup in stocks took place in industries where orders and shipments were generally strong—aircraft, for example. Inventories in some other sectors became uncomfortably heavy at times and precipitated adjustments in orders and production. The clearest area of inventory imbalance at the end of 1989 was at auto dealers, where stocks of domestically produced automobiles were at 1.7 million units in December—almost three months' supply at the sluggish sales pace of the fourth quarter. In response, the domestic automakers implemented a new round of sales incentives and cut sharply the planned assembly rate for the first quarter of 1990. Elsewhere in the retail sector, inventories moved up substantially relative to sales at general merchandise outlets. Overall, though, most sectors of the economy adjusted fairly promptly to the deceleration in sales in 1989 and appeared to have avoided being caught with large holdings of unwanted stocks.

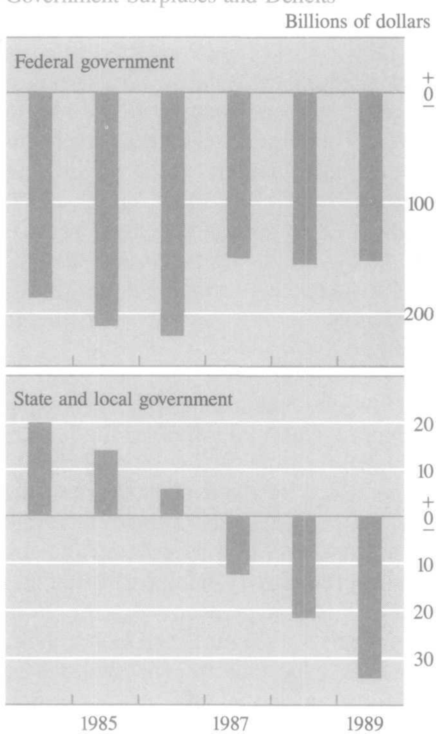
The Government Sector

Federal purchases of goods and services—the part of federal spending that is counted in GNP—fell 3 percent in real terms over the four quarters of 1989. Reductions in the stock of farm products owned or financed by the Commodity Credit Corporation—negative purchases, in effect—accounted for about one-third of the decline. Lower defense purchases made up most of the remainder. Nondefense purchases excluding those of the CCC were down slightly in real terms from the fourth quarter of 1988 to the fourth quarter of 1989; increases in such areas as the space program and drug interdiction were more than offset by general budgetary restraint that imposed real declines on most other discretionary programs.

In terms of the unified budget, the federal deficit in fiscal year 1989 was $152 billion, slightly smaller than in 1988. Growth in total federal outlays, which includes transfer payments and interest costs as well as purchases of goods and services, picked up a bit in fiscal year 1989. Outlays were boosted at the end of the fiscal year by the initial $9 billion of spending by the Resolution Trust Corporation. On the revenue side, growth in federal receipts increased in fiscal 1989. Income tax payments by individuals jumped, and corporate and social security tax payments also rose strongly.

Purchases of goods and services at the state and local level rose 3 percent in real terms over the four quarters of 1989, a rise similar to the increases in each of the two preceding years. Spending for educational buildings increased, and employment in the state and local sector rose 350,000 over the year, a change driven partly by a rise in hiring by schools. The budgetary position of the state and local sector deteriorated further over the four quarters of 1989, as the annualized deficit of operating and capital accounts, which excludes social insurance funds, increased $18 billion.

Government Surpluses and Deficits



The data on the federal government are for fiscal years. They are on a unified budget basis and come from the Department of the Treasury.

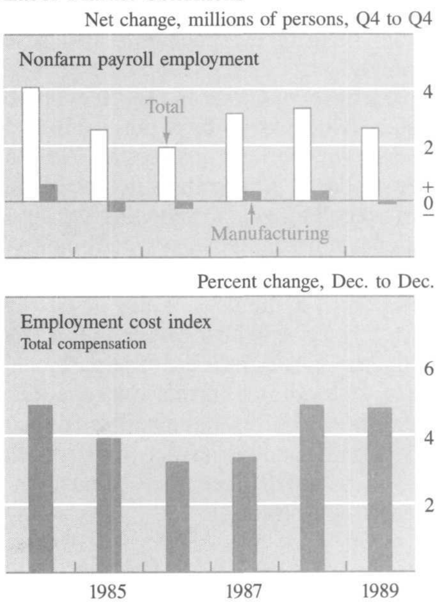
The data on state and local governments are for operating and capital accounts. They are on a national income accounts basis and come from the Department of Commerce.

Labor Markets

Employment growth slowed in the second half of 1989; nonetheless, nonfarm payrolls increased nearly 2½ million during the year. The bulk of this expansion was in the service-producing sector. By contrast, the manufacturing sector lost 100,000 jobs. These cutbacks were more than accounted for by declines in the durable goods industries, which were affected by the slump in auto sales, the second-half sluggishness in capital spending, and the effects of a stronger dollar on exports and imports.

Despite the slowdown in the creation of new jobs, the overall balance of supply and demand in the labor market changed little over the year and, on the whole, gave a sense of continued tightness. The civilian unemployment rate, which had dropped sharply in 1987 and 1988, closed out 1989 at 5.3 percent—unchanged from the level of a year earlier. Other indicators gave a similar picture: The number of "discouraged" workers—those who say they would re-enter the labor force if they thought they could find a job—declined in 1989, as did the number of workers who accepted part-time employment when they would have preferred full-time. The proportion of the civilian population with jobs reached an historic high.

Labor Market Conditions



The data are from the Department of Labor. The employment cost index is for private industry, excluding farm and household workers.

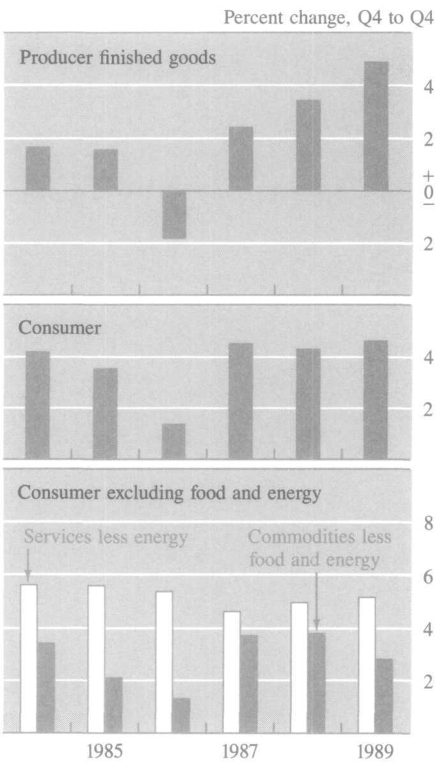
The tightness of labor markets and the persistence—according to surveys—of inflation expectations in the 4 to 5 percent range kept pressure on labor costs. The employment cost index for wages and salaries in nonfarm private industry increased 4¼ percent over the twelve months of 1989, about the same as the rise during 1988. Benefit costs in 1989 continued to rise more rapidly than wages and salaries, with health insurance costs remaining a major factor; nonetheless, the rate of growth in overall benefit costs slowed, in part because of a smaller increase in social security taxes than in 1988. Total compensation, which includes both benefits and wages and salaries, rose 4¾ percent during 1989. Growth of compensation in the service producing sector—at 5 percent—continued to outpace the gain in the goods-producing sector by about ¾ percentage point.

Productivity gains were lackluster in 1989, a phenomenon typical of a slowing economy. Output per hour in the private nonfarm business sector increased only ½ percent over the four quarters of the year—1 percentage point below the rate of increase in 1988. In the manufacturing sector, productivity gains during the first half of 1989 kept pace with the 1988 average of 3 percent; in the second half, however, productivity growth slowed a little, to an annual rate of 2 percent. Reflecting both the sharp increase in hourly compensation and the slowing in productivity, unit labor costs in private nonfarm industry rose 4¾ percent over the four quarters of 1989—the largest increase since 1982.

Price Developments

Inflation in consumer prices remained in the neighborhood of 4½ percent for the third year in a row. Although some relief came in the form of stable import prices, the continued pressures on domestic resources, particularly in the labor markets, precluded any easing of overall price increases. During the first half of the year, inflation was boosted temporarily by a sharp runup in energy prices and a carry-over from 1988 of drought-related increases in food prices. However, inflation in food prices slowed during the summer, and a drop in energy prices in the second half retraced about a third of the earlier run-up. The effect of import prices in holding down inflation also was more apparent in the second half of the year than in the first half.

Prices



Consumer prices are for all urban consumers. The data are from the Department of Labor.

Food prices increased 5½ percent at the retail level over the year, slightly more than in 1988, when a number of crops were severely damaged by drought. A poor wheat crop in 1989 and a shortfall in dairy production were among the factors that prevented food prices from decelerating. In addition, increases in demand, including sharp increases in exports of some foods, also appear to have played a role, as did continued increases in the costs of food processing and marketing. In December, a hard freeze hurt fruit and vegetable crops in Florida and Texas and sent prices soaring as a new year began.

Consumer energy prices surged 16 percent at an annual rate during the first six months of 1989, but fell at a 5 percent rate in the second half. During the first half, increases in the cost of crude oil drove up retail energy prices. In addition, the introduction of tighter standards governing the composition of gasoline during summer months boosted summer gasoline prices. Later on in the year, gasoline prices eased considerably, reflecting the passthrough of lower prices for crude oil and the expiration of the summertime standards. Taking the twelve months of 1989 as a whole, the increase in retail energy prices came to a bit more than 5 percent. At year-end, heating oil prices were surging in response to increased demands and supply disruptions caused by December's unusually cold weather. Crude oil prices at the end of 1989 had moved up to around their highest levels since the big price collapse of 1986.

The rise in the consumer price index for items other than food and energy was almost 4½ percent in 1989, about the same as in 1988. Developments in this category likely would have been less favorable had the dollar not been appreciating in foreign exchange markets through the first half of 1989. The prices of consumer commodities excluding food and energy decelerated sharply, and this slowdown was particularly marked for some categories where import penetration is high, including apparel and recreational equipment. In contrast to goods prices, the prices of nonenergy services – which make up half of the overall consumer price index – increased 5¼ percent in 1989, slightly more than in 1988. The pickup in this category was led by rents, medical services, and entertainment services.

At the producer level, prices of finished goods increased 7½ percent at an annual rate during the first half of 1989 – almost twice the pace of 1988 – but slowed to an annual rate of 2½ percent in the second half. Sectoral developments that affected the prices of finished goods at the producer level were similar to those that affected consumer prices. At earlier stages of processing, the index for intermediate materials excluding food and energy, a broad indicator of trends in materials prices, decelerated sharply during the first half of the year, and then edged down in the second half. Over the four quarters of 1989, this index registered a net increase of only 1 percent, compared with a rise of more than 7 percent in 1988; the deceleration appears to have reflected a relaxation of earlier pressures on capacity in the primary processing industries, along with the influence of the rise in dollar exchange rates through the first half of 1989. These same factors also caused the prices of industrial commodities to weaken as the year progressed; price declines were especially sharp for some primary metals, such as copper, aluminum, and steel scrap. At year-end, however, prices of industrial commodities appeared to be stabilizing. ■

Monetary Policy and Financial Markets in 1989

In 1989, the Federal Reserve continued a policy aimed at containing and ultimately eliminating inflation while providing support for economic expansion. In implementing that policy, the Federal Open Market Committee maintained a flexible approach to monetary targeting, responding to emerging conditions in the economy and financial markets as well as to the growth of the monetary aggregates relative to their established target ranges.

The Implementation of Monetary Policy in 1989

In the opening months of 1989, the Federal Open Market Committee extended the move toward restraint that it had begun almost a year earlier. Policy actions in January and February restrained the availability of reserves, raised the discount rate, and prompted a further increase of ¾ percentage point in short-term market interest rates. Longer- term rates, however, moved up only moderately; the tightening apparently had been widely anticipated and was viewed as a welcome step toward helping to avoid an escalation in underlying inflation. Real short-term interest rates—nominal rates adjusted for expected price inflation—likely moved higher in early 1989 but remained below peak levels earlier in the expansion. The tightening of policy and the related increases in interest rates contributed to a strengthening of the foreign exchange value of the dollar in early 1989. Growth of the monetary aggregates slowed during this period as the additional policy restraint reinforced the effects of actions taken in 1988.

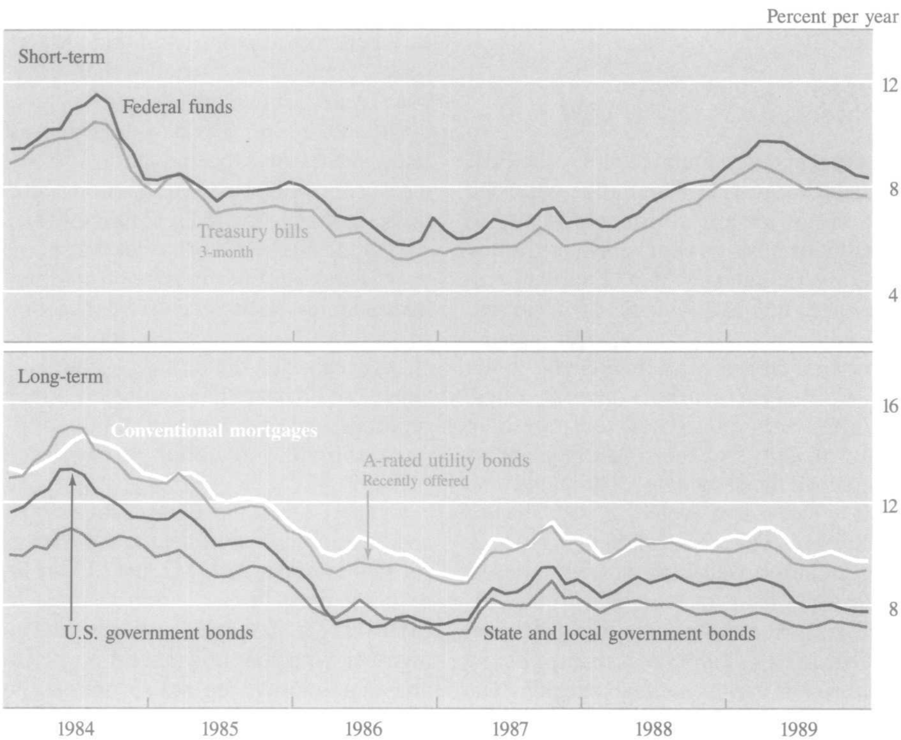
In the spring, the incoming data on activity, along with the strength of the dollar, suggested that the risk of accelerating inflation was beginning to lessen a bit. Consequently, the Committee refrained from further tightening, and in June it began to ease the pressures on reserve markets. Interest rates fell sharply during the second quarter, at both the short and long ends of the maturity spectrum. By mid-year, most long-term nominal interest rates were down as much as 1 percentage point from their March peaks; the yield on the bellwether thirty-year Treasury bond fell to about 8 percent by the end of June. The decline in interest rates outstripped the reduction in most measures of investors' inflation expectations, so that estimated real interest rates also fell from their levels of earlier in the year. These declines in nominal and real interest rates, however, were not accompanied by declines in the foreign exchange value of the dollar. Rather, because of better-than-expected trade reports in late spring, and political turmoil abroad, the dollar strengthened further.

In July, when the FOMC met for its semiannual review of the growth ranges for money and credit, M2 and M3 lay at, or a bit beneath, the lower bounds of their target cones. This weakness, together with the information on prices and real activity, led the Committee to ease reserve positions further. While taking such action, the Committee also reaffirmed the existing 1989 target ranges for the monetary and debt aggregates and tentatively established those same ranges for 1990; it was thought that such ranges likely would encompass money growth at a pace needed to foster further economic expansion and moderation of price pressures in 1990.

Longer-term interest rates moved down a bit further shortly after mid-year, but then turned up later in the summer. During this period, incoming information hinted at the possibility of renewed inflation pressures; with growth in the monetary aggregates rebounding, the Committee therefore kept reserve conditions about unchanged pending clearer signals of the economy and of prices.

In early autumn, evidence of a further slowing in the pace of economic activity began to accumulate. Beginning in October the FOMC reduced pressures on reserve markets in three separate steps; the moves nudged the federal funds rate down to around 8¼ percent by year-end, about 1½ percentage points below its level when the tightening of policy had ceased in February. Over those ten

Interest Rates



All the data are monthly averages.

The federal funds rate is from the Federal Reserve.

The rate for three-month Treasury bills is the market rate on three-month issues on a discounted basis and is from the Department of the Treasury.

The rate for conventional mortgages is the weighted average for thirty-year fixed-rate mortgages with level payments at savings and loan associations and is from the Federal Home Loan Mortage Corporation.

The rate for A-rated utility bonds is the weighted average for recently offered thirty-year investment-grade bonds adjusted to an A-rated basis by the Federal Reserve.

The rate for U.S. government bonds is their market yield adjusted to thirty-year constant maturity by the Treasury.

The rate for state and local government bonds is a *Bond Buyer* index based on twenty-five issues of thirty-year revenue bonds of mixed quality.

months, other short- and long-term nominal interest rates fell about 1 to 1¼ percentage points. Reflecting some reduction in inflation anticipations over the same period, estimated short- and long-term real interest rates fell somewhat less than nominal rates, dropping probably about ½ to ¾ percentage point. Still, most measures of short- and long-term real interest rates remained well above their trough levels of 1986 and 1987—levels that had preceded rapid growth in the economy and a buildup of inflationary pressures.

Reserves, Money Stock, and Debt Aggregates

Annual rate of change based on seasonally adjusted data unless otherwise noted, in percent[1]

Item	1986	1987	1988	1989	1989			
					Q1	Q2	Q3	Q4
Depository institution reserves[2]								
Total	18.2	4.7	2.8	−1.5	−3.1	−8.7	.6	5.1
Nonborrowed	20.0	4.8	.2	1.7	1.2	−10.2	8.7	7.2
Required	18.3	4.8	2.7	−1.4	−3.2	−7.7	.5	5.0
Monetary base[3]	9.5	7.6	6.9	3.4	4.4	1.7	3.2	4.0
Concepts of money[4]								
M1	15.5	6.3	4.3	.6	−.1	−4.4	1.8	5.1
Currency and travelers checks	7.4	8.7	8.1	4.8	6.6	4.3	3.8	4.0
Demand deposits	11.6	−.9	−1.3	−2.8	−4.5	−7.5	−.5	1.1
Other checkable deposits	29.2	13.7	7.6	1.0	−.6	−7.7	2.5	9.8
M2	9.3	4.3	5.2	4.6	2.3	1.6	6.9	7.1
Non-M1 component	7.3	3.6	5.5	5.9	3.2	3.7	8.7	7.7
MMDAs, savings, and small-demonimation time deposits	5.9	3.2	5.7	3.7	1.4	2.4	5.6	5.2
General-purpose and broker/dealer money market mutual fund assets	17.4	5.9	7.7	29.8	18.0	23.0	37.6	29.5
Overnight RPs and Eurodollars (n.s.a.)	16.3	7.0	−5.0	−9.2	3.4	−25.4	−2.9	−12.5
M3	9.1	5.8	6.3	3.2	3.9	3.2	3.9	1.8
Non-M2 components	8.1	12.0	10.6	−1.5	9.6	9.1	−6.8	−17.3
Large-denomination time deposits	1.8	9.3	11.6	4.2	11.4	13.5	−1.3	−6.7
Institution-only money market mutual fund assets	32.3	3.0	−.6	17.1	.3	25.2	36.6	3.3
Term RPs (n.s.a.)	32.0	36.7	14.7	−16.1	9.6	3.8	−29.9	−49.0
Term Eurodollars (n.s.a.)	4.3	14.1	11.1	−22.5	−2.2	−20.2	−33.3	−41.8
Domestic nonfinancial sector debt	13.2	9.9	9.1	8.0	8.2	7.7	7.2	7.9
Federal	14.6	9.0	8.0	7.4	7.7	6.9	4.7	9.5
Nonfederal	12.7	10.2	9.4	8.1	8.3	7.9	7.9	7.4

1. Changes are calculated from the average amounts outstanding in each quarter. Annual changes are measured from Q4 to Q4.

2. Data on reserves and the monetary base incorporate adjustments for discontinuities associated with regulatory changes in reserve requirements.

3. The monetary base consists of total reserves plus the currency component of the money stock plus, for institutions not having required reserve balances, the excess of current vault cash over the amount applied to satisfy current reserve requirements.

4. M1 consists of currency; travelers checks of nonbank issuers; demand deposits at all commercial banks other than those due to depository institutions, the U.S. government, and foreign banks and official institutions, less cash items in the process of collection and Federal Reserve float; and other checkable deposits, which consist of negotiable orders of withdrawal and automatic transfer service accounts at depository institutions, credit union share draft accounts, and demand deposits at thrift institutions. M2 is M1 plus money market deposit accounts (MMDAs); savings and small-denomination time deposits at all depository institutions (including retail repurchase agreements), from which have been subtracted all individual retirement accounts (IRAs) and Keogh accounts at commercial banks and thrift institutions; taxable and tax-exempt general-purpose and broker/dealer money market mutual funds, excluding IRAs and Keogh accounts; wholesale overnight and continuing-contract repurchase agreements (RPs) issued by commercial banks and thrift institutions; and overnight Eurodollars issued to U.S. residents by foreign branches of U.S. banks worldwide. M3 is M2 plus large-denomination time deposits at all depository institutions; assets of institution-only money market mutual funds; wholesale term RPs issued by commercial banks and thrift institutions; and term Eurodollars held by U.S. residents in Canada and the United Kingdom and at foreign branches of U.S. banks elsewhere.

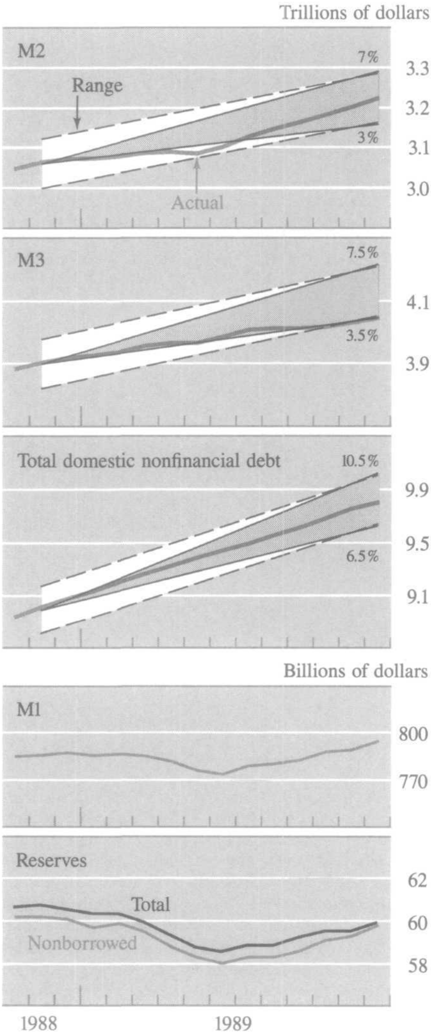
The Monetary Aggregates

Growth in M2 was uneven over 1989, with marked weakness in the first part of the year giving way to robust growth thereafter. All told, the rise in M2 over the year amounted to 4½ percent, down from growth of 5¼ percent in 1988; the 1989 figure was about at the midpoint of the annual target range of 3 to 7 percent. The slowing from 1988 reflected some moderation in nominal income growth as well as the pattern of interest rates and associated opportunity costs of holding money; with regard to the latter, the lagged effects of increased interest rates and rising opportunity costs in 1988 and early 1989 outweighted the effects of the subsequent, smaller reversal.

Compositional shifts within M2 in 1989 reflected the pattern of interest rate movements over the year, an unexpectedly large volume of tax payments in the spring, and a flow of funds out of thrift institution deposits and into other instruments. Early in the year, rising market interest rates buoyed the growth of small-denomination time deposits at the expense of more liquid deposits, the rates on which adjusted only sluggishly to the market's upward movements. The jump in tax payments, which came in April and May, added to the weakness in liquid instruments in those months. However, as market interest rates fell, liquid instruments gained in favor, and their rate of growth rebounded; replenishment of the accounts that had been drawn down to pay taxes added to the stronger growth of liquid deposits.

The swings in interest rates and opportunity costs in 1989 had an especially strong effect on the M1 component of M2. From the fourth quarter of 1988 to May of 1989, M1 declined at an annual rate of about 2½ percent. Then, from May to December, M1 growth rebounded to a 4 percent rate, boosted by the cumulating effects of falling interest rates and the tax-related replenishment of liquid balances. The rise in M1 over the four quarters of the year was only ½ percent; it had grown 4¼ percent in

Monetary Aggregates, Nonfinancial Sector Debt, and Reserves



The ranges were adopted by the FOMC for the period from 1988:4 to 1989:4.

Reserves have been adjusted to remove discontinuities associated with changes in reserve requirements. Nonborrowed reserves include extended credit; the difference between total and nonborrowed reserves is used to meet seasonal and adjustment needs.

1988. M1 velocity continued the upward trend that resumed in 1987, increasing in the first three quarters before edging down in the fourth quarter of 1989.

The composition of M2 also was affected in 1989 by developments in the thrift industry, which led to a shift of deposits from those institutions to commercial banks and money fund shares. The shift stemmed, in part, from regulatory pressures that brought down the interest rates paid by some excessively aggressive thrifts. In addition, beginning in August, the newly created Resolution Trust Corporation (RTC) directed some of its funds toward paying down high-cost deposits at some thrifts; it also began a program of closing insolvent thrifts and selling their deposits to other institutions—for the most part, banks. On balance, the weak growth of retail deposits at thrifts appears to have been about offset by the shift into commercial banks and money market mutual funds, leaving M2 little affected overall.

M3 growth in 1989 was driven largely, as usual, by the funding needs of banks and thrifts; however, the special circumstances of the restructuring of the thrift industry lessened the reliability of M3 as a barometer of monetary policy pressures. Banks' funding needs exhibited continued expansion in 1989 as growth of bank credit was only slightly below the 1988 rise of 7¾ percent. By contrast, credit at thrift institutions, which rose 6¼ percent in 1988, declined on balance in 1989. This weakness in thrift credit stemmed directly from the shrinkage of assets at SAIF-insured savings and loan institutions; the other thrifts—credit unions and mutual savings banks—expanded their balance sheets in 1989. In addition, the funds paid out by the RTC to thrift institutions and to banks that acquired thrift deposits were a direct substitute for other sources of funds. As a result, thrifts lessened their reliance on managed liabilities, as evidenced by the 16 percent decline over the year in the sum of large time deposits and RPs at thrifts. Money market mutual funds that are open only to institutions were bolstered by a yield advantage, as fund returns lagged behind declining market interest rates; these funds provided the major source of growth for the non-M2 component of M3. On balance, the effects of the thrift restructuring dominated the movements in M3, and the rebound in M2 in the second half of 1989 did not show through to this broader aggregate. Thus, M3 continued to hug the lower bound of its 3½ to 7½ percent target cone; it closed the year 3¼ percent above its level in the fourth quarter of 1988. The velocity of M3 increased 3 percent in 1989, 1¼ percentage points faster than the growth in M2 velocity and its largest annual rise in twenty years.

Credit Markets in 1989

Aggregate debt of the domestic nonfinancial sectors grew at a fairly steady pace over 1989, averaging 8 percent, a rate near the midpoint of the FOMC monitoring range of 6½ to 10½ percent. This rise in debt was about 1 percentage point less than the increase recorded in 1988 and was several percentage points below the exceptionally rapid increases of the mid-1980s. Nonetheless, debt growth once again exceeded the growth of nominal GNP, which was 6½ percent in 1989. Federal sector debt grew 7½ percent, about ½ percentage point less than in 1988. Debt growth outside the federal sector amounted to 8 percent, 1¼ percentage points less than in 1988. Households accounted for the bulk of this easing in the growth of nonfederal debt: Mortgage credit slowed in line with the reduced pace of housing activity, and consumer credit growth, though volatile from month to month, was less than in 1988. The growth of nonfinancial business debt slipped further below the extremely rapid rates of the mid-1980s. Corporate restructuring continued to be a major factor buoying business borrowing, although such activity showed distinct signs of slowing late in the year as lenders became more cautious, and the use of debt to retire equity ebbed.

In the mortgage markets, the downsizing of the thrift industry apparently had little effect on either the cost or availability of home mortgages in 1989. The spread between the rate on primary fixed-rate mortgages and the rate on ten-year Treasury notes rose somewhat early in the year but thereafter remained relatively stable. And the gap in mortgage lending associated with the shrinking of thrift assets was largely filled by increased activity on the part of other institutions, notably diversified lenders, who acted in part through other intermediaries such as federally sponsored agencies. Nonetheless, some shrinkage of credit available for acquisition, development, and construction appeared to follow from FIRREA-imposed limits on loans by thrifts to single borrowers, though the reduction in funds available for these purposes probably also reflected problems in some residential real estate markets.

The second half of 1989 was marked by indications of increased financial stress among certain classes of borrowers, with implications for the profitability of lenders, including commercial banks. During this period, delinquency rates on closed-end consumer loans at commercial banks and auto loans at "captive" auto finance companies were close to historically high levels. The delinquency and charge-off rates for real estate loans at commercial banks as a whole were only slightly higher in 1989 than in the previous year. Still, problem real estate loans continued to be a drag on the profitability of banks in Texas, Oklahoma, and Louisiana; and in the second half, such loans emerged as a serious problem for banks in New England. By contrast, smaller, agriculturally oriented banks continued to recover from the distressed conditions of the mid-1980s. As in 1988, agricultural banks charged off loans at well below the national rate, and their nonperforming assets represented a smaller portion of their loans than that for the country as a whole.

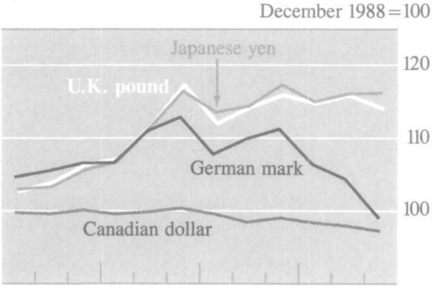
The upswing in the profitability of insured commercial banks that began in 1988 only extended through the first half of 1989. A slowing in the buildup of loan-loss provisions, along with improvements in interest-rate margins, contributed to the first-half gains. In the second half, profits eroded. Several money center banks sharply boosted their loss provisions on loans to developing countries, while evidence of rising delinquency rates on real estate and consumer loans gave evidence of a somewhat more extensive weakening in loan quality. Although these developments might foster a more cautious attitude toward granting credit to riskier borrowers, it seemed unlikely at the end of 1989 that the availability of credit had been reduced in a more general way that could materially impede the ongoing economic expansion. ■

International Developments

Economic growth in foreign industrial countries was again quite robust in 1989, with real GNP in ten major countries increasing by about 3½ percent on a weighted average basis. In non-OPEC developing countries, real GNP grew 3 percent on average, though economic performance among this group of countries was mixed. Progress on adjustment of major external imbalances was uneven in 1989. The deficit in the U.S. current account narrowed by about $21 billion, to $106 billion for the year as a whole. Japan's current account surplus declined about $20 billion, and the surplus of the newly industrialized Asian economies declined substantially further. But Germany's huge surplus increased significantly, and the already large deficits of Canada and the United Kingdom also grew.

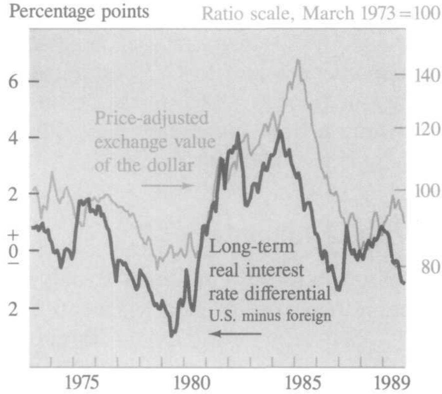
The dollar appreciated sharply against nearly all major foreign currencies during the first half of 1989, propelled by monetary policy restraint in the United States and favorable trade figures that suggested further progress in narrowing U.S. external deficits. Political events in Japan and China also contributed to the dollar's strength. In the summer, however, the Federal Reserve's easing of monetary policy contrasted sharply with a further tightening of monetary policy abroad, particularly in Germany, and the dollar moved off its highs. Nevertheless, by the time of the September meeting of the Group of 7 (G-7), the dollar was still relatively firm. The G-7 statement indicated that officials "considered the rise in recent months of the dollar inconsistent with longer run economic fundamentals." The dollar moved somewhat lower in the wake of the subsequent coordinated intervention and of increases in official interest rates in Europe and Japan. Through the rest of the year, especially

Exchange Value of the Dollar
against Selected Currencies



Foreign currency units per dollar. The data are monthly.

Exchange Value of the Dollar
and Interest Rate Differential



The exhange value of the U.S. dollar is its weighted average exchange value against currencies of other Group of 10 (G-10) industrial countries using 1972–76 total trade weights adjusted by relative consumer prices.

The differential is the rate on long-term U.S. government bonds minus the rate on comparable foreign securities, both adjusted for expected inflation estimated by a thirty-six-month centered moving average of actual consumer price inflation or by staff forecasts where needed.

All the data are quarterly.

November and December, the dollar declined sharply against the mark and related European currencies as political developments in Eastern Europe accelerated, with their favorable implications for the economy of West Germany. The dollar remained firm against the yen, however, despite further monetary easing in the United States and higher interest rates in Japan. The yen's generalized weakness appeared to be importantly influenced by uncertainties over the political outlook in Japan.

Over the year as a whole, the dollar appreciated 3¼ percent (December to December) against a weighted average of the other G-10 currencies; it appreciated 16 percent against the yen and 14 percent against sterling while depreciating 1 percent against the mark and 3 percent against the Canadian dollar. When adjusted for relative consumer price levels, the dollar appreciated somewhat more than in nominal terms, on average, as the U.S. inflation rate again exceeded that of a weighted average of other major industrial countries.

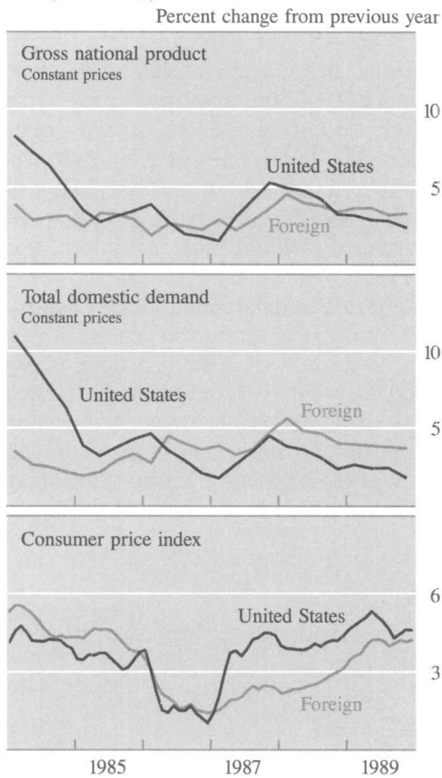
Official intervention in the exchange markets by fourteen major countries, frequently pursuant to G-7 understandings, amounted to net sales of $77 billion, of which a little more than $22 billion was by U.S. authorities.

Foreign Economies

Economic growth continued strong on average in the foreign industrial countries in 1989, but significant differences emerged among countries during the year. Demand in Japan was again supported by robust private investment that offset weaker real net exports. Investment demand also remained buoyant in Germany, where net exports continued to be an important source of strength. Signs of adjustment to slower rates of growth were more apparent in Canada and the United Kingdom, where inflationary pressures have been severe and where monetary tightening was undertaken earlier than in other foreign industrial countries. Growth slipped noticeably in both countries as the contribution from interest-sensitive demand components in the United Kingdom softened and the Canadian external sector weakened in response to a stronger Canadian dollar.

Unemployment rates continued to move down during 1989 in most foreign industrial countries, with some signs of levelling off near year-end. The unem-

GNP, Demand, and Prices



Foreign data are multilaterally weighted averages for the G-10 countries, using 1972–76 total trade weights, and are from foreign official sources.

Data for the United States are from the Departments of Commerce and Labor.

The data for GNP and domestic demand are quarterly; the data for consumer prices are monthly.

ployment rate in the United Kingdom fell more than 1½ percentage points to below 6 percent, and the German unemployment rate fell more than ½ percentage point to less than 8 percent. Smaller declines were recorded in Canada and France, while the unemployment rate was about unchanged in Japan and Italy. Signs of increasing labor-market tightness in some countries, especially Japan and Germany, raised concerns about possible upward pressure on wages as key labor-market negotiations approached in early 1990.

Monetary conditions were tightened in most foreign industrial countries during the year, as inflation was more persistent than had been expected and demand continued to press on capacity. Several factors, including tax changes and weakness in some currencies, added to upward pressures on prices in the first half. U.K. authorities continued to tighten last year following significant increases in interest rates in 1988; the 1989 year-over-year rate of inflation moved up to 7½ percent. As inflation in Japan and Germany moved up in the first half to more than 3 percent, those two countries (and others in the European Monetary System) raised official rates several times. Although the growth of monetary aggregates in some countries accelerated slightly in 1989, it was steady in most cases and key aggregates stayed within target ranges. The stance of fiscal policy, as measured by cyclically adjusted budget deficits calculated by the Organisation for Economic Co-operation and Development, was more restrictive—notably so in Germany and Japan, where new indirect taxes were introduced.

The combined current account surplus of the foreign G-10 industrial countries contracted by more than $40 billion in 1989, with half that change produced by a narrowing of the Japanese external surplus to about $57 billion. Larger deficits in the United Kingdom, Canada, and Italy also contributed to the smaller overall surplus. Strong demand for German exports, however, caused the German current account surplus to widen by about $4 billion, to nearly $53 billion.

The combined current account deficit of developing countries in 1989 declined about $4 billion, to $12 billion. The volume of trade grew briskly for these countries in 1989, with imports expanding strongly for the third year in a row. Among subgroups of developing countries, the newly industrialized economies (NIEs) of Asia showed a large reduction in their combined current account surplus. The surplus of the four Asian NIEs—Taiwan, Korea, Hong Kong, and Singapore—fell from about $29 billion in 1988 to $22 billion in 1989, with most of the adjustment taking place in Korea. The reduction in the combined surplus of the NIEs in 1989 is attributable to the lagged effects of currency appreciation, large wage increases, slower growth in major export markets, strike-related production shortfalls in Korea, and the liberalization of import restrictions in Taiwan and Korea.

The current account deficit of a group of fourteen heavily indebted developing countries increased about $3 billion in 1989. An increase in the trade surplus of this group was more than offset by an increase in interest payments.

Economic performance in the larger heavily indebted countries continued to be mixed in 1989. Growth in Mexico accelerated to about 3 percent despite continued progress in reducing inflation. Inflation accelerated to extremely high levels in Argentina and Brazil; gross domestic product fell sharply in Argentina and increased only slightly in Brazil. Argentina's stabilization effort was intensified when President Menem took office in July, but by year-end the program was in the midst of substantial alteration. Venezuela began implementing an adjustment program early in the year. The short-term effect of the program was a recession combined with a spurt in the general price level that was due to changes in administered prices and devaluation. However, by the end of the year, inflation was on a downward trend and the external current account had been significantly adjusted.

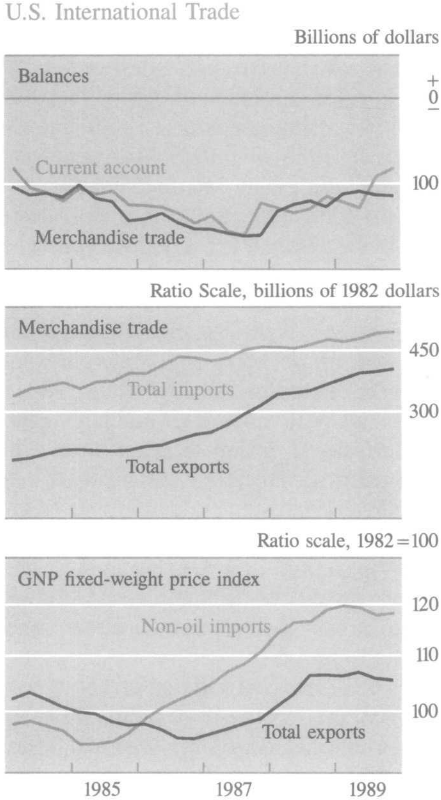
In March 1989, Treasury Secretary Brady called for a revitalization of the debt strategy toward heavily indebted developing countries. He stressed the crucial role of policy reforms to achieve growth, and he recognized the need for voluntary reductions in debt and debt service, with the International Monetary Fund and the World Bank providing financial support for such operations. During 1989, financing packages based on the Brady framework were agreed upon for Mexico, the Philippines, and Costa Rica. The packages for Mexico and the Philippines were completed in early 1990.

U.S. International Transactions

The U.S. merchandise trade and current account deficits narrowed further in 1989. A $43 billion increase in merchandise exports and a $29 billion increase in merchandise imports yielded a trade deficit of $113 billion for the year, compared with $127 billion in 1988. The current account balance moved about in line with the trade balance, as net transactions in services and other transfers remained in rough overall balance. A substantial increase in net payments of portfolio income to foreigners, associated with the growing U.S. net international indebtedness, was about offset by the continued advance in receipts of U.S. net direct investment income, excluding capital gains and losses.

Exports rose 10 percent during the four quarters of 1989, a bit more than half the pace of the preceding four quarters. All of the increase was in quantity; the average price of exports was little changed, held down by the rise in the dollar and relatively small increases in the domestic prices of goods that are exported. The growth in exports reflected the strong growth in income abroad and the continuing positive effects of the decline in the dollar through the end of 1987. Most of the advance in exports was in the first half of the year; growth slowed substantially in the second half, as the rise in the dollar through mid-year began to depress U.S. price competitiveness. In

U.S. International Trade



The data are quarterly, seasonally adjusted at annual rates, and are from the Department of Commerce.

addition, a strike at Boeing caused a sharp drop in aircraft shipments during the fourth quarter.

The expansion of exports during 1989 was broadly based both across commodity categories and across regions of the world. Shipments of capital goods and industrial supplies, which together account for about two-thirds of total export volume, scored healthy gains in 1989. In addition, the quantity of agricultural exports rose 10 percent between the fourth quarter of 1988 and the fourth quarter of 1989, reflecting strong demand in the Soviet Union and China. Agricultural shipments expanded only half as fast in value terms, however, as prices fell from their drought-induced highs of 1988.

Merchandise imports rose 4½ percent in value and slightly more in quantity during 1989, as the average price of imports fell slightly. A sharp increase in the price of oil imports largely offset moderate declines in the prices of other imports. Prices of non-oil imports fell 1 percent over the first three quarters—largely because of the rise in the dollar

U.S. International Transactions[1]
Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
			1988	1989			
	1988	1989	Q4	Q1	Q2	Q3	Q4
Current account							
Published	**−127**	**−106**	**−29**	**−30**	**−32**	**−23**	**−21**
Excluding capital gains and losses	−126	−104	−33	−27	−27	−26	−25
Merchandise trade balance	−127	−113	−32	−28	−28	−29	−29
Exports	319	362	84	88	91	91	92
Imports	446	475	116	116	119	119	121
Investment income							
Published	2	1	4	−2	−6	3	7
Excluding capital gains and losses	3	3	1	1	−1	0	3
Direct investment							
Published, net	32	36	13	6	3	12	15
Capital gains and losses, net	−1	−2	4	−3	−5	3	4
Excluding capital gains and losses	33	38	9	9	8	9	11
Portfolio investment, net	−29	−35	−8	−8	−9	−9	−9
Other services (including military transactions)	13	21	4	4	4	6	6
Unilateral transfers, private and government	−15	−14	−5	−3	−3	−3	−4
Private capital flows, net	**99**	**88**	**32**	**24**	**17**	**19**	**27**
Bank-related capital, net (outflows, −)	14	11	1	−9	6	5	9
U.S. net purchases (−) of foreign securities	−8	−23	−3	−3	−6	−10	−4
Foreign net purchases (+) of U.S. Treasury securities	20	29	5	9	2	13	6
Foreign net purchases of U.S. corporate bonds	27	33	9	9	6	6	12
Foreign net purchases of U.S. corporate stock	−1	7	−2	*	4	5	−1
U.S. direct investment abroad	−18	−32	−9	−5	−5	−10	−12
Foreign direct investment in United States	58	61	23	19	13	12	16
Other corporate capital flows, net	5	1	7	5	−3	−1	0
Foreign official assets in United States (increase, +)	**39**	**7**	**11**	**8**	**−5**	**12**	**−7**
U.S. official reserve assets, net (increase, −)	**−4**	**−25**	**2**	**−4**	**−12**	**−6**	**−3**
U.S. government foreign credits and other claims, net	**3**	**1**	**3**	**1**	*****	**1**	*****
Total discrepancy	**−11**	**35**	**−19**	**1**	**33**	**−3**	**4**
Seasonal adjustment discrepancy	*	*	4	4	−3	−5	5
Statistical discrepancy	−11	35	−23	−3	36	2	−1

1. Details may not sum to totals because of rounding.
*Less than $500 million absolute value.

SOURCE. Department of Commerce, Bureau of Economic Analysis.

during 1989 and substantial declines in world prices of several basic commodities—and recovered moderately in the fourth quarter under the influence of the declining dollar.

The growth in the volume of non-oil imports was not as broadly based across commodity categories. Capital goods grew particularly strongly, largely reflecting the relative strength of domestic spending for computers and other information processing equipment. Imports of consumer goods also increased over the four quarters of the year, but imports of industrial supplies were damped by the slowing of industrial production in the United States. Part of the overall increase in non-oil imports was likely in response to the substantial decline in the relative price of such imports earlier in the year.

The value of oil imports increased sharply in 1989. Prices rebounded from their sharp decline the year before, and the quantity imported advanced as well. The price of imported oil rose $5 per barrel during 1989, to a level of just above $17 per barrel in the fourth quarter. The rebound in oil prices followed OPEC's agreement at the end of 1988 to limit supplies; it was helped along by a downtrend in U.S. output and disruptions to supply caused by accidents in the North Sea and Alaska. Some unusually cold weather and further disruptions to supply during December 1989 and January 1990 moved spot prices another $1 to $2 per barrel above their 1988 fourth-quarter average. The volume of U.S. oil imports (seasonally adjusted) rose from an average of about 7½ million barrels per day (mbd) in during 1988 to nearly 8½ mbd in the second half of 1989, partly reflecting reduced U.S. production. Imports supplied nearly half of total U.S. oil consumption during 1989.

The U.S. current account deficit was balanced by recorded net capital inflows of $71 billion and a statistical discrepancy of $35 billion. Adding the recorded net capital inflows to the previously published U.S. net investment position suggests that the position at the end of 1989 reached around negative $600 billion. However, because of serious valuation problems with direct investment assets, it is likely that U.S. net indebtedness is overstated in the published data. Despite the large recorded negative position, U.S. investors earned about as much on their investments abroad as foreigners earned on their investments in the United States in 1989.

The large statistical discrepancy in 1989 casts doubt on the accuracy of the data in both the current and capital accounts. The wide swings in the discrepancy from quarter to quarter suggest that part of the problem may be in the timing of the recording of transactions. For example, the fiscal year used in reports by direct investors may not coincide exactly with the calendar year, or the counterpart to end-of-period "window dressing" by banks may not be recorded in the same quarter. In any case, the large size of the statistical discrepancy in 1989 is troublesome.

Holders of foreign official reserves added to their investments in the United States in 1989: Holdings by the G-10 countries were reduced by intervention sales of dollars to counter downward pressure on the foreign exchange value of their currencies, but that movement was more than balanced by the increase in holdings of other countries. The United States significantly increased its holdings of foreign currencies as it tried to limit the appreciation of the dollar.

Recorded net private capital inflows were almost as large in 1989 as they were in 1988. Securities transactions accounted for the largest part of the inflow. Net purchases of U.S. government securities by private foreigners reached record levels, as did net purchases of U.S. government agency securities (included with corporate bonds). Net purchases of U.S. corporate bonds (largely Eurobonds) were also substantial. Foreigners added to their holdings of U.S. corporate stocks, and U.S. residents added to their holdings of foreign stocks and bonds.

Direct investment by foreigners in the United States continued at near-record levels in 1989, spurred by large mergers and acquisitions involving foreign entities. U.S. direct investment abroad picked up from the depressed 1988 level, probably reflecting in part the increase in capital expenditures by affiliates abroad.

Foreign Currency Operations

U.S. monetary authorities intervened in the exchange markets on 97 of the year's 260 business days. All of the interventions involved selling U.S. dollars against foreign currencies. Total purchases of foreign currencies amounted to $22,056 million equivalent, of which $10,926 million equivalent was Japanese yen and $11,131 million equivalent was German marks.

Of the total intervention, $11,078 million was for the account of the Federal Reserve System. In addition, the System warehoused $7,000 million equivalent of foreign currencies for the Treasury's Exchange Stabilization Fund (ESF). Under this warehousing arrangement, the System purchased the foreign currency at the spot price and simultaneously sold it forward with the ESF. The System realized no profits or losses on intervention in 1989, but recorded a net translation gain of $1,272 million on its foreign currency position as the gain on marks far exceeded a small loss on yen. At year-end, the value of the System's gross foreign currency balances, including those warehoused for the ESF, was $31,333 million equivalent, predominantly marks and yen.

The only activity in the Federal Reserve's Reciprocal Currency (Swap) network involved a drawing on September 25 by the Bank of Mexico of $784.1 million, including $84.1 million on a new special swap arrangement. The drawing was part of a multilateral bridge loan pending completion of Mexico's new refinancing package and was fully repaid by February 1990. ■

Monetary Policy Reports to the Congress

Given below are reports submitted to the Congress on February 21 and July 20, 1989, pursuant to the Full Employment and Balanced Growth Act of 1978.

Report on February 21, 1989

Monetary Policy and the Economic Outlook for 1989

Overall, 1988 was another year of progress for the U.S. economy, marked by further substantial increases in output and employment and by a significant improvement in the balance of trade. The dramatic stock-market break of October 1987 did seem to affect real activity for a time, but the underlying strength of the economy soon showed through, and, apart from losses of farm output caused by the drought, growth proceeded at a relatively strong pace throughout 1988. Moreover, the sizable employment gains in January of this year suggest that the economy entered 1989 with considerable forward momentum.

Inflation has remained in check into the seventh year of the expansion. Even so, developments during 1988 were a little worrying, as, for a second year, increases in prices were somewhat larger than they were in earlier years of the expansion. Part of the pressure on prices in 1988 came in the food area and reflected the influence of the drought. However, with labor markets tightening, there also was a quickening in the rise of wages and total hourly compensation, which affected prices more generally.

Federal Reserve policy mirrored the changing economic circumstances of 1988. Early in the year, as in late 1987, the Federal Reserve sought to limit repercussions from the plunge in stock prices and, in particular, to guard against the possibility of a significant contraction in business activity. Pressures on the reserve positions of depository institutions were eased a bit further in early 1988, and interest rates edged down for a time, extending the declines that had begun in October 1987. Growth of M2 and M3 was fairly rapid during this period, nearly reaching the upper bounds of the annual target ranges established by the Federal Open Market Committee (FOMC).

As it became clear in the spring that the economy still was strong, the focus of Federal Reserve policy shifted. For much of the year, there was heightened concern about the potential for increased inflation, largely reflecting rapid growth of spending and a continued tightening of labor and product markets. A sharp upswing in real net exports of goods and services that had begun in 1987 continued into 1988; while this upturn was a welcome and necessary part of the adjustment of the U.S. economy toward a better balance in its external accounts, it also intensified the demands on U.S. producers at a time when the utilization of domestic labor and capital already was quite high. Accommodating the improvement in our external position while limiting the risk of heightened inflation required restraint on the growth of domestic demand.

The shift by the Federal Reserve toward restraint was reflected in a tightening of reserve market conditions that began in late March and continued, in several steps, into 1989. Short-term market interest rates moved up during this period, influenced both by the System's tightening and by the strength of the economy, and the discount rate was raised in August, to its current level of 6½ percent. Growth of M2 moderated after the spring and ended the year just below the middle of the 1988 target range. The growth of M3 also ebbed over the last two quarters, as the needs of banks and thrift institutions to fund credit expansion slackened.

At present, short-term interest rates are about 2½ percentage points higher than they were early last spring. Long-term interest rates, by contrast, have changed little, on net, over that same period; although these rates turned up in the spring of 1988, they leveled off over the summer and edged down in the fall, even as short-term rates were continuing to rise. This behavior of bond yields seems to have reflected a lowering of market expectations of long-run inflation.

Monetary Policy for 1989

The commitment by the Federal Reserve to contain inflationary pressures is reflected in the FOMC's decisions to lower the ranges for monetary and credit expansion this year. The Committee has set a range of 3 to 7 percent for M2 growth during 1989 and a range of 3½ to 7½ percent for M3, reaffirming the target ranges established tentatively in June 1988. These ranges were reduced from those for 1988—a full percentage point for M2 and one-half percentage point for M3—signalling the Committee's determination to resist any upward tendencies in inflation in the coming year and to promote progress toward price stability over the long run. The monitoring range for the growth of domestic nonfinancial debt for 1989 was set at 6½ to 10½ percent, which also is lower than that of last year.

In recognition of the degree to which the relationship between the monetary aggregates and economic performance has varied in this decade, the Committee retained the spread of 4 percentage points between the upper and lower ends of the growth ranges that it adopted in 1988. Despite the deregulation of deposit interest rates, M2 velocity has remained very sensitive to changes in market interest rates over periods as long as a year or more. Depository institutions have been slow to adjust some of their offering rates, causing substantial changes over the short and intermediate term in the relative attractiveness to savers of deposits versus market instruments. In these circumstances, it is difficult to specify in advance a narrow range for the appropriate growth of M2 and the other aggregates in the coming year; such growth will depend on the forces affecting the economy and prices and on the response of depository institutions to any changes in market interest rates, both of which are subject to a substantial degree of uncertainty. Moreover, in 1989, the behavior of M2 and M3 also could be influenced by the resolution of problems in the thrift industry, depending, in part, on how pricing practices of these institutions change, on the reactions of retail and wholesale depositors in these institutions, and on the extent of any restraints on the growth of assets of savings and loan associations.

M2 and M3 are now around the lower ends of their 1989 ranges. This slow growth and the accompanying rise in

Ranges of Growth for Monetary and Credit Aggregates

Percentage change[1]

Aggregate	1987	1988	1989
M2	5½ to 8½	4 to 8	3 to 7
M3	5½ to 8½	4 to 8	3½ to 7½
Debt	8 to 11	7 to 11	6½ to 10½

1. From average of the fourth quarter of the preceding year to average of the fourth quarter of the year indicated.

velocity reflect the continuing effects of recent increases in market interest rates. In light of the slow adjustment of deposit rates, velocity could continue to increase, with growth in these monetary aggregates in the lower halves of their ranges. Given the uncertainties about the relation of movements in the aggregates to prices and output, the Committee agreed that in implementing policy, they would need to assess, in addition to the behavior of money, indicators of inflationary pressures and economic growth, as well as developments in financial and foreign exchange markets.

The Committee will continue to monitor the growth of domestic debt in 1989. The expansion of the debt of nonfinancial sectors may slow a little from the 8¾ percent pace of 1988, although it is expected once again to exceed the pace of growth in nominal income. The growth of debt could be importantly affected by corporate financial behavior. The expansion of private debt has been boosted in recent years by the substitution of debt for equity in connection with leveraged buyouts and other corporate restructurings, and business borrowing is likely to be especially sizable in the early part of this year, owing to the recent heavy volume of such activity. The federal government, once again, will be placing heavy demands on credit markets, financing its continuing deficit.

Economic Projections

In general, the Committee members, including the nonvoting Reserve Bank presidents, anticipate that real gross national product will grow moderately in 1989, that prices will rise at a pace similar to, or perhaps slightly above, that of 1988, and that the unemployment rate will remain near its recent level—the lowest in a decade and a half. On balance, the FOMC members anticipate a little less real growth and a somewhat higher rate of inflation than does the administration, but the differences are not large.

Members of the Committee believe that the progress of the economy in 1989 will be determined in large measure by developments on the inflation front. Although special factors, such as the drought, contributed to price increases last year, there also have been troubling indications—most notably in recent wage trends—that inflationary pressures have become more widespread and, potentially, more deeply rooted.

Given the tightening actions taken by the Federal Reserve over the past year and the policy of continued restraint on aggregate demand expressed in the monetary targets for 1989, the members of the Committee anticipate that, if there is any further acceleration of prices from the 1988 pace, it will be quite limited. The majority of the Committee members expect that the consumer price index will

Economic Projections for 1989

Percent

Item	1988 actual	FOMC members and other FRB presidents	
		Range	Central tendency
Change, fourth quarter to fourth quarter			
Nominal GNP	7.0	5½ to 8½	6½ to 7½
Real GNP	2.7	1½ to 3¼	2½ to 3
Consumer price index [1]	4.3	3½ to 5½	4½ to 5
Average level in the fourth quarter			
Civilian unemployment rate	5.3	5 to 6	5¼ to 5½

1. All urban consumers (CPI-U).

rise about 4½ to 5 percent this year. This would be a slightly larger increase than in 1988, and thus would represent something of a setback relative to the Committee's disinflationary objective. However, in light of the tautness of markets and the current momentum of wages and prices, these members viewed such a projection as realistic in the context of a prudent effort to restore price stability over time. It should be noted, however, that some members expect a rise in prices that is significantly below the central-tendency range; in their view this far more desirable outcome could flow from the dollar's recent firmness, which will damp the pressures from rising import prices, and from the recognition by business and labor that restraint is needed to preserve gains in international competitiveness.

A particular uncertainty in the inflation outlook for 1989 centers on the prospects for food prices. FOMC members generally assume that a return to more normal weather conditions this year, together with an increase in acres planted, will lead to a sharp rebound in crop production, in which case food prices might help to temper overall inflation. However, because stocks of some key agricultural commodities have been reduced to low levels, there also is risk that another year of drought could generate strong upward pressures on prices. In the energy area, consumer prices could rise sharply early this year, responding to the runup in oil prices around the end of 1988; nonetheless, world oil supplies still look ample, and members of the Committee are assuming that energy prices will increase only moderately over 1989 as a whole.

With respect to real GNP, the central-tendency forecast of the Committee members is for a rise of about 2½ to 3 percent in 1989, about the same as in 1988. However, this forecast incorporates a working assumption that increased farm output will add around two-thirds of a percentage point to the growth of GNP, similar to the amount that the drought pared from growth in 1988. Excluding this swing in farm output, the central-tendency forecast is for considerably slower growth of real output than last year's gain, excluding drought losses, of more than 3 percent.

Although the economy clearly has entered 1989 on a strong note—even discounting the transitory influence of unusually mild weather in many parts of the country—the members feel that growth soon will move to a lower trajectory, owing both to the general influence of monetary restraint and to a number of sector-specific trends. In the business sector, the boom in capital outlays that was evident in the first half of 1988 has since abated, and surveys of plans for 1989 point to moderate gains in overall plant and equipment spending. Government purchases are expected to be held down by budgetary constraints; defense purchases, in particular, have been trending lower under the influence of cutbacks in real spending authority. Recent increases in mortgage rates likely portend some slackening in the pace of homebuilding, and the growth of consumption expenditures also should begin to taper off from the rapid pace of 1988, as a slowing of expansion elsewhere in the economy damps the growth of real disposable income.

With regard to the external sector, real net exports of goods and services declined over the second half of 1988, but most members of the Committee expect some improvement in the months ahead. However, substantial further progress in external adjustment will require a continuing commitment on the part of U.S. firms to capitalize on the enhanced competitiveness resulting from the depreciation of the dollar since 1985. That commitment must take the form not only of continued cost control and price restraint, but also of more intense efforts at marketing abroad and investment in new capacity where constraints are visible. Failure on these counts would almost certainly leave the U.S. economy considerably less well off over the long haul.

Government policy can do much to encourage businesses to make the longer-range commitments needed to bring about better balance in the economy and to foster longer-run growth. A monetary policy directed steadfastly at movement toward price stability is one critical ingredient. But also crucial is action to bring about further progress toward balance in the federal budget. The Committee has assumed that Gramm–Rudman–Hollings targets will be adhered to in the fiscal 1990 budget process; but the creation of an environment favorable for economic growth with stable prices requires that fiscal policies be put in place to produce the prescribed budget results in the out-years as well.

The Performance of the Economy in 1988

The U.S. economy completed a sixth year of expansion in 1988. Real gross national product rose about 2¾ percent over the course of the year, the number of jobs increased more than 3½ million, and the unemployment rate remained on a downward course, closing the year at 5.3 percent, its lowest level in 14 years. Progress also was made toward restoring external balance, as the merchandise trade deficit fell sharply.

The year began on a note of uncertainty. The sharp break in the stock market in the fall of 1987 had raised concern that the economy might falter, and some signs of weakness did emerge around the start of 1988. By early spring, however, it became clear that the expansion still had considerable vigor, coming in particular from rising exports and a boom in capital spending. Households, meanwhile, adjusted fairly readily to the loss of stock market wealth, and consumer spending rose at a strong pace throughout the year. Toward the end of the year, net exports and capital spending softened, but there was enough impetus from other sectors to keep real GNP on a firm upward course.

The rate of inflation, which had picked up in 1987, remained somewhat higher in 1988 than in earlier years. The step-up in inflation in 1987 had resulted mainly from a rebound in the price of oil and the pass-through of higher prices for imports. This past year, by contrast, extra price pressures reflected the impact of drought on the price of food and, more generally, a widespread pickup in labor costs in the domestic economy.

The rise in real GNP last year would have exceeded 3 percent but for a severe drought, one of the worst of this century, that caused huge losses of farm output. These losses accounted for most of the slowdown in GNP growth that occurred after the first quarter of 1988. Fortunately, inventories of farm products had been sizable coming into 1988, and a drawdown of stocks helped to buffer households and others from the disruption to output. Within the farm sector, the drought strained the finances of some producers, but the financial condition of many others was not seriously affected, and the sector as a whole remains stronger fundamentally than in the first half of the 1980s, when the boom of the previous decade was unwinding.

In most of the nonfarm economy, the growth of activity was robust in 1988. Production in the manufacturing sector increased 5 percent, nearly matching the previous year's gain, and factory employment rose sharply. Employment also continued to grow rapidly in retail and wholesale trade and among the providers of business and health services. However, oil drilling, which had turned up in 1987, when oil prices were rising, experienced renewed weakness in 1988, intensifying economic stresses in some parts of the country.

The External Sector

The U.S. external accounts showed considerable improvement during 1988. On a balance of payments basis, the deficit on merchandise trade fell from an annual rate of $165 billion in the fourth quarter of 1987 to around $120 billion in the second quarter of 1988 and, on average, remained at that lower level in the second half of the year. Over the four quarters of last year, the value of exports rose more than 20 percent; adjusted for inflation, the increase was around 15 percent. Much of the strength in exports, which was concentrated in the first half of the year, appeared to be associated with an improvement in the price competitiveness of U.S. products resulting from an earlier depreciation of the dollar, as well as with efforts at cost control and increases in productivity among domestic producers. Demand for exports also was supported by surprisingly strong economic growth in other industrial countries. The growth in real export volume was spread over most categories of trade; gains were particularly large for capital goods (especially computers and computer parts), automotive products, and consumer goods. The volume of agricultural exports for 1988 was up 9 percent from that for 1987, despite declines in the second half of the year; the value of these exports was boosted further by the drought-induced rise in crop prices.

The value of merchandise imports, other than oil, rose about 7 percent during 1988. The volume of non-oil imports increased about 2 percent. This rise was concentrated mainly in the capital goods area; volume was down for other major categories of imports. The prices of imported industrial supplies (excluding oil) rose significantly in 1988; smaller increases were recorded for consumer goods, automotive products, and various machinery categories. However, price declines for oil and computers held the overall increase in import prices below that of 1987; on a fixed-weight basis, the rise in non-oil import prices during 1988 was 7¼ percent. The value of oil imports declined last year, as an increase in physical volume was more than offset by the decline in price.

For the first three quarters of 1988, the current account showed a cumulative deficit of $102 billion, which was balanced by recorded net capital inflows of $88 billion and a statistical discrepancy of $14 billion. Foreign official assets in the United States increased $28 billion on net (this rise included about $30 billion, on net, of official purchases of U.S. government securities). Net inflows through banks were $21 billion. Excluding banking flows, assets held in the United States by private foreigners increased $68 billion on net; purchases of U.S. government securities were sizable (in contrast to net sales in 1987), and direct investment by foreigners in the United States remained near record levels. Excluding bank flows, the assets held abroad by private U.S. residents increased $26 billion. These recorded capital flows during the first three quarters of 1988, plus the likely net inflows in the fourth quarter, brought the recorded U.S. net indebtedness to foreigners to almost $500 billion at the end of 1988.

The foreign exchange value of the U.S. dollar, which had fallen sharply from early 1985 through the end of 1987, has shown wide fluctuations in the subsequent period. Measured against the other G-10 currencies, the dollar currently is up somewhat, on net, from its end-of-1987 low. However, it has declined in real (price-adjusted) terms against the currencies of our major trading partners among the developing countries, especially South Korea, Mexico, and Brazil.

From mid-April to late August of last year, the dollar rose sharply, on average, against the currencies of the other industrial countries, reflecting the influences of Federal Reserve monetary tightening and monthly trade reports that brightened the market's assessment of the outlook for U.S. external adjustment. When measured against a weighted average of the other G-10 currencies, the appreciation during that period was more than 15 percent. After holding steady through September, the dollar then declined sharply in October and November; market perceptions appeared to shift during that period toward a view that monetary restraint in other countries had increased relative to that in the United States, and incoming trade data suggested a stalling of the adjustment process. Since November, the dollar has again risen, partly in response to further tightening actions by the Federal Reserve.

Measured against the G-10 currencies, the dollar currently is about 7 percent above its December 1987 level. If adjustment is made for changes in relative prices, the resulting real appreciation is somewhat greater, as inflation in the United States has exceeded the weighted average of the inflation rates of the other major industrial countries.

The Household Sector

At the start of 1988, concern about the possible effect of the stock market break on the real economy centered on the household sector. The drop in share values had pared roughly half a trillion dollars from household wealth, and the degree to which spending would be cut in response to this loss of wealth was not clear.

In the event, the loss of wealth may indeed have left an imprint on consumer demand. The personal saving rate did rise after the crash and, over the next year, averaged about a percentage point higher than in the year preceding the crash. But, with exports and capital investment booming, the growth of jobs and real incomes remained strong in 1988, and the uncertainties spawned by the crash soon gave way to renewed optimism among households. Thus, after the initial, one-time jump in the saving rate, real consumption expenditures grew at about the same pace as the trend in after-tax income; the rise over the year was about 3½ percent.

Consumer spending for big-ticket items was brisk in 1988. The unit sales of domestically produced automobiles moved up a bit from the 1987 pace, and the sales of light trucks and vans, which have more than doubled since the expansion began in 1983, reached another new high. Adjusted for inflation, total consumer spending for motor vehicles increased 6½ percent over the four quarters of the year. Among the household durables, real outlays for furniture and appliances, which had slowed in 1987, moved up 7½ percent during 1988, renewing the strength that had been evident over the 1983–86 period.

Real residential investment fell slightly in the first half of 1988, but it turned up in the second half and, by the fourth quarter, was a little above the level of a year earlier. Starts of multifamily housing units, which had slumped in 1987, fell further in the first quarter of 1988, but then flattened out over the remainder of the year; vacancy rates for multifamily dwellings remain high in many areas and are likely to hold down new construction of these units for some time. In the single-family sector, starts edged down through the first three quarters of 1988, but rebounded toward year-end to the highest levels since the fall of 1987. By historical standards, these swings in single-family starts during 1988 were relatively mild; indeed, from a longer-term perspective, the past six years have been an unusually stable period in the single-family market, in sharp contrast to the boom-and-bust cycles of the 1970s and early 1980s. Total housing starts, of course, have fallen sharply since 1986 because of the steep decline in construction of multifamily units.

The Business Sector

Virtually all indicators of business activity exhibited strength in 1988. Business sales, in nominal terms, rose 9 percent over the year. Hiring was brisk in most sectors, and operating rates rose further; in the industrial sector, capacity utilization at the end of 1988 was at its highest level since 1979. Corporate profits remained healthy.

A surge in business equipment spending that had begun in 1987 extended through the first half of 1988, when outlays grew, in real terms, at an annual rate of about 20 percent. The surge was led by sizable investment in high-technology items—computers, communication equipment, and the like—but outlays for other types of equipment also were strong. After midyear, the rise in equipment spending slowed, and some weakness became evident toward the end of the year. However, most reports from the field suggest that the underlying trend in equipment spending still is pointing firmly upward.

Business spending for new construction declined in 1988, reversing the moderate increase of the previous year. Commercial construction, the biggest item in the total, continued to be restrained in 1988 by the big overhang of vacancies that grew out of the building boom of the mid-1980s. Gas and oil drilling, following the lead of oil prices, fell back a little from the pace of late 1987, but remained above the lows of 1986. Construction of buildings for industrial use was little changed over 1988; although capacity utilization is high in manufacturing, many producers also appear to be limiting their needs for additional space by shifting toward technologies that use more compact equipment, by economizing on inventories, or by conserving on space in other ways.

Inventory investment, which had been sizable in late 1987, moderated in 1988, and, with sales on an upward trajectory, stock overhangs were not a problem for most businesses. In manufacturing, stocks grew more rapidly in 1988 than they had in recent years, but much of the accumulation was in industries in which orders and shipments also were generally strong; the ratio of inventories to sales for all of manufacturing moved down during the year from the already low levels of late 1987. In retail trade, concern about a possible overhang of the stocks of nondurables eased a bit during the year, as the ratio of stocks to sales in that sector edged gradually lower from a February high. By contrast, auto dealers' stocks rose sharply in the fourth quarter, and auto manufacturers have enhanced sales incentives and moved to a lower assembly rate in an effort to pare inventories. For all of manufacturing and trade combined, the ratio of inventories to sales varied little over the course of 1988 and was near the lower end of the range in which it has been since the business expansion began.

The Government Sector

Budgetary constraints have led to a slowing of government purchases, both at the federal level and among state and local governments. The federal government's purchases of goods and services—the part of federal spending that adds directly to the gross national product—

fell 4 percent in real terms from the fourth quarter of 1987 to the fourth quarter of 1988. Roughly half of the decline reflected a drought-induced reduction in the farm inventories owned or financed by the Commodity Credit Corporation (CCC), a reduction that is counted as a negative federal purchase. Excluding this inventory swing, federal purchases were down 2 percent over the year—the first decline since 1976. Over the eight years that preceded 1988, real federal purchases, other than those of the CCC, had risen at an average pace of nearly 5 percent, considerably faster than the growth of real GNP. The downturn in 1988 reflected cuts in the defense area; other non-CCC federal purchases rose somewhat over the year.

On a budget basis, total federal outlays, which are almost three times as great as federal purchases alone, continued to rise in fiscal year 1988, but at a somewhat slower rate than in most previous years. There were further increases in entitlements, greater demands on deposit insurance agencies, and increases in net interest payments. Meanwhile, the growth of federal receipts slowed in 1988 from the rapid pace of the previous year. Receipts from social security taxes rose more than 10 percent, in part because of a rate increase in January of 1988. However, growth in receipts from personal income taxes slowed, as increases in employment and nominal incomes were offset by final reductions in income tax rates legislated under the 1986 tax reforms. The federal budget deficit in fiscal year 1988 was $155 billion, slightly above the level of the previous year.

The real purchases of goods and services by state and local governments rose 3 percent over the four quarters of 1988, a little more than in 1987 but less than the average rate of growth over the preceding three years. Spending for construction, which had risen rapidly in the mid-1980s, was little changed during 1988 as a whole, although some pickup was evident in the fourth quarter. Employment in the state and local sector continued to rise during 1988, reflecting, in part, the increased demands for teachers and other school workers associated with growth in the number of elementary students.

The Labor Markets

The rise in the number of jobs during 1988 was somewhat above that of 1987 and brought the total increase in payroll employment since late 1982 to about 18½ million. Virtually all parts of the economy shared in last year's gain. The number of jobs in manufacturing increased 400,000; employment in construction was up 300,000. Close to a million new jobs were created in retail and wholesale trade, and 1.3 million were added in services. Except for a brief slowdown in the summer, the growth of jobs was strong throughout the year.

The continued rise in employment last year led to a tightening of labor markets and called attention to limits on the potential growth of the supply of labor and of output. Growth of the working-age population has slowed in the 1980s, and the increase during 1988 was the smallest annual rise in more than two decades. This slowing of population growth in the 1980s has led, in turn, to a more moderate rate of growth in the labor force, even as the rate of labor force participation, especially for adult women, has continued to rise. A big boost to output during the expansion has come from putting unemployed workers back on the job; now, however, with the unemployment rate at less than 5½ percent, the labor force is more fully utilized than at any time in the last decade and a half.

The tightening of labor markets in 1988 was associated with a pickup in the rise of wages and labor costs. The employment cost index for wages and salaries in the private nonfarm sector increased a bit more than 4 percent over the year – almost a percentage point more than in 1987. The pickup was most pronounced among white collar workers and in the service-producing industries, where unemployment rates currently are the lowest. The cost of benefits provided to employees rose 6¾ percent over the year, nearly twice the increase of 1987; the rise reflected both the hike in the payroll tax at the start of 1988 and a surge in the cost of health benefits. Total compensation per hour – wages and salaries plus benefits – rose nearly 5 percent over the four quarters of 1988, after two years in which the annual increases had been in the neighborhood of 3¼ percent.

Productivity gains slackened somewhat in 1988. The rise in output per hour in the nonfarm business sector over the four quarters of the year was only 0.7 percent – about half a percentage point below the average over this decade. This slippage in productivity growth in 1988, combined with the faster rate of increase in hourly compensation, resulted in a 4 percent rise in unit labor costs in the nonfarm business sector over the four quarters of 1988 – well above the average rate of increase during the previous five years.

Price Developments

The broader measures of prices – including the GNP price measures, the producer price index, and the consumer price index – all indicate that inflation was in a range of 4 to 4½ percent in 1988. Except for the CPI, which had moved up into this range in 1987, these measures showed some acceleration last year, and all of them – including the CPI – rose more rapidly than they did in the first four years of the expansion. In contrast to 1987, when the indexes were boosted by a rebound in energy prices and rising prices for imports, the inflationary pressures this past year were augmented by larger increases in labor costs in the U.S. economy and the drought's influence on agricultural prices.

The drought's effects appeared quickly at the retail level in the summer, as price increases picked up for a wide variety of consumer foods. By late autumn, however, the impact of the drought on food prices began to dissipate, and inflation in the food sector returned to a more moderate path. The increase in consumer food prices over the year as a whole was 5¼ percent – about 2 percentage points above the average of the preceding five years. Prices in 1989 will be sensitive to weather developments over the spring and summer. In the past, major droughts in the United States have been one-year events, often separated in time by several good growing seasons, and most agricultural observers have been assuming that farm output will rebound in 1989, thereby restraining the prices of farm crops. Currently, however, dry conditions still prevail in some important growing regions, and crop prices could rise abruptly if moisture supplies are deficient in coming months.

Energy prices were little changed at the consumer level during 1988 after a sharp rise in 1987 – a pattern that resulted mainly from the continued gyrations in world oil markets. The price of oil, which had risen sharply in 1987, moved lower for much of 1988, as the efforts of OPEC to restrain production unraveled. In late 1988, a new agreement by OPEC to limit production, coupled with higher-than-expected oil consumption and production shortfalls in non-OPEC countries, caused prices to rise sharply once again; however, despite these fluctuations, prices have not made any sustained departure from the range in which they generally have been since the summer of 1986.

Price increases for goods and services other than food and energy were larger in 1988 than in 1987. The pickup, while fairly moderate, was widespread and probably reflected in large part the past year's acceleration in hourly compensation and unit labor costs in the domestic economy. By contrast, the pressures from rising import prices appeared to be a bit less pronounced than in 1987. Even so, higher prices for imports probably were an influence in some areas; the retail prices of apparel, for example, rose nearly 5 percent for the second year in a row, The price increases for industrial commodities slowed in 1988 after steep increases during 1987; by most measures, however, the year-to-year rate of rise in these prices has remained somewhat above that of inflation in general. The producer prices of intermediate inputs, excluding food and energy, rose more than 7 percent during 1988, reflecting the high levels of capacity utilization in a number of industries, as well as the tightening of labor markets.

Monetary Policy and Financial Developments during 1988

During 1988, Federal Reserve policy continued to be characterized by a flexible approach to monetary targeting, with System actions responding to emerging conditions in the economy and in financial markets, as well as to growth of the monetary aggregates. This approach has been necessitated by the short-run variability in the relation of these aggregates to economic performance, owing primarily to their sizable response to changing interest rates, in addition to spending. In the early months of last year, monetary policy was eased in light of incoming data suggesting a weakening in the economic expansion and the possibility of further financial market disruptions. Subsequent information, however, suggested a growing threat of inflationary pressures, as the economic expansion remained strong and margins of available labor and productive capacity dwindled. To head off a potential acceleration of inflation, the Federal Open Market Committee tightened reserve conditions in a series of steps beginning in the spring and extending into 1989. The monetary aggregates were running close to the upper ends of their growth ranges before the tightening actions, but subsequently slowed, and they closed the year in the middle portions of their ranges.

Implementation of Monetary Policy

During the early months of last year, the Committee sought to counter any economic weakness that could result from the stock market break and to ensure the smooth functioning of domestic financial markets. Indicators of aggregate demand suggested that there was a risk of weakness in the economy that warranted some easing of monetary policy. In addition, special emphasis was placed on monitoring domestic financial markets for signs of any new distress and on being alert to the need to alter the provision of reserves quickly in response to any trouble. Against this backdrop, reserve conditions were eased slightly in early February, contributing to reductions in short- and long-term interest rates.

Throughout the spring, incoming economic data suggested that the economy had overcome the effects of lower equity prices on confidence and spending. This information indicated that the economy was expanding at a rate that threatened progress toward long-run price stability. Bond yields increased during this period, as indications of economic strength contradicted the earlier market forecasts of a general slowdown and raised concerns about an uptrend in inflation. Based on evidence of a greater potential for higher wage and price inflation and in the context of rapid growth in M2 and M3, the Federal Reserve firmed reserve conditions further in a series of steps beginning in March and culminating in early August with hike of a one-half percentage point in the discount rate. These moves brought about substantial increases in short-term interest rates, but were accompanied by only small increases in Treasury bond yields, as investors viewed Federal Reserve actions as heading off a long-term acceleration of inflation. The upturn in short-term interest rates, coupled with more optimistic expectations of future inflation, helped boost the foreign exchange value of the dollar during this period.

In view of the policy restraint already in place, which was being reflected in slowing growth in the monetary aggregates, and some signs that economic growth may have been moderating, the Committee postponed any further action over the late summer and early fall, awaiting further information on the course of the economy. During October and November, the foreign exchange value of the dollar declined, partly in response to a rise in foreign interest rates relative to U.S. market interest rates and to investor concern over the lack of progress in reducing the U.S. federal budget deficit and the slowing improvement in the U.S. trade deficit.

In late fall, incoming data suggested that previous monetary restraint had not been sufficient to relieve the potential for higher inflation, and the Committee resumed tightening reserve conditions in a series of moves beginning in November and extending into the new year. As a result of these measures, short-term market interest rates rose. In contrast, bond yields continued to fluctuate narrowly, signaling the market's continued confidence that inflationary pressures would be contained. This confidence, together with the firming of policy, contributed to a strengthening of the foreign exchange value of the dollar.

Behavior of Money and Credit

M2 expanded 5.3 percent last year, just below the middle of its target range of 4 to 8 percent. Although demands for M2 were supported by strong growth in income and spending, they were reduced by increases in its opportunity cost—that is, the difference between market interest rates and the yields on M2-type instruments. Early in the year, opportunity costs had declined in response to decreases in market interest rates relative to deposit rates in late 1987 and early 1988, leading to strong growth in M2 and a decline in its velocity—the ratio of nominal GNP to M2—during the first quarter. But as market interest rates

Growth of Money and Debt [1]

Percentage change [2]

Period	M1	M2	M3	Debt of domestic non-financial sectors
Fourth quarter to fourth quarter				
1979	7.7	8.2	10.4	12.3
1980	7.4	9.0	9.6	9.6
1981	5.2	9.3	12.3	10.0
	(2.5) [3]			
1982	8.7	9.1	9.9	9.0
1983	10.2	12.1	9.8	11.3
1984	5.3	7.7	10.5	14.2
1985	12.0	8.9	7.7	13.2
	(13.0) [4]			
1986	15.6	9.3	9.1	13.3
1987	6.4	4.2	5.7	9.8
1988	4.3	5.3	6.2	8.7
Quarter to quarter (annual rate)				
1988: 1	3.2	6.2	6.8	8.2
2	6.4	6.9	7.2	8.7
3	5.2	3.8	5.5	8.6
4	2.4	3.8	4.9	8.4

1. M1, M2, and M3 incorporate effects of benchmark and seasonal adjustment revisions made in February 1989.
2. From average of the preceding period to average of the period indicated.
3. Adjusted for shifts to NOW accounts in 1981.
4. The annualized growth rate from the second quarter to the fourth quarter of 1985.

moved upward after March and deposit rates lagged behind, the velocity reversed, and it rose 1.7 percent for all of 1988. The response of offering rates was especially sluggish in the last part of 1988. One reason may have been regulatory pressure on thrift institutions and the closing of many insolvent institutions, which often had been overly aggressive in pricing deposits. The extent to which thrift institutions were offering higher rates than banks on small time deposits was greatly reduced, and partly as a consequence, growth of retail deposits was much stronger at banks than at those institutions.

The growth of the components of M2 also responded to changes in deposit rates and market interest rates. Yields on liquid deposits—interest-bearing checking deposits, savings deposits, and money market deposit accounts—changed very little over the year. During the first half of 1988, liquid retail deposits expanded at a strong pace, largely reflecting increases in their relative attractiveness stemming from declines in market interest rates and, to a lesser extent, in rates on small time deposits. Their growth slowed markedly over the last half of 1988, following the reversal in the pattern of interest rate movements. Growth in small-denomination time deposits was particularly robust throughout 1988. Expansion in the early months of the year may have resulted, in part, from shifts in household investment preferences away from stocks toward the safety of these savings instruments. Later, rising yields on small time deposits relative to those on more liquid deposits led households to shift funds from liquid deposits to small-denomination time deposit accounts.

M3 grew 6.2 percent last year, placing it slightly above the midpoint of its target range of 4 to 8 percent. This increase from a 5.8 percent growth in 1987 reflected a modest pickup in the issuance of managed liabilities in M3 to fund credit expansion at banks and thrift institutions. M3 followed a trajectory near the upper end of its target range in the first half of 1988, but moderated thereafter, in association with slowing credit growth at depository institutions. For the year, large time deposits and other managed liabilities included in M3 but not in M2 grew rapidly, as inflows into M2-type deposits were insufficient for banks and thrift institutions to finance their desired pace of asset expansion. This was particularly true in the second half of the year, when M2 growth moderated. To some extent, M3 growth last year was bolstered compared with 1987 by a greater reliance by banks on managed liabilities included in M3 than on nonmoney stock instruments, such as bank borrowings from overseas branches. In contrast, as in recent years, the heavy use of Federal Home Loan Bank advances by thrift institutions—which are not included in M3—has had a moderating effect on M3 growth.

At 4.3 percent, M1 growth last year was down more than 2 percentage points from 1987. Growth of interest-bearing checking accounts moderated, while demand deposits continued running off. As in recent years, the growth of M1 displayed great sensitivity to changes in market rates of interest. Households shifted savings balances between NOW accounts and those M2 components, such as small time deposits, whose yields responded to increases in market rates much more quickly than those on NOW accounts. Because substitutions of this type are internalized within M2, M2 has displayed less sensitivity to interest rates than has M1 in this decade. Demand deposits, the other highly interest-sensitive component of M1, again declined in 1988, partly reflecting increases in their opportunity costs and declines in compensating balances. The amount of such balances that businesses must hold in these non-interest-bearing accounts to compensate banks for services falls when interest rates rise.

The debt of domestic nonfinancial sectors expanded nearly 8¾ percent during 1988, down from 9 percent in 1987, placing it near the midpoint of the Committee's monitoring range of 7 to 11 percent. Although debt expansion was well below the pace of the mid-1980s, it still exceeded nominal GNP growth. Federal debt grew marginally faster last year than in 1987. Expansion in nonfederal debt moderated, as state and local governments trimmed debt issuance and as households expanded their mortgage debt at a less robust pace in response to higher mortgage rates. Growth of business debt picked up a bit from the 1987 pace, with short-term debt growing faster than long-term debt. Corporate borrowing was particularly strong, reflecting increased external financing needs for capital investments and for mergers, buyouts, and stock repurchases.

Other Financial Developments

Although the economy continued to grow at a strong pace last year and the financial markets recovered from their skittishness following the stock market break of 1987, financial developments in certain markets and sectors warranted the attention of policymakers. Of particular note were the worsening condition of the thrift industry, the need to achieve sounder capitalization of commercial banking organizations, and the rising indebtedness of businesses involved in restructuring activity.

As the year wore on, the dimensions of the problems facing the thrift industry became clearer. Although industry losses eased in the third quarter from their record levels in the first half of 1988, this development appears largely to have reflected FSLIC-assistance transactions during the third quarter, rather than a significant underlying improvement in earnings.

Despite the turmoil in the thrift industry, there has been no noticeable disruption of mortgage activity. In part, the development of a deep secondary mortgage market has separated the origination of loans from the need to fund them. For this reason, the base of mortgage credit has broadened in recent years, making the provision of mortgages far less dependent on the condition of any one type of financial institution or on the regional supply of loanable funds. During the 1980s, the share of home mortgage credit held in securitized form has increased from about 10 percent to more than one-third. The spread between interest rates on fixed-rate mortgages, which have an average life of roughly ten years, and yields on ten-year Treasury notes did not change appreciably over 1988, which also implies that the mortgage markets continued functioning well despite the problems of many savings and loan associations.

In contrast to the thrift industry, preliminary data indicate that U.S. commercial bank profits were reasonably strong in 1988, even after abstracting from the one-time jump in earnings in the fourth quarter associated with the resumption of Brazilian debt payments. Moreover, most large money-center banks with a significant amount of loans to developing countries have continued to build capital, which provides a cushion against default losses. Giving added impetus to efforts to raise equity was the agreement by bank supervisory authorities of major industrial countries to set more stringent, risk-based standards of capital adequacy. These standards, to be fully phased in by 1992, place a greater emphasis on equity capital, take into account the off-balance-sheet activities of banks, and provide a more uniform regulatory treatment of banks based in different countries.

As in 1987, banks lent considerable sums to finance mergers and leveraged buyouts. Although banks have reported that these loans have had a lower rate of loss than all other business loans combined, and although LBO borrowers typically obtain some insurance against higher loan rates, concern remains about bank exposure to losses in the event of an adverse turn in business conditions. For this reason, the Federal Reserve is closely monitoring developments in this area and has just revised its bank examination guidelines to ensure that member bank loans used to finance buyouts and other highly leveraged corporate restructurings meet prudent credit standards.

Leveraged buyouts and other mergers and restructurings led to a record pace of net equity retirements by nonfinancial corporations in 1988. Despite the large volume of this activity in recent years, the overall corporate debt-to-equity ratio is not out of line with observations since the early 1970s, reflecting increased market valuation of equities since the early 1980s. Much of the recent financial restructuring has been a response to fundamental economic factors; it may impose a discipline on corporate management, which in turn can stimulate efforts to improve productivity. Nevertheless, heavy commitments of cash flow to service debt reduce a firm's ability to cope with stresses or industry-specific shocks. To some extent, the substitution of debt for equity is motivated by simple tax-saving considerations, such as the full deduction for interest payments and the double taxation of dividends. For these reasons, reforming the corporate tax system should be a component of public policy in addressing this difficult issue.

Report on July 20, 1989

Monetary Policy and the Economic Outlook for 1989 and 1990

As 1989 began, a reduction in inflationary pressures appeared essential if the ongoing economic expansion was to be sustained. Monetary policy during 1988 had been directed toward reducing the risks of an escalation of inflation and inflation expectations, but at the time of the Board's report to the Congress in February of this year, success in that effort seemed far from assured.

Indeed, among the data reported in the early part of 1989 were very large increases in the producer and consumer price indexes, reflecting not only the effects of run-ups in oil and agricultural commodity prices, but also broader inflationary developments, including unfavorable trends in unit labor costs over the preceding year. Under the circumstances, with pressures on productive resources still intense, monetary policy was tightened further. Reserve availability was curtailed through open market operations, and the discount rate was raised ½ percentage point in late February. In response to these policy actions and to expectations that additional tightening moves might be needed, market interest rates climbed throughout the first quarter, and money growth was subdued.

Over the course of the second quarter, several indicators suggested the emergence of conditions that were more conducive to a future easing of inflationary pressures. Growth of the monetary aggregates weakened further, with M2 running noticeably below its target range for the year. Aggregate demand for goods and services moderated, reducing somewhat the strains on productive resources, especially in the industrial sector of the economy. The dollar exhibited considerable strength in the foreign exchange markets, portending a direct reduction in price pressures and slower growth in demands on domestic production capacity. Although the unemployment rate remained essentially unchanged in the neighborhood of 5¼ percent—the lowest level since the early 1970s—trends in wages and total compensation showed little, if any, further step-up, reflecting at least in part an awareness among workers and management of the need to contain costs in a highly competitive world economy. Meanwhile, prices of actively traded industrial commodities leveled out, enhancing the prospects for a broader slackening in the pace of inflation.

In this environment, interest rates turned down during the spring, as financial market participants responded not only to the better outlook for inflation but also in anticipation of an easing of monetary restraint by the Federal Reserve. The System began to provide reserves slightly more generously through open market operations at the beginning of June and took an additional small easing step in early July. This helped bring about a further decline in market rates of interest, which by mid-July generally had more than retraced the increases that had occurred earlier in the year. Most short-term interest rates were down about ½ percentage point from their December levels, while long-term rates had fallen as much as 1 percentage point on balance.

Ranges of Growth for Monetary and Credit Aggregates

Percentage change[1]

Aggregate	1988	1989	Provisional ranges for 1990
M2	4 to 8	3 to 7	3 to 7
M3	4 to 8	3½ to 7½	3½ to 7½
Debt	7 to 11	6½ to 10½	6½ to 10½

1. From average of the fourth quarter of the preceding year to average of the fourth quarter of the year indicated.

Monetary Objectives for 1989 and 1990

In February, the Federal Open Market Committee specified a range for M2 growth in 1989 that was a full percentage point below that of 1988 and ranges for M3 and debt that were ½ percentage point below those of the previous year. This was the third consecutive year in which the ranges had been lowered. At the same time, the Committee recognized that, in light of the continuing uncertainty regarding the shorter-term relation between monetary growth and changes in income and spending, a variety of indicators of inflation pressures and economic activity as well as the behavior of the aggregates would have to be considered in determining policy.

In February, the Committee had anticipated relatively slow money growth over the first half of the year because of the effects of the firming of policy through late 1988 and into 1989. In addition to the influence of the higher interest rates on desired holdings of money, however, several special factors—including the difficulties of the thrift industry and a drawdown of liquid assets to meet unusually large individual tax payments—appear to have further reduced money balances in the first half. These factors contributed to a substantial rise in velocity, the ratio of nominal GNP to the stock of money.

By June, money growth had picked up. Nonetheless, M2 ended the quarter just 2 percent at an annual rate above the fourth quarter of last year, compared with its annual growth range of 3 to 7 percent. In June, M3 was at the lower end of its annual range of 3½ to 7½ percent. The rate of expansion of domestic nonfinancial sector debt also slowed in the first half of this year compared with 1988, though by less than the monetary aggregates; debt has grown about 8 percent so far this year, near the middle of its monitoring range of 6½ to 10½ percent.

At its meeting earlier this month, the Committee agreed to retain the current ranges for growth of money and debt in 1989. The Committee anticipates that by the fourth quarter all three aggregates will be well within those ranges. The more rapid growth in M2 and M3 already evident since mid-May is expected to extend through the second half. The recent declines in short-term market interest rates have made M2 holdings more attractive, tending to offset the restraining effects on M2 of previous increases of interest rates. With M2 expansion likely also to be boosted by a further replenishing of liquid balances depleted by tax payments, this aggregate is expected to grow a little faster than nominal GNP in the second half, bringing it into the lower portion of its annual growth range. The faster growth of M2 should show through at least in part to a quickening in M3 growth over the second half of the year, so that this aggregate would move into the middle part of its range. Domestic nonfinancial debt is likely to remain in the middle portion of its range through year-end.

For 1990, the Committee provisionally decided to use, for all three aggregates, the same growth ranges in force for 1989. The Committee recognized that the economic and financial outlook over the next year and a half is uncertain; in particular, it is unclear at this juncture whether the velocities of M2 and M3 are more likely to trend higher or lower next year. Although the Committee's initial assessment is that growth of money and credit through 1990 within the bounds of the reduced ranges of this year likely would foster the slower inflation and sustained real economic expansion that it is seeking, it will reevaluate the ranges next February in light of the unfolding economic and financial situation. The outlook for spending, prices, and financial markets in 1990 should have clarified somewhat by then, as should the influence on monetary expansion of the ongoing resolution of thrift industry problems. For the long term, the Committee recognized that ultimate attainment of price stability will require that the ranges for money and credit growth be reduced further in future years.

Economic Projections for 1989 and 1990

Voting members of the Committee and other Reserve Bank presidents believe that the monetary ranges specified are consistent with some progress in reducing inflation, which likely will be associated in the near term with continuation of a slower pace of economic growth. The central tendency of the forecasts is for increases in real GNP of 2 to 2½ percent in 1989 and of 1½ to 2 percent in 1990.

The expected easing of pressures on resources should contribute to a damping of inflation in 1990, although the Board members and Bank presidents also are anticipating some near-term relief from the special problems that boosted prices in the first half of this year. Larger crops later this year should result in more favorable behavior of food prices, and the recent peaking of crude oil prices suggests the likelihood of some softening in consumer energy prices. Thus, retail inflation should be considerably slower over the remainder of this year, and the central tendency of consumer price index forecasts for 1989 as a whole is 5 to 5½ percent – compared with the rate of more than 6 percent observed through May. The forecasts for the CPI in 1990 center on 4½ to 5 percent.

The Administration's economic forecast, presented in connection with its mid-session update of the budget outlook, does not differ greatly from the projections of the FOMC members. Nominal GNP is near the upper ends of the central-tendency ranges of the FOMC for 1989 and 1990, but with a more favorable mix of real output versus inflation, especially in 1990. There appears to be no basic inconsistency between the policy objectives of the Federal Reserve and the economic forecast of the Administration; indeed, the Administration has indicated that it shares the view that the maintenance of anti-inflationary monetary policy is a precondition for healthy economic expansion.

In an environment of relatively slow overall growth, such as is expected by the FOMC members, some industries and regions are likely to experience setbacks; but major imbalances that could threaten the continuation of the economic expansion are not anticipated. In the household sector, growth of consumer purchases has been sluggish and may remain so for a while. Residential construction activity should pick up some in coming months, in response to the recent decline of mortgage rates, although an overhang of supply in some locales could damp the recovery. Surveys of business plans suggest that capital spending will post further gains over the remainder of 1989, but some moderation from first-half growth rates is to be expected in light of declining levels of capacity use and the recent weakening in corporate profits. Spending on equipment is likely to continue to be buoyed by the desire to modernize industrial facilities so as to enhance efficiency and meet intense competition here and abroad.

The external sector represents an area of considerable uncertainty in the economic outlook for the next year and a half. Real net exports of goods and services increased earlier this year, but improvements may be more difficult to achieve in the period ahead as the effects of past depreciation of the dollar wear off and are offset by those associated with the more recent appreciation. In addition,

Economic Projections for 1989 and 1990

Percent

Measure	FOMC voting members and other FRB presidents		Administration
	Range	Central tendency	
		1989	
Change, fourth quarter to fourth quarter			
Nominal GNP	5 to 7¾	6 to 7	7.1
Real GNP	1½ to 2¾	2 to 2½	2.7
Consumer price index[1]	4½ to 5¾	5 to 5½	4.9
Average level in the fourth quarter			
Unemployment rate[2]	5 to 6	Around 5½	5.3
		1990	
Change, fourth quarter to fourth quarter			
Nominal GNP	4¼ to 7½	5½ to 6¾	6.8
Real GNP	1 to 2½	1½ to 2	2.6
Consumer price index[1]	3 to 5¾	4½ to 5	4.1
Average level in the fourth quarter			
Unemployment rate[2]	5 to 6½	5½ to 6	5.4

1. For the Federal Reserve, all urban consumers (CPI-U); for the Administration, urban wage earners and clerical workers (CPI-W).

2. For the Federal Resrve, percent of civilian labor force; for the Administration, percent of total labor force, including armed forces residing in the United States.

the path of exports will depend importantly on economic growth abroad, which may slow as a result of policy actions taken by some of our major trading partners to offset mounting inflationary pressures. Ultimately, achievement of the adjustment needed in the external sector will depend not only on governmental policies that foster macroeconomic stability, but also on the determination of U.S. firms to meet foreign competition through application of stringent cost controls and intensified marketing efforts abroad.

A key ingredient in maintaining a healthy pace of economic expansion is further progress in reducing the federal budget deficit. Since 1983, the deficit has fallen relative to GNP from more than 6 percent to around 3 percent, but it remains large by historical standards. Taking the actions required to meet the Gramm–Rudman–Hollings targets on schedule will foster confidence in the U.S. economy, particularly among financial market participants. At the same time, reduced demands by the federal government for credit will free up the available supply to interest-sensitive private sectors, such as housing and business investment. The Committee thus views as highly encouraging the commitments expressed by the Congress and the Administration to begin soon to address the problems of meeting the fiscal 1991 budget target.

The Performance of the Economy during the First Half of 1989

After two years of rapid expansion, economic activity decelerated substantially in the first half of 1989. Even at this more moderate pace of growth, however, job creation was considerable—nearly 1½ million between December and June—and the civilian unemployment rate, fluctuating around 5¼ percent, remained in the lowest range since the early 1970s.

Inflation rose in the first half of 1989, but most of the increase appears to have resulted from transitory events. In particular, energy prices increased sharply, as the rise in crude oil prices between November 1988 and May 1989 was passed through, and food prices surged as the agriculture sector continued to experience adverse supply developments. Outside food and energy, the rate of inflation has, on average, remained at about its 1988 pace, even in the face of relatively high levels of resource utilization.

This apparent stability of underlying price trends is attributable in part to the appreciation of the dollar on exchange markets. So far in 1989, prices of imported goods other than oil have been virtually flat on average, restraining increases in the prices of domestically produced items. In addition, despite the tightest labor markets in some time, wage trends have been fairly stable, helping to limit the acceleration in unit labor costs during a period in which productivity has weakened.

The External Sector

Developments in foreign exchange markets have played an important role in shaping events in the domestic economy in recent years. After depreciating over most of the period from 1985 to late 1987, the foreign exchange value of the dollar in terms of other G-10 currencies changed little, on net, in 1988, as a decline in the final few months reversed much of the increase that had occurred earlier in the year. In December the dollar began to rebound, and it rose substantially through mid-June before dropping back somewhat. The appreciation of the dollar through the first half of 1989 was frequently met by concerted intervention sales of dollars by U.S. and foreign monetary authorities.

During December, and in the first quarter of this year, the dollar rose in response to perceptions of a relative tightening of U.S. monetary policy. Reports of somewhat higher rates of inflation and news about the strength of the economy contributed to expectations that Federal Reserve policy would be tightened still further. There was a brief pause in the dollar's rise after the Group of Seven finance ministers and central bank governors stated in April that a further rise in the dollar that undermined the adjustment process would be counterproductive.

In May and early June, the dollar appreciated significantly on balance, even though interest rates on nondollar assets rose relative to those on dollar-denominated instruments. Sentiment in favor of the dollar was, perhaps, partly a response to concerns about political events abroad, but the data on the U.S. trade balance, which were better than expected, also may have played a role. For a while, the dollar's rise appeared to be associated with expectations of capital gains on U.S. stocks and bonds. Since mid-June, the dollar has retraced much of its second-quarter rise, under the influence of increasing interest rates abroad, declines in dollar rates, and some easing of demands for dollar assets after the initial response to political uncertainties in certain other countries.

Measured in terms of a trade-weighted average of the other G-10 currencies, the dollar is about 8 percent higher than it was in December 1988 and about 12 percent higher than it was in December 1987. After adjustment for changes in relative price levels, the appreciation of the dollar has been larger because U.S. inflation has remained above the average for the other G-10 countries. Meanwhile, the currencies of South Korea and Taiwan have risen moderately against the dollar so far in 1989.

In most of the other industrial countries, economic growth has been strong. The resulting very high rates of capacity utilization and the diminishing slack in labor markets, together with higher world oil prices and special factors, have spurred an appreciable pickup in inflation abroad in recent quarters. Policymakers in many foreign industrial countries have responded by raising official interest rates. Growth of the newly industrializing economies in Asia has slowed recently, though the rates remain relatively high. In contrast, developing countries that are burdened with large external debts have continued to struggle to achieve sustained economic growth.

The U.S. merchandise trade deficit in the first quarter was $110 billion at a seasonally adjusted annual rate, significantly better than the figure for the fourth quarter and that for 1988 as a whole. In the first two months of the second quarter, the trade deficit was essentially unchanged from the first-quarter pace.

Exports have continued to expand this year, although not so rapidly as in 1988. Export gains have been broadly based, with notable increases for agricultural goods, industrial supplies, capital goods, and consumer goods. Meanwhile, imports have increased moderately; in fact, in April and May imports of products other than petroleum averaged less than 1 percent above their fourth-quarter rate. Notable decreases were recorded in imports of consumer goods and automotive products. So far in 1989, the value of oil imports has risen sharply, as higher prices for petroleum and petroleum products were accompanied by a small increase in physical volume. The further improvement in the U.S. trade balance in the first five months of this year reflects several factors, most importantly the strength of economic activity abroad, the slower growth of U.S. activity, the continuing, if diminished, benefit for

U.S. price competitiveness from the depreciation of the dollar through the end of 1987, and the restraint that the recent rise in the dollar placed on prices of non-oil imports.

The current account deficit widened in the first quarter to $123 billion. The increase from the fourth-quarter rate was more than accounted for by capital losses on assets denominated in foreign currencies resulting from the dollar's appreciation. Setting aside those losses, the current account balance in the first quarter showed a deficit of $108 billion, an improvement of about $22 billion from the previous quarter. Nearly all of this improvement resulted from the narrowing of the trade deficit. Preliminary information on capital transactions in the early months of 1989 suggests an increase in net private foreign purchases of U.S. Treasury securities and corporate bonds and substantial foreign direct investment in the United States.

The improvement in real net exports accounted for nearly half of the overall rise in the GNP during the first quarter, more than reversing its negative contribution in the fourth quarter. The contribution to GNP growth in the second quarter probably was negligible, however, as real net exports may have begun to be depressed by the loss in U.S. price competitiveness associated with the cumulative rise in the dollar since the end of 1987.

The Household Sector

Much of the slowing in overall economic growth in the first half of 1989 reflected a deceleration in consumer spending. The slump in demand was fairly broad, encompassing a variety of durable and nondurable goods. Despite the widespread availability of special financing deals and other incentives, sales of motor vehicles in the first half were about 6 percent below the pace of 1988 as a whole. A weakening in purchases of furniture and appliances likely was related in part to the drop in home sales.

Consumption slowed against a backdrop of strong income growth in the early part of the year, although weaker income growth was evident in the spring. Personal income gains in the first quarter were accentuated by the assumption of the national income accountants that the income of farm proprietors would return to normal levels over the year, after the drought-induced reductions in 1988. With hiring down in the spring, increases in wages and salaries softened noticeably, showing virtually no growth in real terms. Also, growth of the nonwage components of personal income was weaker on balance in the second quarter.

The personal saving rate has been on a distinct upswing since reaching a forty-year low in mid-1987. Several explanations have been propounded for the recent rise, among them the lower level of household net worth relative to income since the stock market break of 1987, higher costs of consumer credit (especially in after-tax terms, because of the phase-down of interest deductibility), and concerns about a potential softening of the economy. Whatever the cause, households appear to have adopted a more cautious spending stance, though it also should be noted that the personal saving rate has remained below the norms of the 1960s and 1970s.

Residential construction declined over the first half in response to the rise in interest rates and to earlier overbuilding in some markets. The more recent drop in rates, which began in May, likely will be reflected in some improvement in construction over the summer and fall. Total housing starts, at an average annual rate of 1.44 million units through May, were down 3¼ percent from their 1988 pace.

Starts in the single-family sector averaged about 1 million units at an annual rate between March and May, a period relatively free from the weather-related distortions that affected construction in January and February. Interest rates on fixed-rate mortgages rose above 11 percent for the first time since 1985, with part of the rise attributable to investor concerns about sizable future liquidations of mortgage assets by troubled thrift institutions. Also, rates on adjustable-rate mortgages rose nearly a full percentage point during the early months of 1989, as discounting of initial interest rates on ARMs was reduced. In recent years, relatively low initial terms on ARMs led an increasing number of households to favor this instrument for home purchases. Since their highs in the spring, interest rates on ARMs have fallen more than ½ of a percentage point, while fixed-rate mortgage rates have dropped about 1¼ percentage points.

Meanwhile, multifamily starts fell further in the first half of the year from the already low level recorded in 1988. Multifamily housing production has been limited by an overhang of vacant rental units. Moreover, building in this sector continues to reflect the effects of the Tax Reform Act of 1986, which, by curtailing many of the financial advantages associated with investment in rental housing, sharply reduced its after-tax profitability.

The Business Sector

In contrast to the household sector, business capital spending strengthened in early 1989, responding in part to high levels of capacity utilization in the United States and to international pressures to lower costs. In the first quarter of 1989, real business fixed investment rose at an annual rate of 7½ percent, and such spending appears to have increased substantially further in the second quarter.

The gain in investment has occurred in the equipment category. Particularly noteworthy in the first quarter was a sharp rise in outlays for industrial machinery. Increases in that area, which includes spending for fabricated metal products, engines, turbines, and a variety of other types of industrial apparatus, have been exceptionally strong since mid-1987. Spending for high-technology equipment also has been robust. Computer outlays decelerated during the second half of 1988, possibly reflecting some hesitation on the part of potential purchasers in response to the rapid pace of new product announcements; but spending was up considerably in the first quarter, and another gain appears in train for the second quarter.

High levels of factory utilization apparently have spurred a rise in industrial building in recent quarters. Outlays for construction of office and other commercial buildings also rose earlier this year, although the level of total spending on commercial structures remained below that of the 1985–86 period, depressed by excess space in many areas. And, while the rise in energy prices led to some increase in oil and gas drilling in the spring, the level of activity remained very low compared with that of the early 1980s.

Inventory investment slowed over the first five months of 1989, as businesses adjusted with apparent promptness to the more moderate expansion of final demand. Inventory buildups by manufacturers have been concentrated in the aircraft and other capital goods industries, where production has risen and order backlogs are large. In contrast, in the retail sector, automobile inventories rose sharply in the first quarter and have remained high. In an effort to reduce the overhang before introducing new models in the fall, carmakers have lowered factory assembly rates and have enhanced sales incentives. Qualitative reports have suggested that stocks at some other retailers also may have risen above desired levels, although most firms appear to have been following cautious inventory policies, and problems of excess stocks seem to be limited.

In the first quarter of 1989, before-tax economic profits of nonfinancial corporations declined, in part because unit labor costs increased as sales growth slowed and productivity deteriorated. The drop in profits was spread over most types of businesses; the largest decline was in the manufacturing sector, which had especially strong gains in both 1987 and 1988. Meanwhile, corporate tax liabilities edged up in the first quarter, owing in part to higher profits generated from the rise in prices of inventories. The combination of lower operating profits and higher tax liabilities reduced the internal cash flow of nonfinancial corporations.

The Government Sector

In the first quarter, real federal purchases of goods and services, the part of federal outlays that is counted directly in GNP, were virtually unchanged. Such purchases are dominated by defense; nominal spending authority in this area has been virtually flat since 1985, and procurement of some major new weapon systems is winding down. As a result, real military purchases have fallen and in the first quarter were nearly 5 percent below the mid-1987 peak. The decline in defense spending has been partially offset by increases in other federal purchases. Inventories held by the Commodity Credit Corporation edged down further in the first quarter, but the rate of decline has been slowing (on a seasonally adjusted basis) since the middle of last year as the effects of last summer's drought have dissipated. Spending for the space program and for tax and immigration enforcement also has risen.

On a unified budget basis, total nominal outlays for the fiscal year through May were more than 6 percent above the comparable year-earlier total. Spending related to the thrift institution problem spiked at year-end 1988 and then dropped sharply in the first half of this year. On the other hand, growth has continued in entitlement spending (principally Medicare and Social Security) and in net interest outlays.

Federal receipts have grown even more rapidly than outlays, buoyed by increases in employment and income. In addition, there was an extraordinary spurt in nonwithheld tax collections in April and May, the sources of which are at this point uncertain. Some possible explanations relate to the Tax Reform Act of 1986 and include greater-than-anticipated effects from its base-broadening provisions and a shifting of income from earlier years into 1988, when the reduction in personal tax rates was fully phased in. In addition, realizations of taxable capital gains may have been hefty last year because of the large number of corporate mergers and leveraged buyouts. All told, receipts thus far in 1989 are 10 percent above year-earlier levels, and the Administration now projects that the total budget deficit for FY1989 will be $148 billion, compared with the $155 billion recorded in FY1988.

Real purchases of goods and services by state and local governments have been on a moderate uptrend this year. Outlays for personnel and construction in the education and law enforcement areas have been subject to considerable upward pressure. Some other expenditures have risen because of federal mandates, especially those in recent health legislation. As in the federal sector, growth of state and local outlays has been tempered by budgetary pressures; excluding retirement trust funds, which are running a large surplus, the sector had a deficit of about $17 billion at an annual rate in the first quarter. Revenue experience was favorable this spring, however, as a significant number of states reported personal income tax receipts that were larger than expected.

Labor Markets

Job growth was substantial over the first half of 1989, though it slowed in the spring. In the first quarter, additions to nonfarm payrolls averaged 264,000 a month, about the same pace seen over the previous two years. By spring, hiring had begun to slow, and payroll employment growth dropped back to 200,000 per month in the second quarter as a whole. Even at this reduced rate, however, job gains were larger than are likely to be sustained, given the underlying trend in labor force growth. Manufacturing employment declined in the second quarter, while the number of construction jobs was about unchanged. Growth of employment moderated in the service-producing sectors, where advances have been the largest over the course of this business expansion.

The moderation in the growth of the demand for labor in the second quarter did not lead to any appreciable reduction in labor market tightness. The unemployment rate has fluctuated between 5.0 and 5.4 percent thus far this year; in June it stood at 5.3 percent. Although many Americans remain involuntarily unemployed, the difficulty of matching workers with jobs—given considerations of skill and location—is much greater than it was earlier in the expansion.

By at least one aggregate measure, the rate of increase in wages seems to have leveled off in recent quarters. Average hourly earnings of production and nonsupervisory workers accelerated from late 1986 through mid-1988; since then the rate of increase has flattened out, and in June earnings were up 3¾ percent from a year earlier. The employment cost index for wages and salaries in the private nonfarm sector, a broader measure of wages that is available only through March, indicated some easing of wage trends in the goods-producing sector; however, in the service-producing industries, the trend remained sharply upward. The cost of benefits provided to employees in the goods and services sectors rose slightly faster than wages over the year ended in March, and total compensation per hour—wages and salaries plus benefits—was up 4½ percent over that period, in the same range as the 12-month increases recorded in the preceding three quarters.

Productivity performance has deteriorated somewhat in recent quarters. In some instances, higher levels of production have forced firms to use less efficient capital and to employ less skilled labor. Output per hour in the nonfarm business sector was down in the first quarter, and virtually unchanged on a four-quarter basis. With the sizable increases in compensation over the same period, unit labor costs accelerated to a 5¼ percent annual rate, the largest year-over-year increase since late 1982. In manufacturing, the rise in unit labor costs in the year ended in the first quarter was about 1 percent; unit costs had declined earlier in the business expansion. This step-up in unit labor costs reflects a slackening in the improvement of factory productivity; compensation increases have remained moderate.

Price Developments

Inflation increased sharply in early 1989, reflecting higher costs for food and energy. The consumer price index for all items, a broad-based measure for finished goods and services, rose at an annual rate of more than 6 percent through May, compared with the pace of 4½ percent in 1987 and 1988. The producer price index for finished goods recorded an even more pronounced acceleration, owing to the greater importance of food and energy in that index. However, the underlying inflation trend has not deteriorated: Excluding food and energy, inflation at the retail level has been running at a rate of around 4¾ percent, about the same as in 1988.

Energy prices began rising sharply last November, after the OPEC nations agreed to limit crude oil production. Subsequently, temporary supply disruptions in Alaska and in the North Sea added to price pressures. The posted price of West Texas Intermediate, the U.S. benchmark for crude oil, jumped from about $13 per barrel in November to over $19 in early May. As a result, energy prices at the producer level soared, and consumer energy prices rose nearly 25 percent at an annual rate between December and May. More recently, posted prices of crude oil have remained between $19 and $20 per barrel.

Increases in retail food prices were large in the first half of 1989, in part reflecting the lingering effects of last summer's drought and additional damage to some crops this year. From the beginning of the year through May, the rise in the CPI for food was close to 8 percent at an annual rate. Although drought curtailed the winter wheat crop for 1989, total crop acreage has expanded, and overall production should rebound this year if weather conditions are satisfactory. In addition, meat supplies seem likely to hold fairly steady over the second half of this year. Thus, pressures from the supply side should not be a big factor in the food price outlook.

Excluding food and energy, prices for commodities at the consumer level have risen at a rate slightly lower than that recorded for 1988. A marked diminution of increases in non-oil import prices associated with the appreciation of the dollar apparently has restrained the prices of many goods, notably apparel and a variety of household items. In contrast, inflation in the service sector has increased, especially in labor-intensive services, such as medical care, entertainment, and public transportation.

At early stages of processing, prices of goods have risen little or declined in recent months. Prices for many crude industrial commodities, which had climbed sharply in 1987 and 1988 with the expansion of factory output, have softened this year. This in turn has helped hold down the increase in prices at the intermediate level of production; the producer price index for intermediate materials, excluding foods and energy, was unchanged on net in the second quarter.

Monetary Policy and Financial Developments during the First Half of 1989

In conducting monetary policy over the first half of the year, the Federal Open Market Committee continued its effort to foster long-run price stability, so as to build a base for sustainable expansion of the economy. In again reducing the ranges for money and debt growth at its February meeting, the Committee recognized that restraint on the expansion of money and credit would be needed to promote this goal.

At the same time, the Committee realized that considerable uncertainty remained about the behavior of the monetary aggregates. Relatively wide monetary ranges—4 percentage points in breadth—were retained, in part to take account of the substantial interest rate sensitivity of money demand over horizons of as long as a year and of the unpredictable effects on money demand of the resolution of the crisis in the thrift industry. Moreover, in these circumstances, the Committee recognized that, in addition to the behavior of the monetary aggregates, a variety of indicators of inflationary pressures and the course of economic activity would have to be taken into account in shaping policy over 1989.

The Implementation of Monetary Policy

As noted previously, developments early in 1989 suggested that a worrisome risk remained that inflation was picking up and could become more deeply embedded in the economy. Wage and benefit costs had accelerated in 1988, and the readings for the consumer and producer price indexes were troubling. Extending the move toward restraint that began almost a year earlier, the Federal Reserve increased reserve market pressures at the start of this year and again in mid-February. On February 24 the discount rate was raised ½ percentage point to 7 percent.

These policy actions were accompanied by marked increases, of about a percentage point, in most short-term interest rates. Yields on long-term securities also moved up, but by considerably less than short-term rates. The foreign exchange value of the dollar strengthened as interest rates in the United States rose relative to those abroad. Money growth slowed: M1 was roughly flat in the first quarter, and M2 and M3 decelerated from already reduced rates in the second half of 1988.

By spring, the outlook for spending and prices had become more mixed. Employment growth still looked strong; indicators of capital spending suggested a rebound from the fourth quarter of 1988; and prices continued to advance rapidly. But consumer demand appeared to have moderated; industrial production was weakening; and the behavior of commodity prices and some other indicators of potential price trends suggested that inflationary momentum might begin to wane. In view of the uncertainties surrounding the outlook and taking into account the subdued pace of money growth, the Committee left reserve market conditions unchanged through the middle of the second quarter.

Many interest rates began to move off their March highs early in the second quarter as indications mounted of moderation in the pace of economic activity and in underlying price pressures. With the passing weeks, a considerable weakening in housing activity became evident, and incoming data showed employment to be expanding at a noticeably slower rate. Market expectations of some additional tightening of monetary policy shifted to anticipations of an easing. The ensuing decline in interest rates did not, however, prompt a drop in the foreign exchange value of the dollar. Instead, the dollar appreciated further over this period, in part because of political uncertainties abroad and in part because of data on the U.S. trade balance that were better than expected. The dollar also may have gained support for a while from expectations that the rallies in U.S. securities markets would continue. The monetary aggregates weakened further in April and early May, reflecting the drawdown of liquid balances to make personal tax payments that were larger than expected. In May, M2 fell to the lower edge of the parallel band associated with its annual target range, and M3 slipped just below the bottom of its growth cone.

The FOMC eased policy slightly at the beginning of June and again in early July. The federal funds rate moved down about ½ percentage point in two steps to around 9¼ percent. Evidence that the more moderate pace of economic activity was persisting, indicators of the behavior of wages and sensitive prices, and the weakness of the monetary aggregates all were consistent with a prospective ebbing of inflationary pressures. Moreover, the dollar was appreciably above year-end levels, which could be expected to have favorable effects in restraining inflation. While inflation remained a concern, an intensification of price pressures did not appear to be a present danger, and the risks of cumulating weakness in the economy had increased.

Although the easing steps were largely expected, most short-term interest rates continued downward in anticipation of further monetary policy actions, more than offsetting their first-quarter rise. The bond market rallied further, leaving long-term rates by mid-July down ½ to 1 percentage point on balance from late-1988 levels. Stock prices continued their brisk upward movement, reaching post-October 1987 highs. The value of the dollar also moved down somewhat in late June and dropped further in early July; it retraced most of its rise during the second quarter, although remaining well above its level at year-end 1988.

The Behavior of the Monetary Aggregates

Growth of the monetary aggregates was quite sluggish over the first half of 1989, reflecting the effects of increases through March in market interest rates relative to returns on monetary assets, some depositor concern over the problems of the thrift industry, and large tax payments by individuals. From the fourth quarter of 1988 through June, M2 edged up at an annual rate of only 2 percent, markedly below last year's pace of 5¼ percent. M2 velocity rose sharply through the second quarter.

The deceleration of M2 in the first quarter stemmed largely from a combination of continued increases in market interest rates and unusually slow upward adjustment of rates paid on retail deposits. Yields on NOW accounts moved up only about 10 basis points over the year ended in March, while those on other liquid deposits – savings and Money Market Deposit Accounts (MMDAs) – rose about ¼ and 1 percentage point respectively; many short-term market rates increased more than 3 percentage points over the same period. Rates on small time accounts increased much more than those on the more liquid retail deposits, but they too failed to keep up with the rise in market yields.

Some of the sluggishness in the adjustment of returns on retail deposits over this period may have reflected continued regulatory pressures on thrift institutions to moderate their pricing of deposits, as well as the closing last year of some insolvent institutions with aggressive pricing policies. More broadly, the slow upward adjustment of deposit rates, especially on accounts without fixed

Growth of Money and Debt

Percentage change

Period	M1	M2	M3	Debt of domestic non-financial sectors
Fourth quarter to fourth quarter				
1979	7.7	8.2	10.4	12.3
1980	7.4	9.0	9.6	9.6
1981	5.2 (2.5)[2]	9.3	12.3	10.0
1982	8.7	9.1	9.9	9.0
1983	10.2	12.1	9.8	11.3
1984	5.3	7.7	10.5	14.2
1985	12.0	8.9	7.7	13.2
1986	15.6	9.3	9.1	13.4
1987	6.4	4.2	5.7	9.8
1988	4.3	5.2	6.2	8.9
Quarter to quarter (annual rate)				
1989: 1	−0.4	1.9	3.7	8.2
2	−5.5	1.3	3.1	7.4[e]

1. From average of the preceding period to average of the period indicated.
2. Adjusted for shifts to NOW accounts in 1981.
e Estimated

terms—NOW accounts, MMDAs, and savings deposits—also reflected the continued evolution of pricing strategies by depository institutions in the deregulated environment. By concentrating upward rate adjustments in small time deposits and offering more sophisticated account structures, in which larger balances receive higher rates, institutions found that they could retain the bulk of their funds while minimizing the effects of higher market rates on their overall interest expense.

Nonetheless, as yields on market instruments became increasingly attractive relative to those on deposits over the first quarter, some funds were redirected to instruments not included in the monetary aggregates. Noncompetitive tenders for Treasury bills and notes, a rough indicator of the extent to which individual investors are increasing their holdings of Treasury securities, surged early in the year and remained strong through March. The increase in demand for Treasury securities was greater than would have been expected from interest rate movements alone, suggesting that depositors' nervousness about the problems of the thrift industry were playing a role too. Although the President submitted to the Congress a comprehensive plan for resolving the industry's difficulties early in the year, and gave assurances that the U.S. government would back insured deposits fully, FSLIC-insured thrift institutions experienced large outflows of deposits throughout the first quarter. These outflows apparently depressed overall M2 growth somewhat during that period, but the bulk of the funds likely remained within the aggregate. Commercial banks experienced relatively strong growth in core deposits, and M2-type money market mutual funds, whose rates adjust relatively quickly to changes in market interest rates, saw sizable inflows of funds.

The increased opportunity costs of the first part of the year continued to damp money growth into the second quarter, but, in addition, liquid balances were drawn down to meet large April tax payments. Nonwithheld personal tax payments were $16 billion greater this April than last. The tax-related effect was manifested in a sharp drop in the liquid components of M2 in late April and into May as the payments continued to clear. Transaction accounts posted large declines, outflows of savings and MMDA balances accelerated, and inflows to money market mutual funds paused. Balances began to bounce back in late May, however, as depositors started to rebuild their holdings of monetary assets; and in June, M2 grew at an annual rate of 6¾ percent.

Also contributing to the rebound in holdings of money balances after mid-May were declines in opportunity costs as market interest rates headed down. Yields on small time deposits lagged this move, and returns on these deposits at times exceeded those on market instruments. Demand for Treasury securities through noncompetitive tenders fell back, and growth in small time deposits, already robust, jumped to an annual rate of more than 20 percent for the quarter. Yields on small time deposits at thrift institutions responded somewhat more slowly than those at banks to the downturn in market interest rates, and growth of these deposits at thrift institutions surged. Largely because of this strength in small time accounts, and because the most anxious depositors probably had already moved their funds elsewhere, overall deposit balances at FSLIC-insured thrift institutions stabilized in the second quarter.

M3 grew at an annual rate of 3½ percent from the fourth quarter of last year to June, placing it at the lower bound of its target range. In the first quarter, expansion of M3 was subject to offsetting forces. It was bolstered somewhat by bank funding needs generated by strong demand for business loans. Added demand for commercial and industrial loans stemmed both from merger-related financings and from shifts to short-term borrowing by businesses facing rising long-term interest rates and investor concerns about "event risk" – the possibility that a firm's debt obligations would be significantly downgraded in a corporate buyout or restructuring. Acting to damp M3 growth over the first quarter, however, was heavy reliance by thrift institutions on Federal Home Loan Bank advances and other borrowings, which are not included in the money stock. M3 growth edged down a bit in the second quarter with some easing of bank credit demands and strong growth in government deposits – also not included in the money stock – resulting from the large volume of tax payments. By June, however, M3 had rebounded as tax effects unwound.

Reflecting interest rate and tax-related effects, M1 declined at an annual rate of 3½ percent from the fourth quarter of 1988 to June. Balances in other checkable deposits, which had moved down a little over the first quarter in response to higher opportunity costs, dropped substantially in late April and early May as the tax payments cleared. Demand deposits also declined on balance over the first half of the year, because opportunity costs increased and because the balances businesses are required to hold to compensate their banks for services fell. After changes in market rates of interest, banks often adjust with a lag the "earnings credit" rates used to determine the level of required compensating balances; thus, downward adjustments to compensating balances can continue for some time after market rates have stopped rising. The large personal tax payments also affected household demand-deposit balances. Late in the quarter, however, both demand and other checkable deposits began to increase, perhaps as some of the earlier influences started to be reversed with the drop in market interest rates over the second quarter.

Credit Flows

The aggregate debt of domestic nonfinancial sectors expanded at an annual rate of close to 8 percent over the first half of this year, near the midpoint of its monitoring range and down somewhat from its 1988 pace. The growth of federal sector debt slowed as tax receipts surged. Expansion of the debt of nonfederal sectors also moderated, partly in response to higher levels of market interest rates over much of the first half of the year. Household borrowing in mortgage markets slowed as increases in lending rates damped housing demand, while the pace of consumer borrowing slackened along with the deceleration in consumption spending.

Mortgage lending by thrift institutions did not appear to be unusually weak in the first few months of 1989, given the prevailing interest rates. These institutions coped with weak deposit flows by running off cash and investments and, through the first quarter, stepping up borrowing from the Federal Home Loan Banks. Despite signs of a reduction in mortgage lending activity by these institutions in the second quarter, the overall availability of housing credit did not appear to be significantly impaired.

Spreads between rates on both fixed-rate mortgages and mortgage-backed securities and rates on Treasury instruments of comparable maturity did widen over the first six months of the year, with some market participants reportedly fearing that large-scale liquidations of mortgage-backed securities by troubled thrift institutions could adversely affect the market for those instruments. However, the widening also may have reflected other developments: a general increase in uncertainty about movements in long-term interest rates (and therefore about prospective prepayments), and the flattening of the yield curve, which discouraged issuance of derivative mortgage instruments and thus reduced demand for the underlying mortgage-backed securities.

Total borrowing by nonfinancial businesses in the first half of the year was close to its 1988 pace. Credit demands continued to be buoyed by sizable merger-related financing in the first quarter, and an apparent pickup in capital expenditures increased business borrowing in the second quarter even as credit demands related to mergers and restructurings, while still strong, eased a bit. Because of investor fear of event risk triggered by the RJR–Nabisco acquisition in late 1988 as well as higher long-term rates through much of the period, corporate borrowing was concentrated in short-maturity vehicles. Commercial paper issuance surged during the first half of the year; businesses also relied on bank loans, albeit to a lesser extent. In response to investor concerns about event risk, many firms issued bonds with relatively short maturities of one to five years, or they brought issues to market with straight puts or with so-called poison puts—covenants designed to protect against negative effects on bondholders from future restructurings. Toward the end of the second quarter, with the introduction of these protections and the decline in rates, long-term financing in the corporate bond market was on the upswing.

Net issuance of tax-exempt securities by state and local governments fell sharply over most of the first half of 1989. Investor demand for tax-exempt securities remained strong and, with diminished supply, the ratio of tax-exempt to taxable yields fell to its lowest level since 1984. This ratio rose somewhat late in the second quarter, when the decline in long-term interest rates began to bring forth an increase in refunding activity and a pickup of issuance of bonds to raise new capital. ■

Part 2

Records, Operations, and Organization

Record of Policy Actions of the Board of Governors

Regulation B (Equal Credit Opportunity)

November 22, 1989—Amendments

The Board amended Regulation B, effective April 1, 1990, to implement recent changes in the Equal Credit Opportunity Act relating to business credit.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell and LaWare. Absent and not voting: Mr. Kelley.[1]

The Women's Business Ownership Act of 1988 amended the Equal Credit Opportunity Act to provide small business owners who borrow with the same rights and protection under the act as are afforded consumers. The legislation had been enacted in response to a perception by women that they were being discriminated against in obtaining business credit. The act requires creditors to give written notice to business applicants of their right to obtain a written explanation of a credit denial. Also, creditors are required to retain records relating to business credit applications for at least a year.

The amendments to Regulation B implement the statutory requirements and define a small business as a firm that had gross revenues of $1 million or less in the preceding fiscal year. The amendments require that creditors provide written notices and retain records on applications involving small businesses. Applications from businesses with higher revenues are subject to the regulation's modified notice requirements and recordkeeping rules. In addition, the revisions eliminate an exception that had permitted creditors to make inquiries about the marital status of an applicant for business credit and an exception concerning the reporting of credit information.

Although Governor Angell supported the revisions to Regulation B, he preferred defining small businesses as those having annual gross revenues of $500,000 or less. He believed that business credit applicants with revenues greater than that amount have enough alternatives for credit that discrimination would not be as much a factor in credit decisions.

The amendments are effective December 8, 1989; compliance is not mandatory, however, until April 1, 1990.

Regulation C (Home Mortgage Disclosure)

December 6, 1989—Revision

The Board revised Regulation C, effective January 1, 1990, to implement recent amendments to the Home Mortgage Disclosure Act that expanded coverage and required additional disclosure of certain residential lending data.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Kelley, and LaWare.[1]

The Home Mortgage Disclosure Act requires covered lenders in metropolitan statistical areas to disclose annually the amount of their mortgage and home

1. Throughout this chapter, note 1 indicates that a vacancy existed on the Board when the action was taken.

improvement lending, and to indicate by census tract or by county the location of loans originated or purchased. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 amended the Home Mortgage Disclosure Act by (1) extending coverage to all types of mortgage lenders, including those not affiliated with a depository institution or a holding company; (2) requiring disclosure of information on the disposition of loan applications, in addition to the information on loan originations and purchases; (3) requiring disclosure of data on the race, gender, and income of borrowers and applicants; and (4) requiring disclosure of information on those who acquire loans sold by an institution.

The Board revised Regulation C to implement these changes. In addition, the Board adopted a new loan application register form to facilitate compliance with the disclosure requirements. Under the new register format, institutions are required to record loan applications, loans made, and loans purchased. The first set of reports using the new format is due March 31, 1991.

Regulation D (Reserve Requirements of Depository Institutions)

December 6, 1989—Amendment

The Board amended Regulation D to decrease the amount of transaction balances to which the lower reserve requirement applies.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Kelley, and LaWare.[1]

Under the Monetary Control Act of 1980, depository institutions, Edge and agreement corporations, and U.S. agencies and branches of foreign banks are subject to reserve requirements set by the Board. Initially, the Board set reserve requirements at 3 percent of an institution's first $25 million in deposit balances and at 12 percent of balances above that level. The act directs the Board to adjust annually the amount subject to the lower reserve requirement to reflect changes in transaction balances nationwide. By the beginning of 1989, the amount was $41.5 million. Recent declines in transaction balances warranted a decrease of $1.1 million. The Board, therefore, amended Regulation D to decrease to $40.4 million the amount of transaction balances to which the lower reserve requirement applies. The amendment is effective with the reserve computation period beginning December 26, 1989, for institutions that report weekly; and December 19, 1989, for institutions that report quarterly.

The Garn–St Germain Depository Institutions Act of 1982 established a zero percent reserve requirement on the first $2 million of an institution's reservable liabilities. The act also provides for annual adjustments to that exemption based on deposit growth nationwide. Because of the lack of growth in deposits this year, no adjustment was made to the exemption.

Regulation H (Membership of State Banking Institutions in the Federal Reserve System)

February 3, 1989—Amendment

The Board amended Regulation H, effective April 1, 1989, to improve public access to financial information about the condition of state member banks and U.S. agencies and branches of foreign banks.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, Kelley, and LaWare.

The amendment to Regulation H requires that member banks make available to shareholders and to the public, upon request, one free copy of their year-end reports of condition and of income for the preceding two years, or alternatively, reports containing information equivalent to the data provided in the year-end statements. Agencies and branches of foreign banks are required to provide, upon request, free copies of three specified schedules from their year-end reports. After the effective date of the amendment, covered institutions must provide the year-end statements no later than April 1 of the following year and must notify shareholders and the public when the information becomes available.

February 10, 1989—Interpretation

Effective February 17, 1989, the Board issued an interpretation of Regulation H that conditionally authorizes member banks to purchase stock of certain investment companies.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and LaWare. Absent and not voting: Mr. Kelley.

The interpretation of Regulation H permits state member banks to purchase the stock of an investment company that invests in obligations of the U.S. Treasury, federal agencies, states and municipalities, corporate debt instruments, or certain other securities. Investment in these companies is permissible if the investment portfolio of the investment company or mutual fund in which the member bank would invest consists entirely of securities that the bank could acquire directly itself. Because this authorization includes investment in money market mutual funds, the Board also rescinded an interpretation that had authorized member banks to invest in those funds.

Regulation Y (Bank Holding Companies and Change in Bank Control) and Rules Regarding Delegation of Authority

August 24, 1989—Amendments

The Board amended Regulation Y, effective October 10, 1989, to permit bank holding companies to acquire savings associations. The Board amended its Delegation Rules, effective September 18, 1989, to delegate authority to approve the acquisition of a failing savings institution to a senior Board officer.

Votes for these actions: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Kelley, and LaWare.[1]

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 amended the Bank Holding Company Act to allow holding companies to acquire healthy and failed or failing savings associations. The Board revised Regulation Y to permit the acquisition of a savings association in any state, without regard to whether the bank holding company may operate a subsidiary bank in that state. The amendments do not impose branching restrictions or operating limitations on savings associations; the institutions, however, are required to confine their activities to those activities that are permissible for bank holding companies under the Bank Holding Company Act.

The revisions to the Rules Regarding Delegation of Authority authorize the Staff Director of the Division of Banking Supervision and Regulation to approve applications to acquire a savings association if expeditious action is needed to prevent the failure of that institution. The Staff Director currently has delegated authority to approve applications to acquire failing banks.

Regulation Z (Truth in Lending)

March 30, 1989—Amendments

The Board amended Regulation Z to implement the Fair Credit and Charge Card Disclosure Act of 1988.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Kelley, and LaWare. Absent and not voting: Mr. Heller.

The act and the amendments require that issuers of credit cards and charge cards provide specific information on application forms and solicitations. The required information, such as annual percentage rate, annual fee, and any grace period, must be included on all application forms in tabular form, including those provided in magazines or catalogs. The amendments also include rules for direct-mail applications and telephone solicitations. Card issuers that impose an annual fee must provide disclosures before the annual renewal of the card. If a card issuer that provides credit insurance decides to change insurance carriers, it must disclose to consumers any substantial increase in rates or decrease in coverage that will result from the change.

The amendments are effective April 3, 1989, with compliance optional until August 31, 1989. Compliance with the provisions pertaining to disclosures required for applications and solicitations made available to the general public is optional until November 29, 1989.

May 31, 1989—Amendments

The Board amended Regulation Z to implement the Home Equity Loan Consumer Protection Act of 1988.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, Kelley, and LaWare.

The Home Equity Protection Act was enacted to ensure that borrowers who pledge their homes as collateral for a line of credit have received adequate information about the terms of the home-equity plan before they consummate the agreement. The legislation and the Board's implementing rules specify the types of disclosures that creditors must provide and stipulate that the information must be disclosed when an application for a home-equity loan is provided to a consumer. The information, which must be provided along with the loan application, includes the following: payment terms and an example of the payments; fees imposed to open or use the line of credit; and an estimate of any fees imposed by third parties. If the loan carries a variable interest-rate feature, the creditor must disclose that fact and indicate the index used to determine the rate and the frequency of changes in the rate. Besides those disclosures, creditors also must provide a brochure describing the general features of home equity plans. The Board has developed a sample brochure that meets this requirement.

In addition to the expanded disclosure requirements, the act and the amendments establish substantive limits on home equity plans. The act limits, for example, a creditor's ability to terminate a plan or accelerate payment on an outstanding balance. Also, plans with a variable-rate feature must be based on a publicly available index outside the creditor's control.

The amendments are effective June 7, 1989; compliance is optional, however, until November 7, 1989.

Regulation CC (Availability of Funds and Collection of Checks)

March 30, 1989—Amendments and Policy Statement

The Board adopted amendments to Regulation CC that were technical or clarifying in nature and issued a policy statement to discourage delayed disbursement practices.

Votes for these actions: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Kelley, and LaWare. Absent and not voting: Mr. Heller.

The Board amended the regulation and the related official commentary to clarify and refine the regulation, which was adopted in mid-1988 to implement the Expedited Funds Availability Act. The changes are designed to remove ambiguities and to facilitate compliance. The amendments are effective April 10, 1989, except for the provisions governing agencies of foreign banks and the changes to Appendix A, which are effective August 10, 1989.

In a related action, the Board issued a policy statement to discourage certain abuses of the check collection system, particularly delayed disbursement practices. An institution that engages in delayed disbursement practices issues checks drawn on an institution located in an area remote from the payee. Delayed disbursement practices increase the time required to collect and return a check, as well as processing and transportation costs. The practice also increases the likelihood that a check will not be returned until after the funds have been withdrawn. The problem has become more acute since passage of the Expedited Funds Availability Act because the act requires banks to make available for withdrawal on the next business day after deposit the proceeds of certain types of deposits, including cashier's checks, teller's checks, and checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank.

The Board's policy statement urges institutions that issue official checks to take steps to minimize delays in the collection and return of checks. In taking this action, the Board indicated that the policy statement was issued in lieu of more formal regulatory action and that the Board would monitor delayed disbursement practices to determine whether institutions are complying with the voluntary system. If delayed disbursement practices continue, the Board will seek regulatory remedies.

July 26, 1989—Amendment

The Board amended provisions in Regulation CC relating to payable-through checks.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell and Kelley. Absent and not voting: Messrs. Heller and LaWare.

When the Board adopted Regulation CC last year to implement the Expedited Funds Availability Act of 1988, it had included a provision stipulating that a bank check or a credit union share draft that was written on an account at one institution but payable through another institution would be considered local or nonlocal depending on the location of the institution through which the check would be paid. Subsequently, a court determined that that provision was inconsistent with the act. The court's ruling indicated that payable-through checks should be treated as local or nonlocal depending on the location of the institution on which a check is written, not on the location of the bank through which the check is paid.

The Board, therefore, made two revisions to Regulation CC to reflect the court's decision. Effective February 1, 1991, payable-through checks are required to identify conspicuously the name, location, and first four digits of the routing number of the bank on which a check is written, and include the words "payable through," followed by the name and location of the payable-through bank. The regulation also was revised to provide that the risk of loss for the return of a payable-through check will be placed on the bank on which a check is written, when the return of such a check takes longer than would have been required if the check had been returned expeditiously by the bank on which it was written. The latter revision is effective February 1, 1990.

Other Actions

In July the Board issued its 1989 report to the Congress on the effects of the Expedited Funds Availability Act and Regulation CC on consumers and depository institutions. The report also recommended ways to facilitate compliance with the act, to reduce the risk of fraud in accepting checks that must be given next-day availability, and to clarify the Board's authority to allocate liability for violations of subpart C of Regulation CC.

In October the Board issued its second report to the Congress on deposits at nonproprietary automated teller machines (ATMs). The report recommended that the Congress amend the Expedited Funds Availability Act to treat deposits at nonproprietary ATMs under the permanent schedule in the same manner as they are treated under the temporary schedule. Such an amendment would help ensure that deposit-taking at nonproprietary ATMs is not restricted or discontinued by those banks that believe they need the flexibility to place longer holds on these deposits to limit their risk exposure.

In December the Board issued for public comment proposed technical and clarifying amendments to Regulation CC and an amendment to shorten the maximum time allowed for sending a notice of nonpayment to the bank that first received the check. In December the Board also issued for comment a proposed determination of preemption regarding a California law on funds availability. No final action was taken on these proposals in 1989.

The Board continued to evaluate comments received on its April 1988 proposal regarding same-day payment. The proposal would require paying banks that receive checks by 2:00 p.m. from a private collecting bank to pay for the checks on the same day without charging a presentment fee. An advisory group representing commercial banks, savings and loan institutions, credit unions, check clearinghouses, Federal Reserve Banks, and corporate cash managers has provided information on alternatives to the proposal that would address concerns of the commenters.

Rules Regarding Delegation of Authority

February 15, 1989—Amendment

The Board amended its rules to delegate authority to the Reserve Banks to permit, under certain conditions, interlocking directorates for diversified savings and loan holding companies.

Votes for this action: Messrs. Greenspan, Johnson, Angell, and Heller. Absent and not voting: Ms. Seger, Mr. Kelley, and Mr. LaWare.

The Depository Institutions Management Interlocks Act authorizes the Board to determine whether a request by a diversified savings and loan holding company to maintain an interlocking director relationship with a state member bank or bank holding company satisfies the requirements of the act. The Board decided to delegate authority to make such determinations to the Reserve Banks, after consultation with the Board's General Counsel. The amendment to the rule is effective March 10, 1989.

Policy Statements

February 10, 1989—Revisions to the CRA Information Statement

The Board authorized issuance of a revised Community Reinvestment Act (CRA) statement to provide guidance regarding the policies and procedures the agencies will apply when assessing an institution's compliance record.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and LaWare. Absent and not voting: Mr. Kelley.

The Community Reinvestment Act of 1977 directs federal bank regulatory agencies to assess during examinations an institution's record of helping to meet the credit needs of the entire community it serves, including the low- and moderate-income neighborhoods. Institutions are required to prepare public statements describing the communities they serve and the product lines offered. The act also requires regulatory agencies to take an institution's CRA record into account when evaluating applications; private citizens and community groups are encouraged to comment on an institution's compliance with the act.

The Board, along with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board, issued a joint policy statement, effective March 21, 1989, to provide insured financial institutions and the public with guidance regarding the requirements of the act and the criteria the agencies will use when evaluating an institution's compliance record during the applications process. The statement, which revises the information statement adopted in 1980, reflects the agencies' experience during the past ten years in administering the act.

The joint policy statement encourages institutions to expand their CRA statements to include information regarding their record of meeting community credit needs so that the CRA statements can be used as the basis for comment by community groups. The policy statement also encourages public comment on an institution's CRA performance before an application is filed so that any issues or problems can be addressed more effectively. The statement also describes such matters as the role of private meetings between financial institutions and community groups in the applications process and the agencies' policies regarding private agreements. In addition, the statement indicates the elements of a CRA program that the agencies have found to be effective.

May 31, 1989—Risk Reduction Measures for Payments System Networks

The Board issued three policy statements, effective June 15, 1989, dealing with measures to reduce the risks associated with certain types of transactions on large-dollar wire transfer systems.

Votes for these actions: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, Kelley, and LaWare.

The Board issued three policy statements and proposed several other actions in connection with an overall plan for reducing risks on both public and private wire transfer systems. The first statement, dealing with private book-entry securities systems, establishes principles for reducing risks on certain delivery-against-payment securities systems. Such systems settle transactions for their participants by transferring securities and the related payment obligations on the books of either a clearing corporation or a depository institution, and arrange for final settlement of the funds position on a net basis at the end of the day. The policy statement indicates that private transfer systems should adopt safeguards for timely settlement that are commensurate with the risk of failure. Such safeguards could include liquidity arrangements to enable a system to make settlement payments at the end of the day and measures to ensure that transfers can be reversed.

The second policy statement provides guidance for offshore clearing systems that settle, directly or indirectly, in dollars on Fedwire (the Federal Reserve's wire transfer system) or on the interbank payments system of the New York Automated Clearing House Association. The statement was issued on an interim basis, pending completion of a study and issuance of recommendations by the Bank for International Settlements.

The third policy statement encourages the prudential use of rollovers and continuing contracts to reduce the risk of overdrafts of an institution's account on Fedwire. Rollovers are overnight credit transactions between two banks. Under such an arrangement, the amount of the principal does not change and is rolled over each night. The rate of interest on such credit, however, is negotiated daily by the two parties. Continuing contracts are similar to rollovers except that the principal amount might vary from day to day. Use of these two measures reduces the amount of funds transferred over Fedwire and minimizes the possibility of overdrafts by eliminating the time lag between payment of borrowings and receipt of credit.

1989 Discount Rates

The Board approved one change in the basic discount rate during 1989, an increase in late February from 6½ percent to 7 percent. The Board had voted at a meeting in mid-January to disapprove requests for a similar increase; it took no other votes during the year to approve or deny requests for changes in the basic discount rate. The reasons for the Board's decisions are reviewed below. Those decisions were made in the context of the policy actions of the Federal Open Market Committee and the general economic and financial developments that are covered in more detail elsewhere in this REPORT. A list of Board members' votes on discount rate actions during 1989 follows this review.

Actions on the Basic Discount Rate

In mid-January the Board disapproved requests from seven Federal Reserve Banks to increase the basic rate from 6½ percent—the level in effect since August 9, 1988—to 7 percent. In reaching its decision, the Board took account of the concerns about inflation expressed by Reserve Bank directors but concluded that the earlier tightening of monetary policy through open market operations, including relatively recent firming actions in mid-December and at the start of 1989, had fostered an appropriate degree of monetary restraint, at least for the moment. That restraint was being felt in part through upward pressure on the dollar, which could intensify if the discount rate were raised.

In mid-February, monetary policy was tightened somewhat further through open market operations, and on February 24 the Board approved an increase of ½ percentage point in the basic rate, to 7 percent. In taking this action, Board members noted that the business expansion continued to display considerable momentum and that there were related perceptions that inflationary pressures might be worsening. The members recognized that the full effects of earlier policy tightening actions had not yet been felt and that higher interest rates could have adverse short-run effects on interest-sensitive sectors of the economy, including many problem thrift depository institutions. Nonetheless, a majority concluded that the balance of considerations made an increase in the basic rate desirable in order to implement in a visible way the System's continuing commitment to the fight against inflation; given the strength of the expansion, they felt that an increase of ½ percentage point would not incur an unacceptable risk to the continued growth of the economy.

No further requests for a change in the discount rate were received from Federal Reserve Banks until well into the second quarter. During this period, signs began to accumulate that some easing of inflationary pressures might be in prospect: overall spending on goods and services appeared to be expanding more slowly, monetary growth weakened appreciably, the dollar strengthened in foreign exchange markets, and prices of actively traded commodities leveled out. In this environment, interest rates turned down.

In the latter part of May, the Federal Reserve Bank of Dallas requested a reduction of ¼ percentage point in the basic rate; subsequently the proposed reduction was increased to ½ percentage point. The Board reviewed but took no action on these requests. The Board members increasingly came to believe that some lessening in the degree of monetary restraint was desirable, but they also took into account the easing of reserve pressures through open market operations that was initiated in early June. Over the summer months, additional easing of monetary policy was implemented through open market operations, and no action was taken on renewed requests by the Dallas Bank to lower the discount rate. As the summer progressed, indicators of business conditions pointed to some pickup in the economic expansion, and monetary growth accelerated to a relatively rapid pace. While many Board members believed that the risks to the economy continued to be tilted toward slower growth over time, they generally concluded that under prevailing circumstances the decisions of the Federal Open Market Committee to lessen pressures on reserve positions should not be reinforced by a reduction in the discount rate.

By the latter part of September, indicators of business conditions had become more mixed, and the Federal Reserve Banks of Chicago and Dallas proposed a reduction of ½ percentage point in the basic rate. The directors at those Banks saw increased risks of a weaker economy and an improved outlook for reduced inflation. All of the other Reserve Banks preferred not to change the current rate. The Board reviewed but took no action on the proposed reductions. Most of the Board members acknowledged that the risks of a recession might have risen, but they continued to view sustained, moderate growth of the economy as a reasonable expectation for the next several quarters. Key measures of inflation indicated that prices had risen more slowly since midyear, in part because of sharp reductions in energy prices, but data on labor compensation suggested no significant change in prevailing trends. Some members expressed concern that under current circumstances a cut in the discount rate would communicate a misleading signal regarding the System's commitment to an anti-inflationary policy.

From early November through year-end, the Board reviewed but took no action on renewed requests by the Dallas Bank to lower the discount rate by ½ percentage point. The Board took account of indications of considerable slowing in overall economic growth in the fourth quarter but noted that some of the softening appeared to be related to temporary factors that seemed likely to be reversed. At the direction of the Federal Open Market Committee, some further easing of monetary policy was implemented in October and the first part of November and again in the latter part of December; growth of the monetary aggregates remained relatively strong in this period and the dollar was weak in foreign exchange markets. Against that background, the Board members agreed that the discount rate should not be changed.

Structure of Discount Rates

The basic discount rate is the rate charged on loans to depository institutions for short-term adjustment credit and for credit extended under the seasonal program; under the latter program, loans may be provided for periods longer than those permitted under adjustment credit to assist smaller institutions in meeting regular needs arising from certain seasonal movements in their deposits and loans.

A higher, flexible rate may be charged on extended-credit loans (for other than seasonal purposes) to depository institutions that are under sustained liquidity pressure and are not able to secure funds on reasonable terms from other sources. The flexible rate is somewhat higher than the market rates to which it is linked but is always at least 50 basis points above the basic discount rate. The flexible rate is adjusted periodically, subject to Board approval. The first 30 days of borrowing on extended credit may be at the basic rate, but further borrowings ordinarily are charged the flexible rate. The highest rate applicable to any credit extended to depository institutions will be assessed on exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems, unless the difficulty clearly is beyond the reasonable control of the borrowing institution; under the current structure, that rate is the flexible rate.

At the end of 1989, the structure of discount rates was as follows: a basic rate of 7 percent for short-term adjustment credit and for credit under the seasonal program and a flexible rate of 8.9 percent. During 1989 the flexible rate ranged from a high of 10.5 percent to a low of 8.9 percent.

Board Votes on the Basic Discount Rate

Under the provisions of the Federal Reserve Act, the boards of directors of the Federal Reserve Banks are required to establish rates on loans to depository institutions at least every fourteen days and to submit such rates to the Board of Governors for review and determination. Reserve Bank actions on the discount rate include requests to renew the formula for calculating the flexible rate on extended credit. The votes of the Board of Governors listed below involved changes in the basic discount rate. Votes relating to the reestablishment of existing rates or the updating of market-related rates under the extended credit program are not shown. All votes during 1989 were unanimous except for the vote on February 24.

January 17, 1989
The Board disapproved actions taken on the dates indicated by the directors of the following Federal Reserve Banks to raise the basic discount rate from 6½ percent to 7 percent: Boston and New York on January 5; Cleveland, Richmond, Minneapolis, and San Francisco on January 12; and Atlanta on January 13.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell, Heller, Kelley, and Laware. Votes against this action: None.

February 24, 1989
Effective February 24, 1989, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, and San Francisco to raise the basic discount rate from 6½ percent to 7 percent.

Votes for this action: Messrs. Greenspan, Johnson, Angell, Heller, Kelley, and LaWare. Vote against this action: Ms. Seger.

Ms. Seger dissented because monetary policy had already been tightened considerably by the Federal Open Market Committee and she wanted to allow more time to assess the effects on the economy, which would occur only with a lag.

Effective February 27, 1989, the Board approved a similar action taken by the directors of the Federal Reserve Bank of Dallas. ∎

Record of Policy Actions of the Federal Open Market Committee

The record of policy actions of the Federal Open Market Committee is presented in the ANNUAL REPORT of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each such action, and that it shall include in its Annual Report to the Congress a full account of such actions.

The pages that follow contain entries relating to the policy actions at the meetings of the Federal Open Market Committee held during the calendar year 1989, including the votes on the policy decisions made at those meetings as well as a résumé of the basis for the decisions. The summary descriptions of economic and financial conditions are based on the information that was available to the Committee at the time of the meetings, rather than on data as they may have been revised later.

It will be noted from the record of policy actions that in some cases the decisions were made by unanimous vote and that in other cases dissents were recorded. The fact that a decision in favor of a general policy was by a large majority, or even that it was by unanimous vote, does not necessarily mean that all members of the Committee were equally agreed as to the reasons for the particular decision or as to the precise operations in the open market that were called for to implement the general policy.

During 1989 the policy record for each meeting was released a few days after the next regularly scheduled meeting and was subsequently published in the Federal Reserve Bulletin.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market activities, the Federal Reserve Bank of New York operates under two separate directives from the Open Market Committee: an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Committee operates under an Authorization for Foreign Currency Operations and a Foreign Currency Directive. These four instruments are shown below in the form in which they were in effect at the beginning of 1989. Changes in the instruments during the year are reported in the records for the individual meetings.

Authorization for Domestic Open Market Operations

In Effect January 1, 1989

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to

carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $6.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

(c) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and prime bankers acceptances of the types authorized for purchase under 1(b) above, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 15 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(c), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

Domestic Policy Directive

In Effect January 1, 1989[1]

The information reviewed at this meeting suggests that, apart from the direct effects of the drought, economic activity has continued to expand at a vigorous pace. Total nonfarm payroll employment rose sharply in October and November, with sizable increases indicated in manufacturing after declines in late summer. The civilian unemployment rate, at 5.4 percent in November, remained in the lower part of the range that has prevailed since early spring. Industrial production advanced considerably in October and November. Housing starts turned up in October after changing little on balance over the previous several months. Growth in consumer spending has been somewhat more moderate in recent months, and indicators of business capital spending suggest a substantially slower rate of expansion than earlier in the year. The nominal U.S. merchandise trade deficit narrowed further in the third quarter. Preliminary data for October indicate a small decline from the revised deficit for September. The latest information on prices and wages suggests little if any change from recent trends.

Interest rates have risen since the Committee meeting on November 1, with appreciable increases occurring in short-term markets. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined significantly further on balance over the intermeeting period.

Expansion of M2 and M3 strengthened in November from relatively slow rates of growth in previous months, especially in the case of M2. Thus far this year, M2 has grown at a rate a little below, and M3 at a rate a little above, the midpoint of the ranges established by the Committee for 1988. M1 has increased only slightly on balance over the past several months, bringing growth so far this year to 4 percent. Expansion of total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987 and around the midpoint of the Committee's monitoring range for 1988.

1. Adopted by the Committee at its meeting on Dec. 13–14, 1988.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth of total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth of total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to increase somewhat the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from November through March at annual rates of about 3 and 6½ percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Authorization for Foreign Currency Operations

In Effect January 1, 1989

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Austrian schillings	Italian lire
Belgian francs	Japanese yen
Canadian dollars	Mexican pesos
Danish kroner	Netherlands guilders
Pounds sterling	Norwegian kroner
French francs	Swedish kronor
German marks	Swiss francs

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding $12.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	700
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination

of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager for Foreign Operations, for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations toappropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive

In Effect January 1, 1989

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks and with the Bank for International Settlements.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

Meeting Held on February 7–8, 1989

Domestic Policy Directive

The information reviewed at this meeting suggested that, apart from the direct effects of the drought, economic activity had continued to expand at a fairly vigorous pace. The latest information on prices indicated little change in the rate of inflation from recent trends, while labor costs had continued to accelerate.

After strong gains in the fourth quarter, total nonfarm payroll employment rose sharply in January. Although some of the strength may have reflected such temporary factors as unusually mild winter weather, job gains were widespread; in manufacturing, sizable increases were registered in nonelectrical machinery, transportation equipment, and food processing. The civilian unemployment rate, at 5.4 percent, remained in the lower part of the range that had prevailed since the early spring of last year.

Industrial production rose appreciably further in December and January, with gains continuing at about the robust pace experienced in 1988 as a whole. Output of consumer goods advanced strongly, despite a somewhat slower pace of automobile assemblies over the two months, and production of business equipment picked up a bit. Total industrial capacity utilization moved higher, owing to a sizable jump in the utilization of manufacturing capacity to the highest level since 1979. Housing starts declined somewhat in December but were up substantially on balance for the fourth quarter as a whole, largely because of a strengthening in single-family construction. Multifamily starts have remained relatively flat in recent months.

Consumer spending was up considerably in the fourth quarter, capping a strong year. Spending on household durables rose vigorously in the quarter; and outlays for services again advanced at a rapid pace, reflecting big increases in expenditures for medical care, airline travel, and recreation. Consumption of nondurables advanced further, after a steep rise the previous quarter, while purchases of motor vehicles were little changed over the quarter as a whole.

Indicators of business capital spending suggested some weakening in recent months from the rapid increases evident earlier in 1988. Real outlays for business fixed investment were estimated to have fallen somewhat in the fourth quarter. Softness was fairly widespread among various types of equipment, but the most pronounced weakness was in office and computing equipment. Nonresidential construction activity picked up in December but was estimated to have been about flat on balance for the quarter; oil drilling and expenditures on commercial buildings other than offices declined further. Inventory investment in the manufacturing sector in the fourth quarter was little changed from the third-quarter pace, with much of the accumulation continuing to occur in durable goods industries where demand had been strong. At the retail level, increases in nonautomobile inventories generally kept pace with the growth in sales.

Excluding food and energy, producer prices of finished goods rose sharply in December, the rise reflecting large increases for tobacco products, women's apparel, and passenger cars. Prices for intermediate materials again increased substantially in November and December. The most notable hikes occurred in industries such as metals, chemicals, and paper products in which capacity utilization has been high. Consumer prices, reflecting more favorable developments in the food, energy, and apparel components, rose at a somewhat slower pace in November and December. Excluding food and energy, consumer prices rose in the fourth quarter at about the rate observed over 1988 as a whole. Reflecting tighter market conditions, wages and salaries, and labor costs more generally, advanced at a faster pace in the fourth quarter than was observed a year earlier.

The nominal U.S. merchandise trade deficit was slightly larger on average in October and November than it was in the third quarter. The value of imports rose as a sharp rise in the value of non-oil imports, especially from industrial countries, outweighed a drop in the value of oil imports resulting from a decline in oil prices. Increases were widespread across trade categories but were paced by a rebound in imports of passenger cars from somewhat depressed levels in the third quarter. The value of exports was little changed as a decline in agricultural exports offset a rise in nonagricultural products.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose substantially over the intermeeting period and nearly reversed its decline of October and November. Despite the release of data indicating U.S. trade deficits that were larger than expected for October and November, the dollar climbed persistently from early December in response to perceptions of a relative tightening of monetary policy in the United States; short-term interest rate differentials moved in favor of the dollar relative to the yen.

At its meeting on December 13–14, the Committee adopted a directive calling for some immediate increase in the degree of pressure on reserve positions, with some further tightening to be implemented at the start of 1989 if economic and financial conditions remained consistent with the Committee's expectations. These reserve conditions were expected to be associated with growth of M2 and M3 at annual rates of about 3 percent and 6½ percent respectively over the period from November through March. The members agreed that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.[1]

In accordance with the Committee's instructions, a firming of reserve supply conditions was carried out in two stages over the intermeeting period, although operations were complicated by continuing uncertainty about the relationship between borrowing and money market

1. These growth rates and all subsequent data on the monetary aggregates reflect annual benchmarks and seasonal factors as published on February 9, 1989.

The monetary aggregates are defined as follows: M1 comprises demand deposits at commercial banks and thrift institutions, currency in circulation, travelers checks of nonbank issuers, negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts at banks and thrift institutions, and credit union share draft accounts. M2 contains M1 and savings and small-denomination time deposits (including money market deposit accounts (MMDAs) at all depository institutions, overnight repurchase agreements (RPs) at commercial banks, overnight Eurodollars held at foreign branches of U.S. banks by U.S. residents other than banks, and money market mutual fund shares other than those restricted to institutions). M3 is M2 plus large-denomination time deposits at all depository institutions, large-denomination term RPs at commercial banks and savings and loan associations, institution-only money market mutual funds, and term Euro-dollars held by U.S. residents in Canada and the United Kingdom and at foreign branches of U.S. banks elsewhere.

conditions. In the circumstances, open market operations continued to be conducted with a special degree of flexibility. Adjustment plus seasonal borrowing averaged somewhat more than $500 million over the period, but such borrowing fluctuated over a wide range, including a typical bulge around the year-end. The federal funds rate rose from around 8½ percent to a little above 9 percent during the intermeeting period.

Changes in other short-term market rates were mixed over the intermeeting period. Treasury bill rates rose somewhat on balance, although less than the federal funds rate, while rates on private market instruments were generally unchanged to slightly lower. To some extent, the firming of monetary policy had been anticipated; in addition, private rates in particular were affected by the passing of year-end pressures. Bond yields declined somewhat, apparently influenced in part by the favorable effect of actual and anticipated monetary restraint on inflationary expectations. Major indexes of stock prices rose considerably over the intermeeting period.

Growth of the broader monetary aggregates weakened appreciably in January, especially M2, which apparently declined slightly after a moderate increase in December. The behavior of these aggregates appeared to reflect recent increases in short-term market rates, which in turn widened the opportunity costs of holding deposits. Those costs were accentuated by slower-than-usual adjustments in offering rates by depository institutions on most of their retail deposits. Also, needs for deposits to fund credit growth were damped in this period. On average in December and January, growth of M2 was slightly below Committee expectations and that of M3 considerably below. M1 changed little on balance over the two months. For the year 1988, M2 expanded at a rate a little below and M3 at a rate around the midpoint of the Committee's ranges. Growth of total domestic nonfinancial debt moderated in 1988 to a pace around the midpoint of the Committee's monitoring range.

The staff projections prepared for this meeting suggested that the expansion was likely to moderate in 1989 from the pace in 1988, although the adjustments related to the assumed end of the drought would be reflected in relatively strong measured growth in the first quarter. To the extent that expansion of final demand tended to remain at a pace that could foster higher inflation but was not accommodated by monetary policy, pressures would be generated in financial markets that would restrain domestic spending. The staff continued to project slower growth in consumer spending, sharply reduced expansion of business fixed investment, and some decline in housing construction. Foreign trade was expected to make a smaller contribution to growth in domestic output than in 1988. The staff anticipated somewhat faster increases in consumer prices and also some further cost pressures over the year ahead, especially because of reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, members commented that the expansion in business activity was generally well balanced and that continuing growth was a reasonable expectation for the year ahead. Nearly all the members believed that the risks remained on the side of greater inflation and that the Federal Reserve would need to stay especially alert to inflationary developments. However, views differed to some extent with regard to the likely strength of the expansion and the degree of inflationary risk. Several members stressed that, in the absence of some further monetary restraint, economic growth was likely to continue at a rate that would foster greater pressures on already strained production resources and induce more inflation. Other members gave more weight to indications of possible slowing in the expansion and to the possibility that the substantial restraint applied over the past year might be sufficient to foster sustainable expansion without increased inflationary pressures. The members agreed that the chances for satisfactory economic performance over time would be greatly enhanced by progress in reducing the federal budget deficit in order to contain domestic demands and to facilitate the process of adjustment in the nation's external balance.

In conformance with the usual practice at meetings when the Committee considers its long-term objectives for monetary growth, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared specific projections of economic activity, the rate of unemployment, and inflation for the year 1989. The central tendency of these forecasts pointed to somewhat slower expansion and somewhat greater inflation than had occurred in 1988. For the period from the fourth quarter of 1988 to the fourth quarter of 1989, the forecasts for growth of real GNP had a central tendency of 2½ to 3 percent and a full range of 1½ to 3¼ percent. Forecasts of nominal GNP centered on growth rates of 6½ to 7½ percent and ranged from 5½ to 8½ percent. Estimates of the civilian rate of unemployment in the fourth quarter of 1989 were concentrated in a range of 5¼ to 5½ percent with a full range of 5 to 6 percent. The projected increase in the consumer price index centered on rates of 4½ to 5 percent and had an overall range of 3½ to 5½ percent for the year. In making these forecasts, the members took account of the Committee's policy of continuing restraint on aggregate demand to resist any increase in inflation pressures and foster price stability over time. They also assumed that normal weather conditions and a rise in acreage under cultivation this year would increase farm output and add around ⅔ of a percentage point to the growth of GNP, an amount similar to the reduction in GNP that resulted from the drought in 1988. Excluding this swing in farm output, the central tendency of the forecasts implied considerably slower growth in output than in 1988. Finally, the forecasts assumed that fluctuations in the foreign exchange value of the dollar would not be of sufficient magnitude to have a significant effect on the economy or prices.

In the Committee's discussion of developments bearing on the economic outlook, a number of members stressed that the economy had a good deal of momentum and that there was little or no current evidence of a potential slowdown or downturn in the expansion. Indeed, some recent data, including those on employment and consumer spending, could be viewed as consistent with some strengthening of the expansion in recent months. Reports from around the country suggested a high level of business activity in many parts of the nation and at least modest improvement in some previously depressed areas. On the whole, growth in production was being well maintained, buttressed by continuing expansion in exports. Other members saw a greater potential for some softening in the rate of economic growth. They referred to sectors of relative weakness in the economy, including energy, nonresidential construction, and housing. With regard to the outlook for capital expenditures, many firms were investing in new equipment to improve their efficiency in competitive markets, but they generally continued to hold back on investments to expand production facilities. More generally, a number of members emphasized that the behavior of money, whose growth had been relatively damped for an extended period and was likely to remain so in 1989 under the Committee's targets, probably was consistent with only limited strength in spending.

A key element in the outlook for business was the extent of the improvement in the nation's external trade balance. The members generally expected further gains, at least over the year ahead, but several observed that these might be considerably smaller than in 1988, given the behavior of the dollar over the past year and assuming a steady dollar in the future. Such an outcome could have the advantage of helping to moderate potential inflationary demand pressures in the economy but at the cost and the risks associated with a continuing need to finance massive external deficits. It also was noted that substantial improvement in the trade balance at a time of increasing pressure on productive resources would require the expansion in domestic demand to slow sufficiently—perhaps more than was currently anticipated—to permit added production for exports.

Turning to the outlook for inflation, several members expressed concern that, with margins of unused labor and capital relatively low, any slowing in the growth of overall demands now in train might be inadequate to prevent some rise in the underlying rate of inflation, much less to permit progress to be made in bringing inflation down. In this view the economy's current momentum in association with a reduced availability of production resources clearly biased the economic risks toward greater inflation. A number of these members expressed particular concern about recent indications of higher labor costs, which might augur escalating inflationary pressures. Other members saw a lesser risk that inflation would intensify, at least in the absence of unfavorable developments such as a second year of drought conditions, a sharp upturn in energy prices, or a substantial decline in the foreign exchange value of the dollar. It was difficult to judge the point at which added pressures on production resources might be translated into stronger inflationary pressures, but several members observed that despite relatively vigorous economic growth the impact on the overall rate of inflation had been less than they might have anticipated earlier. Promising factors in the inflation outlook included the continuation of strong competitive pressures, notably competition from abroad that tended to inhibit efforts to raise prices, restrained monetary growth, and generally favorable inflationary expectations as evidenced by developments in financial markets. In one view, commodity prices, while still affected by the impact of the drought, might be signalling at least tentatively a downturn in the overall rate of inflation.

Against the background of the members' views regarding the economic outlook and in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee at this meeting reviewed the ranges of growth for the monetary and debt aggregates that had been established on a tentative basis in late June 1988 for the year 1989. The tentative range for M2 had been reduced by 1 percentage point to 3 to 7 percent and that for M3 by ½ percentage point to 3½ to 7½ percent for 1989. The monitoring range for growth of total domestic nonfinancial debt had been lowered by ½ percentage point to 6½ to 10½ percent for the year. The Committee had decided in June not to establish any range for M1.

In the Committee's discussion, a majority of the members indicated that they were in favor of affirming the reduced ranges that had been set on a tentative basis in mid-1988, while the remaining members expressed a preference for some further reductions. Members who supported the tentative ranges believed that they were fully consistent with progress toward price level stability. Indeed, the reduction of a full percentage point in the M2 range was larger than usual and would convey in this view an appropriately strong signal of the System's commitment to an anti-inflationary policy. This lower range encompassed money growth that was fully consistent under likely economic and financial conditions with continued expansion of spending but at the somewhat slower pace needed to contain inflationary pressures. A number of members also commented that the tentative ranges would provide more room in subsequent years for continuing the desirable policy of gradually lowering the monetary growth targets to noninflationary levels while also reducing the possibility that unanticipated economic or financial developments might require those targets to be raised on a temporary basis. Even though temporarily higher ranges might be consistent with progress toward price stability, a decision to raise the ranges could be misinterpreted as a weakening of the System's anti-inflationary resolve.

Other members believed that further reductions in the ranges would provide greater assurance of encompassing the potential policy responses and associated monetary growth that might be needed to resist inflationary pressures over the year ahead, should they prove to be especially strong. Such reductions would underscore the Committee's commitment to its longer-run objective of price stability, since achieving that objective would require lower money growth at some point than was indicated by the middle of the tentative ranges. Lower ranges for the broader aggregates would have midpoints that were more clearly below actual growth in 1988 and given the slow growth thus far this year, especially in the case of M2, would improve the prospects that expansion for the year would approximate the midpoints. Moreover, the upper ends of the tentative ranges, while below those for 1988, nonetheless remained appreciably higher than the rates of monetary growth that were likely to be consistent with price stability over time.

The Committee agreed on the desirability of retaining the relatively wide spread of 4 percentage points between the upper and the lower ends of the growth ranges for M2 and M3. These ranges were initially widened in 1988 in recognition of the uncertain outlook for financial markets and the economy and the extent to which the relationship between monetary growth and economic performance had varied over an extended period. In particular, the growth of M2 and its velocity had remained very sensitive to fluctuations in interest rates, reflecting in turn a tendency of depository institutions to adjust only sluggishly their offering rates on many types of deposit accounts. In these circumstances and against the background of the multiplicity of largely unpredictable factors affecting the economy and interest rates, the appropriate rate of monetary growth remained subject to considerable uncertainty and could not be projected within narrow ranges with any degree of confidence. An additional uncertainty in 1989 would be the impact of developments affecting thrift depository institutions as serious financial problems at many of those institutions moved toward resolution under the aegis of new government programs. The behavior of M2 and M3 was likely to be affected by such developments, but there was only limited basis in prior experience to gauge the extent of the impact.

The members found acceptable the tentative reduction of ½ percentage point in the monitoring range for total domestic nonfinancial debt in 1989. As in several previous years, growth of total debt was expected to exceed that of nominal GNP. The members anticipated that the federal government would continue to place heavy demands on credit markets to finance its large ongoing deficits. In addition, the expansion of business borrowing would probably continue to be boosted by a widening financing gap and by the substitution of debt for equity in conjunction with leveraged buyouts and other corporate restructuring activities. Growth of household debt might moderate somewhat, reflecting the effect of increases in interest rates in 1988 on mortgage debt and of reduced expansion in consumer credit in association with a smaller rise in outlays on consumer durables over the year.

In keeping with the Committee's tentative decision in late June, no member proposed the inclusion of M1 among the monetary target ranges. The Committee continued to view the prospective relationship between M1 and aggregate measures of economic activity as too unpredictable to warrant reliance on this monetary measure as a guide for the conduct of monetary policy.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept the ranges for 1989 that had been established on a tentative basis in late June 1988. Against the background of the uncertainties that continued to surround the relationship between monetary growth and broad measures of economic performance, most of the members endorsed a proposal to make explicit in the directive the Committee's procedure in recent years of evaluating money growth in the conduct of policy in light of the behavior of other indicators, including inflationary pressures, the strength of the business expansion, and developments in domestic financial and foreign exchange markets.

At the conclusion of this discussion, the Committee approved for inclusion in the domestic policy directive the following paragraph relating to its longer-run policy for 1989:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting reaffirmed its decision of late June to lower the ranges for growth of M2 and M3 to 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt was set at 6½ to 10½ percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Johnson, Kelley, LaWare, and Parry and Ms. Seger. Vote against this action: Mr. Hoskins.

Mr. Hoskins dissented because he preferred lower ranges for the year. In his view satisfactory progress in reducing the underlying rate of inflation would require a degree of restraint over the year that would be likely to result in money growth at the low end of the tentative ranges, and he believed that the ranges adopted should be more closely centered on that possible outcome. He also felt that lower ranges were desirable at this time to underscore the System's determination to pursue an anti-inflationary policy.

In the Committee's discussion of policy implementation for the period until the next meeting, a majority of the members indicated a preference for maintaining unchanged conditions of reserve availability, at least initially, following today's meeting. Further monetary restraint might be desirable in the near future, perhaps during the intermeeting period. However, recent information had given a somewhat mixed picture of economic and price developments, and these members preferred to wait for further confirmation of inflationary pressures before additional firming of monetary policy was undertaken. Appreciable policy tightening had been implemented only recently and the impact would be felt only after a considerable lag. Monetary policy was now fairly restrictive, as evidenced for example by relatively high real rates of interest, a slightly inverted yield curve, and the slow growth of the monetary aggregates. The credibility of the System's anti-inflationary policy was quite high. Some members expressed concern that higher interest rates would exacerbate the financial difficulties of many thrift depository institutions, weaken heavily indebted firms, and in the context of a strong dollar possibly lead to an undesired upward ratcheting of interest rates in world financial markets. It also was noted that further tightening should be approached with special caution when the dollar was under upward pressure in the foreign exchange markets.

Other members indicated a preference for some immediate firming of monetary policy in light of their concerns about current and prospective inflationary pressures in the economy. In this view delaying further tightening would only worsen such pressures and could greatly increase the difficulty and ultimate cost of achieving the Committee's anti-inflationary objectives. Moreover, while higher interest rates could have adverse effects on interest-sensitive sectors of the economy, a failure to arrest and to reverse inflation would lead to even higher interest rates and greater damage over time. Some concern also was expressed that maintenance of steady reserve conditions might disappoint market expectations, with adverse repercussions in present circumstances on the credibility of the System's anti-inflationary policy and thus on inflationary expectations. Should too much restraint later prove to have been applied, it could be reversed more readily and with less lasting implications for economic performance than too little restraint, which would tend to embed inflation and inflationary expectations in the economic structure.

A number of members observed that the relatively slow monetary expansion that had been experienced in recent months—and indeed on balance for some two years—portended restraint on prices and was a welcome development. A staff forecast suggested that money growth was likely to remain damped over coming months, with both M2 and M3 growing at the lower end of the Committee's 1989 ranges. In the view of a number of members, this might be acceptable or even desirable depending on the extent of inflationary pressures being experienced in the economy. At the same time some members cautioned that a persistent shortfall from the ranges might be a cause for concern.

In the Committee's discussion of possible intermeeting adjustments in the degree of reserve restraint, members generally felt that there should be a clear presumption of some further firming if the incoming information tended to confirm expectations of growing inflationary pressures. Indeed, several members indicated that such a presumption would enable them to accept a directive that called for no immediate change in the degree of reserve pressure. Some members expressed the view that developments in foreign exchange markets might have an important bearing on the timing or even the desirability of any firming in the period ahead. More generally, the Committee agreed that consideration would need to be given to the usual range of factors that might call for a change in policy implementation, including the possibility that some easing might be warranted under certain conditions. For the immediate future, however, several stressed that any perceptions that monetary policy might be easing should be resisted.

At the conclusion of the Committee's discussion, all but two members indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve conditions and for remaining alert to potential developments that might require some firming during the intermeeting period. Accordingly, somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 2 percent and 3½ percent respectively over the three-month period from December to March. It was understood that operations would continue to be conducted with some flexibility in light of the persisting uncertainty in the relationship between the demand for borrowed reserves and the federal funds rate. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 7 to 11 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that, apart from the direct effects of the drought, economic activity has continued to expand at a fairly vigorous pace. After strong gains in the fourth quarter, total nonfarm payroll employment rose sharply in January, including a sizable increase in manufacturing. The civilian unemployment rate, at 5.4 percent in January, remained in the lower part of the range that has prevailed since the early spring of last year. Industrial production rose appreciably further in December and January. Housing starts declined somewhat in December but were up substantially on balance in the fourth quarter. Consumer spending advanced considerably in the fourth quarter, in part reflecting stronger sales of durable goods. Indicators of business capital spending suggest some weakening in recent months. The nominal U.S. merchandise trade deficit was slightly larger on average in October and November than in the third quarter. The latest information on prices suggests little change from recent trends, while wages have tended to accelerate.

The federal funds rate and Treasury bill rates have risen since the Committee meeting in mid-December; other short-term interest rates are generally unchanged to somewhat lower. Bond yields have declined somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose substantially over the intermeeting period.

M2 and M3 weakened appreciably in January, especially M2. For the year 1988, M2 expanded at a rate a little below, and M3 at a rate around, the midpoint of the ranges established by the Committee. M1 has changed little on balance over the past several months; it grew about 4¼ percent in 1988. Expansion of total domestic nonfinancial debt appears to have moderated somewhat in 1988 to a pace around the midpoint of the Committee's monitoring range for the year.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting reaffirmed its decision of late June to lower the ranges for growth of M2 and M3 to 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt was set at 6½ to 10½ percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from December through March at annual rates of about 2 and 3½ percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Votes for the paragraph on short-term policy implementation: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Johnson, Kelley, and LaWare and Ms. Seger. Votes against this action: Messrs. Hoskins and Parry.

Messrs. Hoskins and Parry dissented because they believed that a prompt move to greater monetary restraint was needed. Mr Hoskins felt that additional restraint was desirable to put policy on a course that would lead toward longer-run price stability. Mr. Parry emphasized that inflationary pressures appeared to be intensifying as the economy had grown to a level in excess of its long-run, noninflationary potential. Both believed that any delay in implementing more restraint probably would aggravate inflationary pressures, thereby increasing the difficulty of achieving the Committee's anti-inflationary objectives and leading to even higher interest rates over time.

Meeting Held on March 28, 1989

1. Domestic Policy Directive

Information reviewed at this meeting suggested that activity in the nonfarm economy expanded appreciably further in the first quarter. Gains in jobs and personal income were sizable in the first two months of the year. The available indicators on domestic demand presented a mixed picture, but preliminary data for January suggested some improvement in the external sector. The latest price data indicated some pickup in inflation from recent trends, only in part reflecting jumps in food and energy prices.

Total nonfarm payroll employment rose markedly further in January and February after strong gains in the fourth quarter. The rise was paced by continuing steady advances in service-producing industries. Appreciable increases in factory and construction jobs also were recorded over the two months, but unusually mild winter weather contributed to a bunching of construction employment gains in January followed by some retrenchment in February. The civilian unemployment rate fell to 5.1 percent in February.

Industrial production was unchanged in February after rising considerably over the previous several months. A reduced rate of automobile assemblies and weakness in the output of materials contributed to the leveling of industrial activity. In other areas, production gains were well maintained for consumer goods, and the output of business equipment rose rapidly following weakness in the fourth quarter. Total industrial capacity utilization edged down in February. Despite appreciable drops in utilization rates in primary metals, petroleum products, and paper, these industries continued to operate at relatively high levels. In manufacturing, the operating rate moderated a bit but remained high. After a weather-related surge in January, housing starts fell in February to a level somewhat below their average in the fourth quarter.

Growth in consumer spending moderated in January and February. Purchases of cars and light trucks fell back considerably, and the unusually warm weather held down expenditures on heating bills. Outlays for goods other than motor vehicles changed little, while purchases of nonenergy services posted another sizable rise.

Indicators of business capital spending suggested a rebound from a decline in the fourth quarter. Shipments of nondefense capital goods excluding aircraft were well above the fourth-quarter level in January and February. Nonresidential construction activity rose strongly for a second month in January, with gains recorded in almost all categories of building. Petroleum drilling, which declined through much of last year, appeared to be stabilizing. Inventory investment in the manufacturing sector picked up in early 1989. Much of the rise was recorded in the aircraft industry, where work-in-progress inventories were growing in reflection of booming production, and in nonelectrical machinery, where computer demand had flattened out in the fourth quarter. At the retail level, the pace of non-auto inventory investment generally remained in line with the pattern of sales.

Producer prices of finished goods rose sharply in both January and February, mostly reflecting higher prices for food and energy, but prices of a broad range of other finished goods also increased at a faster rate. Among intermediate materials, prices continued to rise at a substantial pace. Excluding food and energy, consumer prices advanced in January and February at a rate a shade above the average for 1988. Revised data for labor costs in the fourth quarter and the limited data available for early 1989 continued to suggest that these costs remained under upward pressure.

After a considerable increase in the fourth quarter of last year, the nominal U.S. merchandise trade deficit narrowed in January, according to preliminary estimates. The value of imports declined substantially, reflecting an apparent reversal of the strong rise in non-oil imports that had occurred in the fourth quarter. The value of exports also declined, but by less than that for imports, with decreases recorded in almost all major trade categories. Economic growth slackened in most of the major foreign industrial nations in the fourth quarter, but data available so far in 1989 did not indicate further slowing.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose somewhat on balance over the intermeeting period. The dollar was under downward pressure through most of February, partly in response to unexpectedly large increases in U.S. price indexes. After the Federal Reserve Board approved an increase in the discount rate on February 24, the dollar rebounded as U.S. short-term interest rates rose relative to key foreign interest rates.

At its meeting on February 7–8, the Committee adopted a directive calling for no immediate change in the degree of pressure on reserve positions. It was agreed that policy would be tightened promptly if incoming information tended to confirm expectations of growing inflationary pressures. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about 2 and 3½ percent respectively over the period from December through March.

In the context of incoming data tending to reinforce earlier evidence of mounting inflation, the Manager for Domestic Operations adjusted the provision of reserves in mid-February to incorporate a higher level of adjustment plus seasonal borrowing. Subsequently, on February 24, the Board approved an increase in the discount rate from 6½ percent to 7 percent. The federal funds rate moved up from about 9 to 9⅛ percent at the time of the February meeting to an average a little above 9¾ percent from late February to late March.

The uncertainties about the relationship between borrowing and the federal funds rate that had complicated open market operations for many months persisted during the intermeeting period. Adjustment plus seasonal borrowing continued to fall considerably short of expectations in relation to the federal funds rate and, as contemplated by the Committee, operations continued to be implemented with some flexibility. In light of accumulating indications of additional weakness in borrowing demands relative to earlier patterns, the borrowing assumption was adjusted downward in the maintenance period beginning March 9. This technical adjustment was made to bring the assumed level of borrowing in line with recent experience and with desired overall conditions in reserve markets. Adjustment plus seasonal borrowing averaged about $450 million in the three reserve maintenance periods ending during the intermeeting interval.

The tightening of monetary policy along with growing market concerns about inflation led to sizable increases in interest rates during this period. In short-term markets, rates on most private issues rose nearly 1 percentage point, somewhat more than the increase in the federal funds rate, and the prime rate was raised in two steps of ½ percentage point. Rates on Treasury bills moved up appreciably less, at a time when there was no overall growth in the size of the weekly auctions and the supply available for competitive awards was reduced by substantial retail demand through noncompetitive tenders. In longer-term debt markets, yields generally were up about ⅓ to ½ percentage point, but yields on fixed-rate mortgages rose somewhat more. Major indexes of stock prices declined somewhat over the intermeeting period.

After weakening appreciably in January, growth of M2 and M3 strengthened in February and was estimated to have picked up further in March. On balance, however, the expansion of both aggregates had remained quite subdued this year, apparently reflecting increases in short-term market rates that had widened the opportunity costs of holding deposits. In addition, the outflows of funds and other adjustments associated with the problems of financially troubled thrift depository institutions probably reduced slightly the growth of the broader monetary aggregates. On average in the first quarter, growth of M2 was a little below the Committee's earlier expectations, while that of M3 was close to expectations. The levels of M2 and M3 in March were estimated to be respectively, a little below and a little above the lower bounds of the Committee's 1989 ranges for those aggregates. M1 apparently declined on balance in the first quarter, while total domestic nonfinancial debt grew at a rate near the midpoint of the Committee's monitoring range for the year.

The staff projections prepared for this meeting suggested that the expansion in the nonfarm economy was likely to moderate appreciably during 1989. The projections assumed that the drought had ended and that normal growing conditions would prevail in agriculture this year. The staff anticipated somewhat faster increases in consumer prices and further cost pressures over the year ahead, especially because of reduced margins of unutilized labor and other production resources. A monetary policy to contain inflation necessarily would involve slower growth of overall demand and an easing of pressures on resources; to the extent the strength in demand were to persist, such a policy could imply additional pressures in financial markets. On that basis, the staff projected slower growth in consumer spending and in business fixed investment than had occurred in 1988 and some decline in housing construction. Foreign trade was expected to make a smaller contribution to growth in domestic output than it did in 1988. It was assumed that fiscal policy would become somewhat more restrictive over the year.

In the Committee's discussion of the economic situation and outlook, members focused on recent indicators of business activity that pointed at least tentatively to some moderation in the rate of economic growth. The members agreed that the extent and possible duration of any slowing in the expansion were subject to a great deal of uncertainty, and that more time was needed to assess whether recent developments augured for a sustained period of reduced expansion. The most recent softening in some of the economic data reflected at least in part a normal adjustment to unusual, weather-related strength at the start of the year and thus did not provide a firm basis for concluding that more than a pause, such as often occurs during an expansion, might be involved. Indeed, in the view of many members, the economy retained considerable momentum and there was a substantial risk that without further policy action the expansion might not slow sufficiently to relieve inflationary pressures. Others believed that policy already might have been tightened sufficiently to contain price pressures in 1989 and to permit progress to be made over time in bringing inflation under control. In addition to the indications of possible moderation in the expansion, these members pointed to the sluggish growth of the monetary aggregates and to the recent increases in interest rates and in the exchange value of the dollar as consistent with a less robust economy and a less inflationary environment over time.

In their review of specific developments bearing on the economic outlook, members reported that the expansion continued to display considerable vigor in many regions of the country, while at least modest overall improvement was occurring in some previously depressed areas. At the same time, many business contacts around the country provided indications of marginally less ebullient business conditions or business expectations. Manufacturing continued to bolster economic activity in many regions and was in turn buttressed by sales in export markets. Another positive factor was the apparent absence of excessive inventories in most industries relative to current sales. Some members referred to strength in the agricultural sector, although concerns about drought conditions were growing in some regions. With regard to developments pointing to reduced economic expansion, several members referred to signs that the growth in consumer spending had moderated, but it also was noted that the recent softness in the major automobile component had followed a spurt in late 1988 and might be reversed later. Some slowing in the growth of consumer spending was deemed to be desirable to assure satisfactory economic performance, given the need to ease inflationary pressures on labor and capital resources while accommodating continuing gains in exports. In addition, the rise in mortgage rates together with reduced investor demand had dimmed the outlook for housing, although unusual weather early this year made developments in this sector of the economy especially difficult to assess. Prospects for business investment were tempered by ongoing indications of weak construction activity in many areas and by some softness in new orders for business equipment. However, overall spending on business equipment was being well maintained and some rebound in total business fixed investment appeared likely after the slowdown in the latter part of 1988. On the whole, the expansion, while apparently moderating, showed few signs of the kinds of imbalances that might lead to substantial or cumulative weakening.

The members recognized that the appreciation of the dollar over the past year, a byproduct of reliance on monetary policy to resist inflationary pressures, would help to damp price increases. On the other hand, a stronger dollar implied slower progress in reducing the nation's trade deficit. Nonetheless, many domestic industries remained competitive in world markets at current dollar exchange rates, and further growth in exports was seen as a reasonable expectation, at least over the quarters immediately ahead.

As at earlier meetings, the members gave considerable attention to the outlook for inflation. Recent large increases in key price indexes were disappointing, if not entirely unexpected, and depending on the performance of the volatile food and energy sectors, the rate of inflation might well remain relatively high over the near term. Labor market conditions remained tight in many areas, especially for skilled workers, and many business contacts reported pressures on both labor and nonlabor costs. There also were indications that businesses were finding it less difficult to pass on rising costs by increasing prices, although efforts to meet competitive pressures by curbing costs were continuing. At the same time, historical experience suggested that a sustained pickup of inflation was unlikely in light of the reduced rate of money growth that had been experienced for an extended period, especially if such growth were to continue to be relatively restrained.

In the Committee's discussion of policy implementation for the intermeeting period ahead, a majority of the members expressed a clear preference for maintaining unchanged conditions of reserve availability. They emphasized the uncertainties surrounding the current business outlook and the desirability of waiting to see if the tentative indications of some slowing in the expansion signaled the start of a sustained period of slower economic growth and reduced inflationary pressures. Because of the usual lags in the impact of monetary policy on the economy and prices, the full effect of the firming in 1988 had not yet been felt, much less the effect of the substantial further policy tightening this year. Other members, while willing to accept an unchanged policy for now, preferred an immediate move to further restraint. They gave more weight to the possibility that the current slowing of the expansion might be inadequate to restrain inflationary pressures, and they felt that additional restraint should be implemented promptly to provide better assurance that sufficient monetary restraint was in place.

Most members endorsed the view that, in the absence of unexpected developments, policy implementation should resist any perceptions that monetary policy might be easing. A number also commented that they would not oppose some further small rise in money market interest rates. More generally, a majority of the members felt that policy implementation over the intermeeting period should be adjusted more readily and promptly toward greater restraint than toward ease. Some who preferred an immediate move to more restraint indicated that such an understanding would make an unchanged policy acceptable to them at this time. Other members preferred not to bias the approach to intermeeting adjustments although all but one could accept an asymmetric directive. A number of members urged caution in implementing any policy change; in particular, they wanted to avoid reacting to a single new piece of information and preferred instead to wait for evidence to accumulate on the possible need for a further tightening of policy.

The members took account of a staff projection that indicated that with unchanged reserve conditions, expansion of M2 and M3 was likely to remain subdued during the second quarter, although such growth probably would be somewhat faster than in the current quarter. The expansion in these monetary aggregates was likely to continue to be held back by the relatively slow adjustment of offering rates on liquid deposit accounts in response to the increases that had occurred in market interest rates. Additionally, developments at thrift institutions might continue to depress growth of the broad aggregates, but probably by less than in the first quarter, assuming no new developments that aggravated depositor concerns. On a cumulative basis from the fourth quarter to June, the projection implied expansion of M2 at a rate just below the lower bound of the Committee's 3 to 7 percent range for the year, while expansion of M3 would be in the lower half of the Committee's 3½ to 7½ percent range. A number of members stressed that slow monetary growth was a desirable development in current circumstances, but some also expressed concern that the slowing could be overdone.

In light of the tightening of reserve conditions that had occurred since the February meeting and the related increase in the federal funds rate, the members decided to raise the intermeeting range for the federal funds rate 1 percentage point to 8 to 12 percent. Such an increase implied that the expected federal funds rate would average closer to the middle of the range. That range provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all but one member indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving particular weight to potential developments that might require some firming during the intermeeting period. Accordingly, some added reserve restraint would be acceptable, or some slight lessening of reserve pressure might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 5 percent respectively over the three-month period from March to June. It was understood that operations would continue to be conducted with some flexibility in light of the persisting uncertainty in the relationship between the demand for borrowed reserves and the federal funds rate.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that activity in the nonfarm economy has expanded appreciably further in the current quarter. After strong gains in the fourth quarter, total nonfarm payroll employment rose markedly further in January and February. The civilian unemployment rate fell considerably to 5.1 percent in February. Industrial production was unchanged in February after rising substantially over the previous several months. After a weather-related surge in January, housing starts fell in February to a level somewhat below their average in the fourth quarter. Growth in consumer spending moderated in January and February. Recent indicators of business capital spending suggest a rebound after a decline in the fourth quarter. The nominal U.S. merchandise trade deficit was larger in the fourth quarter than in the third quarter; the preliminary estimate of the deficit for January was smaller than the average for the fourth quarter. The latest information on prices suggests some pickup in inflation from recent trends.

Interest rates in both short- and long-term markets have risen considerably since the Committee meeting in early February. On February 24 the Federal Reserve Board approved an increase in the discount rate from 6½ to 7 percent. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose somewhat on balance over the intermeeting period.

Growth of M2 and M3 strengthened in February and apparently picked up further in March; over the first quarter such expansion was about in line with Committee expectations. M1 appears to have declined marginally since December.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt was set at 6½ to 10½ percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from March through June at annual rates of about 3 and 5 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 8 to 12 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Kelley, LaWare, Melzer, and Syron. Vote against this action: Ms. Seger.

Ms. Seger supported the decision to keep policy unchanged in the period immediately ahead, but she could not accept a directive that allowed intermeeting adjustments to be made more readily in a firming than in an easing direction as new information became available. The lagged effects of the substantial tightening that had been implemented earlier coupled with current indications of slower economic growth suggested that policy already had been tightened enough to lead to lower inflation over time. Under current circumstances, further firming carried substantial risks to interest-sensitive sectors of the economy, the level of the dollar in foreign exchange markets, and the continued growth of the economy.

2. Authorization for Domestic Open Market Operations

Effective March 29, 1989, the Committee approved a temporary increase of $2 billion, to $8 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities that is specified in paragraph 1(a) of the Authorization for Domestic Open Market Operations. The increase was effective for the intermeeting period ending with the close of business on May 16, 1989.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the usual leeway of $6 billion for changes in System Account holdings might not be sufficient over the intermeeting period because of seasonal increases in currency in circulation and in required reserves and a large rise in Treasury balances at the Federal Reserve Banks after the tax payment date in mid-April.

Meeting Held on May 16, 1989

1. Domestic Policy Directive

Information reviewed at this meeting suggested that the rate of economic expansion had slowed in recent months. Job gains had diminished noticeably in March and April, and industrial production was growing more slowly than in 1988. On the demand side, growth in consumer spending appeared to have slackened, and housing activity had weakened considerably. Broad measures of prices had risen somewhat more rapidly in 1989, with a significant contribution from sharp increases in energy prices. Year-over-year increases in labor costs appeared to be continuing on an upward trend but at a more gradual rate.

Gains in total nonfarm payroll employment moderated substantially in March and April from the rate recorded over the previous six months. Much of the March-April increase occurred in the services industry, where employment continued to expand at about the 1988 pace. In April, job growth slackened at wholesale and retail trade establishments, and factory employment remained a bit lower than its January level. Although new claims for unemployment insurance continued low, the civilian unemployment rate rose from 5.0 percent in March to 5.3 percent in April.

Industrial production increased in April after declining on balance over the preceding two months. The April pickup reflected a sizable rise in motor vehicle assemblies after a weak first quarter as well as a retracing of the March decline in output of other consumer goods. Production of business equipment continued to rise in April at about the strong first-quarter pace. Total industrial capacity utilization rose in April but remained below its January level. Operating rates in manufacturing edged up despite a further decline in capacity utilization in primary processing industries.

Growth in consumer spending had slowed considerably this year from the pace in 1988. A reduction in growth of spending for services along with smaller outlays for durable goods, notably motor vehicles, more than offset a pickup in expenditures for nondurable goods. In April, enhanced manufacturer incentives spurred spending on motor vehicles and boosted retail sales after a flat March, but outlays on other durable goods remained weak. After a sizable rise in the second half of 1988, housing starts weakened sharply this year. In April, a substantial drop in starts of multifamily units brought overall housing starts to their lowest level since December 1982.

By contrast, recent indicators of business capital spending showed a rebound in early 1989 after a decline in the fourth quarter. Shipments of nondefense capital goods excluding aircraft picked up sharply in the first quarter; among the major components, computers posted a sizable increase after a sharp fourth-quarter decline, and only business purchases of motor vehicles evidenced weakness. Nonresidential construction activity rebounded sharply in March from a February decline, and petroleum drilling turned up, apparently in response to increases in oil prices. In the first quarter, inventory investment in the manufacturing sector continued at about the average 1988 pace; a substantial part of this accumulation was in stocks of work-in-process in the aircraft industry where new orders and production remained on a distinct uptrend. The overall inventory-to-shipments ratio had changed little from the year-end level. At the retail level, inventory-sales ratios edged up as a result not only of further accumulations in the automotive area but also of some rise in apparel and general merchandise stocks.

After rising sharply in the first two months of the year, producer prices of finished goods advanced at a substantially less rapid pace in March and April. The April increase reflected another large jump in energy prices; prices of consumer foods turned down, partially reversing their sizable first-quarter increase, and prices of other finished goods were little changed. At the intermediate and the crude materials levels, the April price increases were attributable entirely to the surge in energy prices. Both food and energy prices contributed to the rise in consumer prices in March. Nevertheless, excluding these components, consumer prices advanced at a slightly faster rate in the first quarter of 1989 than in the fourth quarter of 1988. The year over-year increase in this measure of consumer prices had edged up only marginally since the beginning of the year, a pattern also evident in broad measures of labor compensation.

The nominal U.S. merchandise trade deficit widened somewhat in February, but the average deficit for January and February together was smaller than that for the fourth quarter. Exports for the January- February period were well above their fourth-quarter level; much of the increase occurred in agricultural products. Imports advanced considerably less, as declines in automotive products, consumer goods, and foods nearly offset increases in oil, industrial supplies, and capital goods. Available indicators suggested that the pace of economic growth and inflation had increased on balance in the major foreign industrial countries in early 1989.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose further on balance over the intermeeting period. The dollar declined early in the period as market participants perceived central bank authorities as actively seeking a lower dollar. Despite some continued narrowing of short-term interest rate differentials between dollar-denominated assets and both mark and yen assets, the dollar subsequently rebounded; market concerns about political uncertainties in Germany and Japan apparently were a factor in the rise.

At its meeting on March 28, the Committee adopted a directive that called for no immediate change in the degree of pressure on reserve positions but that provided for giving particular weight to potential developments that might require some firming during the intermeeting period. An unchanged availability of reserves over the period was expected to be consistent with the growth of M2 and M3 over the period from March through June at annual rates of about 3 percent and 5 percent respectively. It was agreed that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. Reserve conditions remained essentially stable over the intermeeting interval following the March meeting, except that stronger than-anticipated federal tax revenues and related reserve flows associated with the April tax date contributed for a time to slightly firmer reserve markets. In the reserve maintenance periods completed since the March meeting, adjustment plus seasonal borrowing averaged $565 million while federal funds generally traded around 9⅞ percent or a little below.

With incoming information suggesting a more moderate pace of economic expansion, other market interest rates declined over the intermeeting period. Rates on short- and intermediate-term U.S. Treasury issues dropped almost 1 percentage point, and those on private money market instruments fell somewhat less. Yields generally were down 25 to 50 basis points in long-term debt markets, and major indexes of stock prices rose substantially.

M2 and M3 grew more sluggishly in April than had been anticipated, as substantial deposit outflows began after midmonth and continued into early May. Declines in transaction and other liquid balances were associated primarily with outsized personal tax payments and a shortfall in tax refunds. Growth of the broader monetary aggregates also continued to be restrained by the effects of the earlier rise in market interest rates, which had substantially increased the opportunity costs of holding deposits. Through April, expansion of M2 had been at a rate well below the Committee's range for the year, while growth of M3 had been in the lower portion of its range. Reflecting the persisting weakness in transactions balances in 1989, M1 was below its average level in the fourth quarter of 1988. Growth in total domestic nonfinancial debt slowed somewhat in April, damped by strong tax revenues that reduced the Treasury's financing needs and by a virtual halt in refundings of state and local obligations owing to the earlier climb in interest rates.

The staff projection prepared for this meeting suggested that the expansion of the nonfarm economy over the remainder of 1989 was likely to be at a pace somewhat below that officially reported for the first quarter. The projection continued to assume that the drought had ended and that normal agricultural growing conditions would prevail. The staff anticipated that, with margins of unutilized labor and other production resources remaining relatively low, most measures of prices and labor costs would increase at somewhat faster rates in 1989 than in 1988. A monetary policy to contain inflation would involve slow growth of overall demand and an easing of pressures on labor and capital resources; to the extent that strength in final demands were to persist, such a policy would imply additional pressures in financial markets. The staff projected sluggish consumer outlays for goods and services and further weakness in housing construction over the remainder of 1989. The contribution of foreign trade to growth was likely to be limited, and fiscal policy was expected to be moderately restrictive. Growth in business capital spending, particularly for equipment purchases, was expected to moderate over the rest of the year from its vigorous first-quarter pace.

In the Committee's discussion of the economic situation and outlook, members focused on accumulating indications that the expansion in business activity was slowing to a pace that they generally viewed as more sustainable and more consistent with reducing inflation pressures over time. The apparent slowing in the growth of domestic consumer demand would tend to make more domestic resources available for the production of export goods and the expansion of domestic capital. There was little evidence at this point of the kinds of imbalances that normally signal a downturn in economic activity, but some members expressed concern that a cumulative slowing of the business expansion could not be ruled out, especially since the effects of earlier policy tightening actions had not been felt fully. In this regard, the extended weakness in monetary growth, at a time of slowing economic expansion, was a worrisome development. The latest information on prices and wages was cited as encouraging, possibly indicating that the underlying rate of inflation might be leveling out, although it was still undesirably high.

In the course of the Committee's discussion, members observed that the broad indications of slower but continuing business expansion were supported by reports on regional economic developments. While conditions varied across the country, overall activity appeared to be advancing in most regions, though evidence of slower growth was apparent in some of them. Retail sales had flattened out in a number of areas. The weakness in sales was more widespread and pronounced in the case of motor vehicles, particularly after taking account of incentive programs introduced recently by auto manufacturers. Consumer spending was not likely to increase rapidly over coming quarters but should be sustained at a moderate pace by a high level of employment and further expansion in personal incomes. Housing construction was depressed in many areas, and this sector of the economy was not expected to make much, if any, net contribution to the expansion this year, at least on the assumption of unchanged financial conditions in mortgage markets. Business fixed investment presented a mixed picture by industry but, in the context of high capacity utilization rates and strong pressures to cut costs, further overall growth was viewed as a reasonable prospect following the sharp pickup in the first quarter. Conditions in agriculture were described as favorable in most parts of the nation, though some areas were still affected by drought conditions. Outside the motor vehicles sector, inventories displayed few signs of the imbalances that usually presage a downturn in production; some of the recent build-up involved work-in-process inventories in industries such as commercial aircraft that had firm order backlogs. Gains in net exports had contributed importantly to continued expansion over recent quarters. While further progress in reducing the nation's trade deficit was anticipated, some members emphasized the potentially adverse implications of a strengthening dollar for the nation's trade balance and domestic economic growth. On the whole, the economic expansion appeared to be stabilizing at a reduced but sustainable pace that tended to reflect both capacity constraints in some industries and some slowing in the growth of overall domestic demand.

With regard to the outlook for prices and wages, a number of members emphasized that inflationary pressures were still firmly rooted in the economy and that the rate of inflation might well remain unacceptably high for an extended period. However, the slowdown in economic growth should tend to moderate pressures on costs over time, and the most recent information on prices and wages had been encouraging. In addition, the overall outlook for agricultural production this year had favorable implications for food prices, and the recent strength of the dollar augured well for domestic inflation, albeit at the cost of reduced export opportunities. With respect to wages, some members commented that recent patterns were better than they had expected, given the persistence of tight labor markets in many areas and the low rate of unemployment for the nation as a whole. However, reference also was made to indications of greater militancy on the part of labor in some parts of the country and to a recent labor settlement that could have inflationary implications. On balance, in the context of slowing economic expansion, several members noted that the risks to the economy apparently had become less one-sided, having shifted from a strong potential for greater inflation to more equally weighted risks of higher inflation and a substantial shortfall in economic growth.

Turning to the conduct of monetary policy, nearly all of the members endorsed a proposal to maintain unchanged conditions of reserve availability, at least initially in the intermeeting period. There was considerable uncertainty as to whether monetary conditions were sufficiently restrictive to foster lower rates of inflation or had become so tight as to cause an even greater slowing in the expansion than might be needed to relieve inflation pressures. In the circumstances, most members viewed a steady policy as offering the best promise at this point of being associated with the financial market conditions and monetary growth rates that would support an appropriately restrained rate of economic expansion to accommodate the Committee's anti-inflationary objectives. Given current uncertainties, further developments would need to be evaluated carefully and might well call for some adjustment of policy, in either direction, before the next meeting of the Committee.

In the course of their discussion, the members took account of a staff analysis that indicated that unchanged reserve conditions were likely to be associated with some rebound in the growth of the monetary aggregates during the intermeeting period. Earlier increases in market interest rates in the context of typically sluggish adjustments of offering rates on relatively liquid consumer-type deposits had fostered slow growth in M2 and to a lesser extent in M3, while demand deposits had declined appreciably on balance since year-end. In recent weeks, transaction and other liquid accounts had been depressed further in conjunction with larger-than-expected tax payments and atypically small tax refunds. The staff analysis postulated some replenishment of tax depleted deposits and a lessening impact from earlier increases in market rates on interest-sensitive deposit accounts, although there was as yet little evidence of a rebound.

In the light of indications of slower growth in business activity and sluggish monetary expansion that had left M2 well below the lower bound of its annual growth cone and M3 near the lower limit of its annual range, members attached considerable importance to the need for an upturn in monetary growth. Indeed, the behavior of the monetary aggregates would need to be monitored with special care over the weeks ahead, and a failure of monetary growth to revive during this period might well signal some further weakening in the business expansion and warrant a special consultation of the Committee. A pickup in M2 would be needed fairly soon to give some assurance that this aggregate was on a track that would bring it within the Committee's range for the year. In one view the monetary aggregates already were sufficiently weak to justify some immediate easing of reserve conditions in order to improve the prospects that adequate monetary growth would occur to sustain the economic expansion. Other members preferred a more cautious approach, in part to avert the potential need for, and resulting market unsettlement that would be associated with, a subsequent reversal of the easing, particularly if special factors depressing recent monetary growth were reversed.

With respect to possible adjustments in monetary policy during the intermeeting period ahead, a majority of the members supported a directive that would make an easing or a tightening of policy equally likely, depending on economic and financial developments and the behavior of the monetary aggregates. However, one member preferred a directive that was tilted toward ease in order to help assure a prompt policy response if monetary growth did not rebound relatively soon. Other members indicated a preference for retaining the previous intermeeting instruction that tilted more toward tightening than toward easing. Persisting inflationary pressures and, in this view, the still tentative indications of a slower business expansion argued for a continuing bias toward restraint. Some members were concerned that, under prevailing circumstances, a move to a symmetrical directive could be misinterpreted, when published, as a lessening of the Committee's commitment to an anti-inflationary policy.

During the Committee's discussion, consideration was given to the technical relationship between the level of adjustment plus seasonal borrowing and that of the federal funds rate. In comparison with experience in earlier years, borrowing had been low for some time in relation to the federal funds rate. However, the shortfall appeared to have diminished in recent weeks—largely because of a surge in seasonal borrowing—and, according to a staff analysis, unchanged reserve conditions over the upcoming intermeeting period might encompass somewhat higher average borrowing. In light of the persisting uncertainties in the relationship between borrowing and the federal funds rate, the members accepted the need for continued flexibility in the conduct of open market operations.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept a directive that called initially for no change in the degree of pressure on reserve positions. Some firming or some easing of reserve conditions would be acceptable during the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 1½ and 4 percent respectively over the three-month period from March to June. The members agreed that the intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 8 to 12 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that the rate of economic growth has slowed in recent months. Gains in total nonfarm payroll employment moderated substantially in March and April, and employment in manufacturing was about unchanged over the two months. The civilian unemployment rate rose considerably to 5.3 percent in April. Industrial production increased in April after declining on balance in the preceding two months. Growth in consumer spending has slowed considerably in recent months. Housing starts declined further in April. Recent indicators of business capital spending show a rebound after a decline in the fourth quarter. The nominal U.S. merchandise trade deficit was smaller on average in January and February than in the fourth quarter. Broad measures of prices have risen somewhat more rapidly in 1989, with a significant contribution from sharp increases in energy prices.

Interest rates have declined considerably since the Committee meeting in late March. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose further on balance over the intermeeting period.

Growth of M2 and M3 was sluggish in April, primarily because of a sizable decline in transactions balances. Through April, expansion of M2 has been at a rate below the Committee's range for the year, while growth of M3 has been in the lower portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt was set at 6½ to 10½ percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from March through June at annual rates of about 1½ and 4 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 8 to 12 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Kelley, and LaWare, Ms. Seger, and Mr. Syron. Vote against this action: Mr. Melzer.

Mr. Melzer dissented because he favored an immediate move to slightly less pressure on reserve positions. While inflation was currently too high and might move even higher in the short run, he felt that the monetary policy restraint of the past two years would eventually reduce inflationary pressures. In addition, he was concerned that the very restrictive monetary policy of recent quarters, evidenced by extremely sluggish growth of reserves, the monetary base, and the monetary aggregates, heightened the risks of a recession unless the policy were to be reversed soon. In the event of a recession, a policy response aimed at a quick recovery could make the longer-term goal of price stability even more difficult to attain.

2. Foreign Currency Authorization

At this meeting the Committee approved an increase in the limit on holdings of foreign currencies in the System Open Market Account. Paragraph 1D of the Committee's Authorization for Foreign Currency Operations permitted the Federal Reserve Bank of New York, for the System Open Market Account, to maintain an overall open position in all foreign currencies not exceeding $12.0 billion. System holdings of such currencies had risen rapidly this year and totaled nearly $11 billion, based on historical costs. In light of the potential for further System acquisitions of foreign currencies in coordination with similar transactions by the U.S. Treasury and in cooperation with foreign monetary authorities, the Committee agreed to raise the limit in Paragraph 1D of the Authorization to $15.0 billion, effective immediately.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Kelley, and Melzer, Ms. Seger, and Mr. Syron. Vote against this action: Mr. LaWare.

Mr. LaWare dissented because he wanted to convey his skepticism about the effectiveness of sterilized intervention in foreign exchange markets. He did not object to the specific transactions that had been conducted recently.

Following the meeting the dollar remained under strong upward pressure that was resisted through very large additional System purchases of foreign currencies. Effective June 14, 1989, the Committee approved a further increase to $18.0 billion in the limit on System holdings of foreign currencies under Paragraph 1D of the Authorization for Foreign Currency Operations.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None.

Meeting Held on July 5–6, 1989

1. Domestic Policy Directive

The information reviewed at this meeting tended to confirm earlier indications that economic growth had slowed this year. Recent data on production and spending suggested a fairly consistent pattern of weakness in housing and in consumer goods, notably motor vehicles. Running counter to that trend was a further sizable increase in spending for business equipment following a strong first quarter; in addition, the trade deficit had narrowed further. Broad measures of prices continued to rise more rapidly than in 1988, reflecting sharp upward pressures on energy and food prices. There had been no discernible step-up in the pace of wage inflation, however, even though levels of labor utilization remained relatively high.

Growth in total nonfarm payrolls moderated substantially in recent months from the pace of the previous two years. Employment in manufacturing and construction fell in May and on balance had changed little in both sectors since January. Job growth in services was relatively weak in May, judged by recent standards, as gains in trade and business services were small. Despite the slower pace of payroll growth this year, the factory workweek remained high by historical standards in May, and initial claims for unemployment insurance had increased only slightly through mid-June. The civilian unemployment rate, at 5.2 percent in May, stayed close to its average level in earlier months of the year.

Industrial production increased on balance in April and May at about the reduced rate experienced earlier in the year. Assemblies of motor vehicles, which had turned up in April, fell appreciably in May. Production of consumer goods other than automobiles also softened in May, and output of construction supplies registered a decline for the fourth consecutive month. Production of business equipment excluding automobiles continued to advance strongly in April and May, partly as a result of a surge in the manufacture of computers but also owing to gains for a variety of other types of equipment, particularly capital goods for manufacturing industries. Total industrial capacity utilization retraced its April rise in May but remained well above its relatively high level of a year ago. Operating rates in manufacturing slipped further in May for primary processing industries, while those for advanced processing industries were sustained at the already high levels evident in earlier months of the year.

Despite considerable gains in real disposable income in recent quarters, the sluggish growth in consumer spending that had emerged earlier in 1989 continued into the second quarter. In May, a decline in expenditures was led by a reduction in outlays for motor vehicles, although spending also was flat or down for a broad range of other goods, both durable and nondurable. In contrast to outlays on goods, growth in purchases of services was well maintained. Housing starts declined slightly further in May, as single-family starts slipped back to their weak level of March. Starts of multifamily units were little changed in May from the seven-year low recorded in April. Home sales had fallen this year.

Recent indicators of business capital spending suggested a further substantial increase in the second quarter after a strong first quarter. Shipments of nondefense capital goods advanced sharply in April, with solid gains for most broad categories, and remained high in May. Nonresidential construction activity had changed little in recent quarters although industrial structures put in place strengthened somewhat, perhaps reflecting sustained high levels of factory utilization in some industries. Inventory investment by manufacturers continued in April at about the first-quarter pace and such inventories remained in line with shipments. Much of the increase in factory inventories was concentrated in work-in-process stocks in the aircraft industry, where production had been strong. In the retail sector, dealer stocks of automobiles remained high, and inventories at other retail establishments had risen a bit relative to sales, measured on a constant-dollar basis, but there were only limited indications of excess stocks in the nonautomotive segments of retailing.

The nominal U.S. merchandise trade deficit narrowed in April from a first-quarter average that was the smallest in four years. Exports strengthened a little in April when a decline in sales of agricultural products from their high March levels was outweighed by increases in most other major trade categories, especially industrial supplies and machinery. Appreciable declines in imports of automotive products, machinery, and foods more than offset a rise in oil imports. Available data suggested some slowing recently in the growth of economic activity in the major foreign industrial countries following robust expansion in the first quarter; inflation rates had moved up in most of those countries.

Continuing a pattern of sharp increases this year, producer prices of finished goods were up substantially further in May. The May rise was led by further advances in prices of food and energy products, but prices of nonfood, nonenergy goods also rose after being about unchanged in April. In April and May, increases in prices of most materials were noticeably smaller than those registered for finished goods. The consumer price index rose sharply further in April and May. Over the first five months of the year consumer prices increased at a faster rate than in 1988; however, excluding food and energy, the rate of increase in these prices differed little from last year's pace, partly because of the damping effect of the appreciation of the dollar on the prices of a broad range of imported goods. Recent data for labor compensation indicated that year-over-year increases in average hourly earnings of production and nonsupervisory workers remained near the average pace evident since mid-1988.

In foreign exchange markets, the dollar recorded significant gains against most of the other G-10 currencies in the weeks after the Committee meeting on May 16; in mid-June, the dollar reached a two and one-half year high against the mark and a one and one-half year high against the yen. Smaller-than-anticipated trade deficits announced for March and April, political events in China and Japan, and expectations of capital gains in U.S. bond and equity markets appeared to have helped trigger buying pressure at a time of narrowing differentials between interest rates in the United States and abroad. The dollar subsequently fell back sharply in often volatile trading, its weighted-average value in terms of the other G-10 currencies more than retracing the earlier rise. The decline in the value of the dollar occurred largely in the absence of significant new economic developments or clear indications of a reassessment of economic fundamentals by market participants.

At its meeting on May 16, the Committee adopted a directive calling for no immediate change in the degree of pressure on reserve positions. The Committee agreed that somewhat greater or somewhat lesser reserve restraint would be acceptable over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. This policy stance was expected to be consistent with growth of M2 and M3 at annual rates of around 1½ and 4 percent respectively over the period from March through June.

Immediately after the Committee meeting, the Manager for Domestic Operations directed operations toward maintaining the existing degree of pressure on reserve positions. A technical upward revision was made to the assumed level of adjustment plus seasonal borrowing to bring it in line with desired overall conditions in reserve markets; this revision resulted from the recent, unusual strength of seasonal borrowing that perhaps was associated with heavier demands for crop production loans at a time of weak deposit growth at agricultural banks. Later in the intermeeting period, a variety of developments began to suggest that a slackening in inflation pressures might be in prospect as indications of slower economic expansion continued to accumulate, monetary growth remained sluggish, and the dollar climbed further. In these circumstances, the Manager for Domestic Operations acted in early June to reduce somewhat the degree of pressures on reserve positions. Adjustment plus seasonal borrowing averaged about $550 million over the three full reserve maintenance periods completed since the May 16 meeting, while the federal funds rate moved down about ¼ percentage point to 9½ percent or slightly higher more recently.

Other market interest rates also fell over the intermeeting period in response to indications of a continuing softness in the economy and a better outlook for inflation as well as to the easing of monetary policy. Short-term market rates dropped 25 to 70 basis points, and the prime rate was lowered ½ percentage point to 11 percent in early June. In long-term debt markets, yields on Treasury coupon issues dropped 70 to 90 basis points. Stock prices rallied through much of the intermeeting period, and major indexes reached new post-1987-crash highs before giving up most of those gains.

M2 and M3 declined in May, primarily because of sizable reductions in transaction and other liquid deposit balances that seemed to be related to the clearing of unexpectedly large payments to cover federal tax liabilities for 1988. Through mid-June, growth of these aggregates appeared to have rebounded in conjunction with some rebuilding of tax-depleted balances and the declines in market interest rates that brought some narrowing of the large opportunity costs associated with holding liquid deposits. Nonetheless, the growth of M2 for the year to date remained below the lower end of the Committee's annual target range. M1 continued to contract through mid-June, as weakness in transaction balances, especially in demand deposits, persisted. Domestic nonfinancial debt expanded in May at a slightly lower rate than it did in the first quarter.

The staff projections prepared for this meeting suggested that growth of the nonfarm economy over the remainder of 1989 and for 1990 was likely to be at a pace a little lower than that estimated for the first half of this year. The projection continued to assume that normal agricultural growing conditions would prevail. Although the recent strengthening of the dollar was tending to damp import prices and thereby domestic inflation, the staff anticipated that, with margins of unutilized labor and other production resources still relatively low, most measures of prices and labor costs would increase at slightly faster rates in 1989 than in 1988. Inflationary pressures were expected to abate a bit in 1990, partly in response to gradually mounting slack in labor and product markets. The staff projected that the contribution of foreign trade to growth would be very limited, as real export gains dropped well below the pace of recent quarters, and that fiscal policy would remain moderately restrictive. In view of expected meager gains in employment and real income, consumer spending would be sluggish through 1990. Housing activity was projected to benefit from the recent drop in interest rates. Relatively sluggish final demands along with reduced capacity utilization rates were expected to have a restraining effect on the growth of business capital spending.

In the Committee's discussion of current and prospective economic conditions, members focused on accumulating indications of reduced growth in business activity and on the implications for the outlook for the economy and prices. The members generally concluded that continuing expansion at a relatively slow pace was a reasonable expectation for the next several quarters and that the associated lessening of pressures on labor and capital resources was likely to foster progress in curbing inflation over time. Members noted that the economic outlook was subject to considerable uncertainty and that substantial deviations from current expectations might well occur. The latest information suggested some risk that the expansion might weaken further, but current business conditions provided few indications of the kinds of imbalances and distortions that often lead to downturns in economic activity. Some members emphasized that a recession, should one materialize, might be aggravated by the debt burdens or debt exposure of many business and financial firms. At the same time, inflation remained unacceptably high and cost pressures substantial; however, in the context of a weaker economic outlook and an extended period of slow monetary growth, the risks of a sustained acceleration in inflation appeared to be more limited than they had earlier in the year. Nonetheless, a policy designed to bring about some reduction in underlying inflation pressures and improvement in the nation's external accounts might be associated with relatively slow growth of domestic spending for some time.

In keeping with the usual practice at meetings when the Committee considers its long-run objectives for monetary growth, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided specific projections of growth in real and nominal GNP, the rate of unemployment, and the rate of inflation. With regard to the rate of expansion in real GNP, the projections had a central tendency of 2 to 2½ percent for 1989 as a whole, implying continuing growth at a reduced pace in the second half of the year; for the year 1990 the central tendency was 1½ to 2 percent. Projections of growth in nominal GNP converged on rates of 6 to 7 percent for 1989 and 5½ to 6¾ percent for 1990. The projected rates of unemployment centered around 5½ percent for the fourth quarter of 1989 and 5½ to 6 percent for the fourth quarter of 1990. With respect to the rate of inflation, the projections had a central tendency for the consumer price index of 5 to 5½ percent for 1989 and 4½ to 5 percent for 1990. In making these projections the members took account of the Committee's decisions at this meeting with regard to the objectives for monetary growth in 1989 and 1990. The members assumed that progress would be made in reducing the federal budget deficit and that fluctuations in the exchange value of the dollar would not be of sufficient magnitude to affect economic growth and inflation materially in the period through the end of 1990.

In their review of specific developments bearing on the outlook for the economy, members observed that growth appeared to be slowing in many parts of the country but that the utilization of labor and capital resources remained high in most regions and continued to improve in others from relatively depressed levels. In general, business sentiment remained favorable, though the emergence of somewhat more cautious attitudes was detected in a number of areas and industries. With regard to specific sectors of the economy, current data and business contacts did not suggest any general backup in inventories apart from motor vehicles; however, there were some recent reports of marginally excessive inventories in a few nonautomotive businesses, and a further slippage in the growth of final demand could lead to efforts to pare inventories and production schedules. The members generally anticipated continued overall growth in business fixed investment, though at a pace much reduced from that experienced earlier in the year. Nonresidential construction activity was lagging in many areas, but the demand for business equipment remained relatively vigorous, in part because of sales abroad. Housing activity was weak in a number of markets, including some that had displayed considerable vigor until recently, but the decline in mortgage rates was believed likely to sustain activity in this sector of the economy.

A key element in the outlook for overall business activity was the prospects for consumer spending; many members saw little basis for anticipating further slowing in the expansion of consumer expenditures, but others were less persuaded and some cited in particular the possibility that relatively weak sales of motor vehicles might continue. Foreign trade was another important sector bearing on the economic outlook. Some further growth in net exports was viewed as a reasonable prospect, but the improvement might be limited if the dollar remained strong and growth slowed in key economies abroad. Finally, a number of members stressed that some acceleration in monetary growth from the pace in the first half of the year likely was needed to help support expansion in business activity.

Turning to the outlook for inflation, members generally anticipated that reduced economic growth in line with the central tendency of their forecasts would contribute to some damping of underlying inflationary pressures by 1990. The rate of increase in the consumer price index might well moderate over the balance of this year, assuming relief from special factors that had affected food and energy prices during the first half. In particular, the larger farm crops that were anticipated this year would tend to reduce pressures on food prices, and recent oil price developments suggested some softening in consumer energy prices. Other favorable developments included generally restrained increases in wages despite ongoing labor shortages in many parts of the nation and, as evidenced in part by business contacts around the country, some apparent lessening of inflationary expectations. In addition, commodity prices had been subdued in recent months, supporting indications of less intense demands in industrial sectors and perhaps pointing to slower increases in consumer prices in the months ahead. On the negative side, some members stressed that underlying inflation pressures remained strong and, given current levels of resource use, an expansion in line with the forecasts of most members might avert accelerating inflation but was less likely to foster any significant decline over the forecast horizon. More generally, the members' forecasts pointed to a rate of inflation that was unacceptably high and that moderated only slightly over this period; moreover, the risks of some acceleration, while small, were not negligible especially if economic growth turned out to be appreciably faster than most members currently anticipated, putting additional pressure on resources.

Against the background of the Committee's views regarding prospective economic developments and in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee at this meeting reviewed the ranges for growth in the monetary and debt aggregates that it had established in February for 1989 and decided on tentative ranges for growth in those measures in 1990. The 1989 ranges included growth of 3 to 7 percent for M2 and 3½ to 7½ percent for M3 for the period from the fourth quarter of 1988 to the fourth quarter of 1989. A monitoring range of 6½ to 10½ percent had been set for growth in total domestic nonfinancial debt in 1989. For the year to June, the cumulative expansion of M2 was at a rate about 1 percentage point below the Committee's range, while that of M3 placed it at the lower bound of its range. The expansion in nonfinancial debt was near the middle of its range in the first half of the year.

In the Committee's review of the ranges for 1989, all of the members endorsed a proposal to retain the ranges set in February. The Committee took account of a staff analysis that indicated that the more rapid growth in M2 and M3 since mid-May was likely to persist over the months ahead and that by the fourth quarter both aggregates would be well within the current ranges for the year. The staff assessment incorporated the impact of the recent declines in market interest rates, which would tend to reduce the opportunity costs of holding M2 balances, and also assumed that there would be no special factors influencing the growth of the aggregates such as those experienced earlier in the year. Expansion in total domestic nonfinancial debt was projected to continue at a rate around the middle of its range through year-end; growth in this measure had been trending lower in recent years but it remained at a pace appreciably above that for nominal GNP. The members concluded that the ranges set in February for 1989 were still consistent with the Committee's objectives of fostering sustained expansion in economic activity and progress toward price stability.

The ranges for 1989 represented reductions from those for 1988, and the members agreed that restrained monetary growth and further reductions in the ranges would be needed over time to achieve and maintain price stability. Views differed, however, as to whether the ranges for 1990 should be reduced at this meeting.

A majority of the members indicated a preference for extending the 1989 ranges provisionally to 1990, subject to the usual review next February in light of the economic and financial conditions prevailing then. The outlook for next year was uncertain, especially this far in advance. Nonetheless, the 1989 ranges were likely in this view to encompass monetary growth that would foster desired economic expansion and moderation of price pressures in 1990. This outcome could be associated with somewhat more rapid growth of M2 in 1990 than appeared to be in train for 1989. Such a pickup in monetary growth would be consistent with expansion of nominal GNP along the lines of the central tendency of the members' forecasts and should be associated with only minor changes in interest rates and hence in velocity next year. Moreover, somewhat faster growth in M2 might be needed next year to counter any potential weakening tendencies that might develop in the economy. In these circumstances there existed a considerable risk that a reduction in the range for M2 might have to be reversed next year or growth in excess of the range tolerated. Either development might be viewed as inconsistent with the stability and predictability of policy that tended to enhance its effectiveness over time. Especially in light of the foregoing considerations, a marginal reduction in the ranges, although it might be seen as more consistent with the long-run objective of price stability, would seem to imply greater precision than was warranted by the Committee's current ability to project next year's developments. If small adjustments were called for, they could be made early next year when a more firmly based decision would be possible.

Members who preferred lower ranges for 1990 gave a good deal of emphasis to the desirability of continuing the Committee's policy of reducing the ranges from year to year in order to implement anti inflationary objectives. In this view, a failure to reduce the ranges at least slightly in present circumstances might be read as an implicit acceptance of current rates of inflation. These members recognized the possibility that monetary growth next year might be at the upper end, or even above, the ranges that they favored, especially if interest rates were to decline further in the interim. If economic and financial conditions early next year suggested a need, they would be prepared to raise the ranges at that time. Such a decision would be made in the light of circumstances that provided the rationale for it and need not therefore have the adverse consequences for inflationary expectations that some members feared. Members who favored lower ranges also did not want to rule out the possibility that inflation pressures next year might turn out to be more intense than was currently anticipated and that relatively limited monetary expansion therefore might remain appropriate.

In light of the persisting uncertainties about the relationship between monetary expansion and ultimate policy objectives, the members were in favor of retaining relatively wide ranges of 4 percentage points for M2 and M3. For many years prior to 1988, the Committee had set narrower ranges, almost uniformly of 3 percentage points, for the broader monetary aggregates and for total domestic nonfinancial debt. Wider ranges provided greater scope for achieving monetary growth that was consistent with the Committee's objectives for the economy. In assessing appropriate rates of monetary expansion in the prevailing uncertain environment, the Committee would continue to evaluate a wide assortment of economic and financial indicators.

At the conclusion of this review, the Committee approved for inclusion in the domestic policy directive the following statement of its objectives for growth of the broader monetary aggregates and nonfinancial debt for the year 1989:

> The Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6½ to 10½ percent for the year.

> Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None. Absent and not voting: Mr. Heller.

For the year 1990, the Committee approved for inclusion in the domestic policy directive the following statement regarding the ranges for growth of the monetary aggregates and nonfinancial debt:

> For 1990, on a tentative basis, the Committee agreed to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

> Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Vote against: Mr. Keehn. Absent and not voting: Mr. Heller.

Mr. Keehn dissented because he wanted to reduce the ranges for 1990. In his view, a reduction of the ranges for next year would provide an important signal of the System's continuing commitment to price stability. While the velocity of the monetary aggregates had been erratic recently, lower ranges for the aggregates would encompass desirable rates of monetary growth should more normal conditions prevail next year. Given the uncertainty in the relationship between the monetary aggregates and economic growth, he would, however, be prepared to adjust the ranges early next year on the basis of intervening developments.

In the Committee's discussion of policy implementation for the period until the next meeting, the members generally agreed that recent developments suggested that some further easing of reserve conditions would be appropriate. Nearly all endorsed a proposal to lessen the degree of reserve pressure marginally at this time, but one member favored somewhat greater easing and another saw merit in a phased lessening of reserve pressures in the weeks ahead. Many emphasized that current economic and financial uncertainties called for caution in adjusting policy at this point. In this view, more than a slight move to less restraint could have an undesirable effect on inflationary expectations and, at least in the absence of further indications of lagging economic growth, could lead eventually to upward pressure on long-term interest rates. Moreover, in the view of some members, there remained some risk that inflationary pressures would intensify and that the easing might have to be reversed later. Caution also was indicated in light of the prevailing sensitivity and volatility of financial markets.

Several members emphasized the need for faster monetary growth than had been experienced in recent months. Some acceleration in the rate of monetary expansion had occurred since the middle of May, and a staff analysis suggested that such growth was likely to continue as the full effect of recent declines in market interest rates was felt. On the assumption of no further changes in interest rates, the staff projection anticipated that cumulative M2 growth would reach the bottom of the Committee's annual range by late summer. However, given the uncertainties that were involved, a number of members felt that some further easing was desirable to improve the prospects that monetary growth would be within the Committee's ranges for the year, if only in the lower part of the range in the case of M2. A moderate pickup in monetary growth at this time would help assure continued expansion of the economy and possibly avoid a situation in which a substantial weakening of the economy would be followed by rapid monetary growth and a marked rebound in activity—a pattern that would be unlikely to foster the Committee's objective of price stability over time.

Turning to the question of possible intermeeting adjustments in the degree of reserve restraint, a majority of the members indicated a preference for retaining an unbiased instruction as in the directive for the May meeting. This approach, in the context of the indicated preference of the members to move toward some immediate easing, was in keeping with the caution about future policy moves favored by most members. This caution was dictated by current uncertainties regarding the economic outlook, the still rapid rate of inflation, and the relatively sensitive conditions in financial markets. Others preferred an intermeeting instruction that was tilted toward ease partly to help underscore—in conjunction with a decision to ease—their view that the risks were in the direction of a shortfall in economic growth from current expectations and therefore that any intermeeting adjustment would very likely be in the direction of less restraint. Indeed, in this view a dramatic and unlikely turnaround would be needed in the tenor of the incoming economic information to warrant any firming in the weeks ahead.

In light of the easing of reserve conditions in early June and the further slight easing contemplated at this meeting, the members decided to lower the intermeeting range for the federal funds rate by 1 percentage point to 7 to 11 percent. Such a reduction centered the range more closely around the federal funds rate that was expected after this meeting. The range for the federal funds rate provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all but one of the members indicated that they preferred or could accept a directive that called for some slight easing in the degree of pressure on reserve positions. Some firming or some easing of reserve conditions would be acceptable during the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with some acceleration in the growth of M2 and M3 to annual rates of around 7 percent over the three-month period from June to September.

At the end of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting tends to confirm earlier indications that economic growth has slowed this year. Gains in total nonfarm payroll employment have moderated substantially in recent months, but the civilian unemployment rate, at 5.2 percent in May, remained close to its average level in earlier months of the year. Industrial production increased on balance in April and May at about the reduced rate experienced earlier in the year. Growth in consumer spending has weakened considerably this year. Housing starts declined slightly further in May. Recent indicators of business capital spending suggest a substantial additional increase in the second quarter after a rebound in the first quarter. The nominal U.S. merchandise trade deficit narrowed in April from a substantially reduced average value in the first quarter. Broad measures of prices have risen more rapidly this year than in 1988, reflecting sharp increases in energy and food prices.

Interest rates have fallen since the Committee meeting on May 16, with the largest declines generally occurring in long-term markets. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose sharply earlier in the intermeeting period but subsequently more than retraced that rise in often volatile trading.

M2 and M3 declined in May, primarily because of sizable reductions in transaction and other liquid balances arising from the clearing of unusually large tax payments; data through mid-June point to a rebound in these measures of money. Thus far this year expansion of M2 has been at a rate below the Committee's annual range, while growth of M3 has been around the lower bound of the Committee's range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6½ to 10½ percent for the year. For 1990, on a tentative basis, the Committee agreed to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 7 percent. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Votes for the paragraph on short-term policy implementation: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, Melzer, and Syron. Vote against this action: Ms. Seger. Absent and not voting: Mr. Heller.

Ms. Seger dissented because she felt that somewhat greater easing was warranted. In her view, the expansion in business activity already had slowed substantially and recent developments pointed to further weakness. While a change in monetary policy would have little effect on the economy over the remainder of this year, a more pronounced easing than the Committee currently contemplated was needed to foster financial conditions that would support the economy in 1990 and beyond.

2. Authorization for Domestic Open Market Operations

Effective July 7, 1989, the Committee approved a temporary increase of $2 billion, to $8 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the Authorization for Domestic Open Market Operations. Subsequently, effective July 31, 1989, the Committee approved a further increase of $2 billion, to $10 billion, in the intermeeting limit. Both increases applied to the period ending with the close of business on August 22, 1989.

Votes for the action effective July 7: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None. Absent and not voting: Mr. Heller.

Votes for the action effective July 31: Messrs. Greenspan, Angell, Boykin, Guffey, Johnson, Keehn, Kelley, and Oltman, Ms. Seger, and Mr. Syron. Votes against this action: None. Absent and not voting: Messrs. Heller and LaWare. (Messrs. Boykin and Oltman voted as alternates for Messrs. Melzer and Corrigan respectively.)

The increases were approved on the recommendation of the Manager for Domestic Operations. The Manager had advised on July 5 that the usual leeway of $6 billion for changes in System account holdings probably would not be sufficient over the intermeeting period, partly because of expected sales of securities to offset large declines in balances held by the U.S. Treasury at the Federal Reserve Banks and because of large foreign currency transactions. On July 28, the Manager advised that the remaining leeway under the $8 billion limit had been reduced to about $650 million, mainly as a result of declines in Treasury balances at the Reserve Banks but also owing to further official foreign currency transactions and smaller-than-expected increases in currency in circulation. The Manager anticipated that additional leeway might be necessary to meet continuing needs to absorb reserves in upcoming reserve maintenance periods.

Meeting Held on August 22, 1989

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity had continued to expand at a moderate pace in recent months. Job growth had remained sizable; and final demands, most notably in the consumer sector, appeared to be better maintained than had been indicated earlier. At the same time, price inflation had slowed, in large part reflecting a retracing of price increases in the food and energy sectors that had boosted inflation rates earlier this year; wage trends gave no signs of upward pressures.

Total nonfarm payroll employment rose appreciably further in July after a large advance in June. Most of the July increase took place at service establishments and in the construction industry where hiring had slowed during the first half of the year. Employment was little changed in manufacturing after three months of declines; much of the recent weakness had reflected layoffs in the automobile and electrical equipment industries. The civilian unemployment rate, at 5.2 percent, remained close to its average level in earlier months of the year.

Industrial production edged higher in July, offsetting the decline of the two previous months and continuing the general pattern of slow growth since the beginning of the year. Output of capital equipment posted another strong gain in July. Production of motor vehicles and parts declined substantially, but output of other consumer goods continued to rise at a moderate pace. Production of materials rebounded after declining on balance over the first half of the year. Total industrial capacity utilization held steady in July at a relatively high level. In manufacturing, despite a pickup in primary processing industries, operating rates edged lower and were down appreciably since January.

Retail sales rose considerably in July, and revisions for earlier months suggested that consumer spending in the second quarter had not been as weak as previously estimated. Purchases of nondurable goods advanced appreciably further in July from the upward revised levels of recent months. With a new round of manufacturers' incentives boosting sales of motor vehicles, spending on durable goods also increased. Housing starts rose slightly further in July following a large gain in June. The upturn in starts occurred in the wake of a bounceback in sales of both new and existing homes that was associated with the sizable decline in mortgage rates since April.

Recent indicators of business capital spending suggested some slowing of growth from the substantial pace of earlier months in the year. In June, shipments of nondefense capital goods increased modestly as a brisk rise in outlays for aircraft and computers outweighed a sharp decline in spending for other categories of producers' durable equipment. Nonresidential construction activity, led by stepped-up outlays for industrial structures, advanced strongly for a second consecutive month. Inventory investment in manufacturing and trade slowed in June to a pace well below the average rate of increase observed earlier in the year. In the manufacturing sector, inventories of most types of finished goods rose only moderately, while stocks of materials declined further. Inventories of work-in-process in the aircraft industry continued to grow, as the industry expanded production to keep pace with mounting orders. At the retail level, dealer stocks of automobiles rose a bit further. Inventories at other retail establishments also increased, but imbalances with sales appeared to be limited.

In June, the nominal U.S. merchandise trade deficit narrowed considerably, and for the second quarter as a whole it was about unchanged from a substantially reduced average value in the first quarter. Exports rebounded in June as increases in both capital and consumer goods outweighed a further decline in sales of agricultural goods. Imports declined appreciably, largely because of a drop in the value of oil imports. In the major foreign industrial countries, economic growth slowed significantly in the second quarter, following exceptionally rapid expansion in the first quarter.

Partly reflecting further sharp declines in consumer energy prices, producer prices of finished goods fell in July for a second consecutive month. Prices of finished consumer goods other than food and energy also declined, while prices of capital goods held steady. Apart from food and energy, prices of materials had fallen somewhat on balance at the intermediate level in recent months and had come down markedly at the crude stage. Consumer prices rose modestly in June after increasing sharply in earlier months of the year. Lower prices were registered for gasoline, fuel oil, and electricity; and consumer food prices rose more slowly. Prices of consumer services continued to advance in June at about the rate observed over the past year and a half. Average hourly earnings jumped in July after showing little change in the previous two months, and on balance the data for recent months suggested no change in prevailing wage trends.

At its meeting on July 5–6, the Committee adopted a directive that called for a slight reduction in the existing degree of pressure on reserve positions. The Committee agreed that somewhat greater or somewhat lesser reserve restraint would be acceptable in the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. This policy stance was expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 7 percent.

Immediately after the Committee meeting, the Manager for Domestic Operations conducted operations to achieve the slight easing in reserve conditions that the Committee had directed. At the same time, to reflect strength in seasonal borrowing, a small technical upward revision was made to the assumed level of adjustment plus seasonal borrowing. Late in July, as incoming data continued to portray a softer economy and some lessening in inflationary pressures, the Manager sought a further slight reduction in the degree of pressure on reserve positions. Adjustment plus seasonal borrowing averaged nearly $600 million over the three reserve maintenance periods completed since the July 5–6 meeting, while the federal funds rate moved down a little more than ½ percentage point to around 9 percent.

Other market interest rates fluctuated over a wide range during the intermeeting interval. Early in the period, rates tended to decline in response to weaker-than-anticipated economic data and related market expectations of further monetary easing. Subsequently, rates rebounded after the release of other economic indicators that were viewed as suggesting less weakness in the expansion and therefore a reduced likelihood of further easing. As a result, most rates ended the period with only modest net changes. Treasury bill rates were up about ¼ percentage point on balance, while private short-term interest rates declined by roughly 30 basis points, and major banks lowered their prime rate ½ percentage point to 10½ percent. In long-term debt markets, yields were about unchanged to slightly higher over the period. Most major stock price indexes reached record highs during the intermeeting period before giving up part of their gains.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies moved lower on balance through July as interest rate differentials favorable to the dollar were narrowing. In August, the dollar resumed its upward climb, spurred by continued political uncertainties abroad and a reassessment by market participants of the outlook for U.S. interest rates in light of a spate of new economic data. Over the intermeeting period as a whole, the dollar rose but at the end of the period remained below the highs of last June.

Growth of M2 and M3 accelerated in July and appeared to have continued at a fairly strong pace into August, evidently reflecting both the rebuilding of balances drawn down to meet April tax liabilities and the substantial narrowing of opportunity costs associated with holding liquid deposits. Through July, expansion of M2 had been around the lower end of the Committee's annual range, and M3 remained somewhat above the lower bound of its range.

The staff projection prepared for this meeting suggested that the nonfarm economy was likely to grow over the remainder of 1989 at about the pace estimated for the first half of the year but that some slowing of the expansion would occur in

1990. The projection assumed that fiscal policy would move noticeably toward restraint over the projection period and that the contribution of foreign trade to growth would be very limited, owing in part to the earlier appreciation of the dollar. Consumer demand was likely to be somewhat stronger over the next several quarters, bolstered by continued job growth and reflecting the ongoing effects on consumer sentiment of the advance in stock prices this year and the declines in interest rates since spring; in subsequent quarters, gradually mounting slack in labor markets would exert a restraining effect on consumer spending. The lower levels of interest rates also were expected to produce some pickup in residential construction activity. Growth in business capital spending, although moderating somewhat from the pace in the first half of the year, was projected to remain a source of strength. The recent weakening in food and energy prices pointed to a slower rise in consumer prices for the next few quarters; however, with margins of unutilized labor and other production resources still low, the underlying trend in inflation was not expected to improve through 1990.

In the Committee's discussion of the economic situation and outlook, members observed that indicators of business activity looked somewhat stronger on balance than at the time of the July meeting and that, despite some earlier concerns about a progressive slowdown, the economy appeared to be continuing to grow at a moderate pace. Several commented that further expansion at a rate close to that experienced recently was a reasonable expectation for the next several quarters and would constitute a desirable economic performance under prevailing circumstances. A number of members noted that there were no major imbalances in the economy of the sort that often lead to a recession or to a surge in business activity. However, because of the uncertainties that were involved, the members differed to some extent in their views regarding the risks of some deviation in the expansion from its present course; some felt that those risks were about evenly balanced or were tilted toward some strengthening in the months ahead; several others saw some weakening as the most likely prospect, or at least the one that had to be guarded against because of the broad economic and social consequences of a downturn in economic activity. No member anticipated a sharp turn in the economy in either direction. The members also differed to some degree in their views on the outlook for inflation. Recent developments provided a basis for some optimism, but progress in reducing the underlying rate of inflation would depend importantly on the strength of the business expansion and also on the behavior of the dollar in foreign exchange markets.

In their discussion of specific developments bearing on the economic outlook, members noted that consumer spending appeared to have strengthened somewhat in recent months, and most members expected such spending to hold up, or possibly to increase somewhat further, in the months ahead. Others placed more weight on the possibility that further gains, if any, might be relatively limited, in part because they expected automotive sales to be curtailed by higher prices and lower rebates when the new model year began. In the housing sector, current conditions were quite uneven across the country, with an increasing number of areas showing weakness, and the outlook was clouded to an extent by the possible effects of the disposition of properties in conjunction with the resolution of insolvent savings and loan associations. However, recent declines in mortgage rates would help to sustain the overall demand for houses. Should housing markets weaken, for whatever reason, the effect could be to depress not only construction activity but consumption spending as well. In the business investment sector, current demand conditions appeared consistent with further growth in overall investment spending, though probably at a much reduced pace from that experienced in the first half of the year, especially given the likely weakness in construction activity in many areas because of earlier overbuilding. With regard to the outlook for foreign trade, members emphasized that the strength of the dollar could have negative implications for the nation's trade prospects, and several expressed the view that further improvement in the trade balance, if any, was likely to be limited over the next several quarters; on the positive side, reports suggested that export markets remained relatively robust for many products.

In their comments on regional business conditions and business attitudes, members reported a somewhat mixed picture, depending on the industries that were involved. On balance, most parts of the country continued to experience a high level of business activity or at least modest further improvement from relatively depressed conditions. However, signs of somewhat slower growth had become more widespread and there were indications that business activity might have leveled out or turned down in some areas. Many business contacts appeared to be more bearish on the outlook than they had been earlier. In general, these contacts expected the overall economy to settle into a pattern of relatively slow growth. Few expressed concern about a possible decline in business activity.

In their comments on the outlook for inflation, members noted that the behavior of key price and wage measures in recent months was an encouraging development. From the perspective of cost pressures, the prices of many materials had increased less rapidly or had actually declined in recent months, and increases in labor compensation had been relatively moderate despite still tight labor markets in many parts of the country. While a number of members observed that little or no progress had been made thus far in reducing the underlying rate of inflation, most remained confident that the currently restrained growth in overall economic activity had established the necessary conditions for lowering inflation and achieving the Committee's price stability objective over time. Some anticipated that favorable inflation results might well emerge sooner rather than later. For some others a troubling question remained as to whether significant progress in reducing inflation was possible with the current degree of pressure on production resources. In this connection, a few expressed concern that some intensification of labor-cost pressures could not be ruled out under current economic conditions, and they noted in particular that there were indications of growing labor militancy in some industries and parts of the country. The strength of the dollar appeared to have damped inflation, but that effect would be reversed if the dollar were to depreciate substantially in foreign exchange markets.

Turning to the conduct of monetary policy, all of the members supported a proposal to maintain unchanged conditions of reserve availability at least initially during the intermeeting period ahead. The easing steps implemented since early June had been appropriate in the context of earlier indications of some slowing in the business expansion and a prospective lessening of inflation pressures. Partly as a consequence of the easing in policy, growth of the monetary aggregates had picked up, and both M2 and M3 were within the Committee's ranges for the year. For the period ahead, a steady policy course was desirable in light of the latest evidence suggesting that price pressures were not intensifying; in addition, the expansion appeared to have stabilized at a moderate and provisionally acceptable pace, and considerable uncertainty existed with regard to the timing and direction of future deviations from the expansion's current momentum. Some members commented on indications that financial markets anticipated some further easing of monetary policy in the months ahead, if not immediately. If such easing failed to materialize, the result could be some upward adjustments in interest rates that could have an adverse impact on interest-sensitive sectors of the economy such as housing and that could place undesirable upward pressure on the value of the dollar in foreign exchange markets. Despite such concerns, the members agreed that for now an unchanged policy offered the best prospect of fostering the financial market conditions and the monetary growth that would accommodate satisfactory economic performance. They recognized that economic developments would have to be monitored closely to assess whether any change in policy might be needed.

In their consideration of an appropriate policy course, the members took account of a staff analysis indicating that the expansion of M2 and M3 was likely to slow substantially from the recent pace but to remain well within the Committee's ranges for the year. The analysis took note of the decline in market interest rates over the past several months and assumed that they would stabilize at current levels and that the expansion of nominal income would remain near its recent pace. The outlook for money growth was subject to unusual uncertainty, however, stemming from the range of possible responses by thrift depository institutions to the recently enacted legislation and associated government strategy for resolving insolvent institutions. The expansion of M3 would be slowed as savings and loan associations reduced their funding needs by selling assets or curbing the growth of assets; the expansion of M2 might also be affected depending on the impact of these developments on deposit offering rates and related opportunity costs of holding deposits. Any weakness in money growth for these reasons, however, would not be an indication of a slowing economy, given the presumption that highly developed secondary markets would maintain the availability of mortgage credit. Members commented that despite its recent acceleration, monetary growth remained damped when measured over a longer period, suggesting a basically restrained monetary policy. While continued monetary expansion at the recent rapid pace clearly would be undesirable in a period when underlying inflation was unacceptably high, a renewed shortfall in relation to the Committee's ranges also should be averted.

With regard to possible adjustments in the degree of reserve pressure in the intermeeting period, a majority of the members believed that operations should be adjusted more readily toward further easing than toward any firming, and a few indicated that they viewed the incorporation of such an understanding as a key element of an acceptable directive. While most members anticipated that a steady policy course might well prove to be appropriate for the entire intermeeting period, any adjustment called for by prospective developments was more likely to be, in the majority view, in the direction of some reduction in the degree of reserve restraint and such an expectation should be reflected in the directive. Most of the other members indicated that they could accept such a directive, but because they believed that the risks to the economy were more evenly balanced, they favored a directive that did not include a presumption as to the likely direction of any intermeeting adjustments. These members also noted that the current directive was symmetric in form and that a bias in the new directive toward ease might lead to a misreading of System policy in the context of an unacceptably high rate of inflation.

At the conclusion of the Committee's discussion, all but one of the members indicated that they preferred or could accept a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving special weight to potential developments that might require some slight easing during the intermeeting period. With regard to the factors that were important in considering any intermeeting changes in reserve conditions, the Committee continued to give primary weight to the inflation outlook. In that regard, they emphasized that policy actions ought to be consistent with furthering achievement of the ultimate objective of price stability. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period, while some slight lessening of reserve pressure would be acceptable, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 9 percent and around 7 percent respectively over the three-month period from June to September; in the case of M2, such growth was somewhat faster than that anticipated at the time of the July meeting. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 7 to 11 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity has continued to expand at a moderate pace in recent months. In July, total nonfarm payroll employment rose appreciably further after a large advance in June, and the civilian unemployment rate, at 5.2 percent, remained close to its average level in earlier months of the year. Industrial production edged higher in July, continuing the slower growth observed since the beginning of the year. Retail sales have grown at a moderate pace in recent months. Housing starts rose slightly further in July following a large gain in June. Recent indicators of business capital spending suggest slower growth after the substantial increase in the first half of the year. The nominal U.S. merchandise trade deficit narrowed considerably in June and for the second quarter as a whole was about unchanged from a substantially reduced average value in the first quarter. Partly reflecting reductions in energy prices, increases in consumer prices moderated in June and July. The latest wage data suggest no change in prevailing trends.

Interest rates show mixed changes on balance since the Committee meeting on July 5–6. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen on balance over the intermeeting period.

M2 and M3 grew markedly in July, lifting expansion of M2 thus far this year to around the lower end of the Committee's annual range, and keeping M3 somewhat above the lower bound of the Committee's range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6½ to 10½ percent for the year. For 1990, on a tentative basis, the Committee agreed in July to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 9 and 7 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Vote against this action: Mr. Guffey.

Mr. Guffey supported an unchanged policy for the period ahead, but he could not accept a directive that would allow possible intermeeting adjustments to be made more readily in an easing than in a firming direction as new information became available. In his view, the risks to the expansion were fairly evenly balanced and did not warrant an asymmetric directive biased toward ease, especially in light of undesirably high rates of inflation both current and prospective. He also noted his concern that a directive tilted toward ease could give a misleading indication of the weight that the Committee continued to place on achieving its long-run price stability objective.

2. Authorization for Foreign Currency Operations

As part of a proposed multilateral bridge financing facility for Mexico, the Committee approved a special reciprocal currency arrangement of $125 million with the Bank of Mexico. The new facility supplements the regular $700 million arrangement with the Bank of Mexico set out in paragraph 2 of the Authorization for Foreign Currency Operations. The Committee delegated to Chairman Greenspan the authority to approve a drawing on both of these arrangements by the Bank of Mexico, subject to his determination that the appropriate terms and conditions had been met.

Under the terms of the multilateral facility, the Bank of Mexico may draw up to $2 billion in short-term financing in support of the program of the government of Mexico for economic reform and economic growth. Participating with the Federal Reserve in making funds available are the U.S. Treasury through its Exchange Stabilization Fund, central banks from the other Group of Ten countries acting under the aegis of the Bank for International Settlements, and the Bank of Spain. The final maturity date of the facility is February 15, 1990.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None.

On September 14, 1989, the multilateral bridge financing facility became effective, and on September 22, 1989, Chairman Greenspan, acting under the delegation of authority from the Committee, gave final clearance for drawings by the Bank of Mexico on the reciprocal currency arrangements.

3. Agreement to "Warehouse" Foreign Currencies

On September 19, 1989, the Committee agreed to a request by the Treasury for an increase from $5.0 billion to $10.0 billion in the amount of eligible foreign currencies that the System would be prepared to "warehouse" for the Treasury and the Exchange Stabilization Fund (ESF). The warehousing facility involves spot purchases of foreign currencies from the Treasury or the ESF and simultaneous forward sales of the same currencies at the same exchange rate to the Treasury or the ESF. Such transactions are authorized under Paragraphs 1.A and 1.B of the Committee's "Authorization For Foreign Currency Operations," and the maximum size of the facility is determined periodically by the Committee; the most recent change involved an increase from $1¾ billion to $5 billion in December 1978. The proposed increase was intended to enable the ESF to finance its continued participation in foreign currency operations.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None. Abstention: Mr. Johnson.

Effective September 25, 1989, the Committee approved an increase from $18 billion to $20 billion in the limit on holdings of foreign currencies specified in paragraph 1D of the Committee's Authorization for Foreign Currency Operations. That limit applies to the overall open position in all foreign currencies held in the System Open Market Account; at the time of this action, System holdings had reached nearly $18 billion. The higher limit was approved in light of the potential for further System acquisitions of foreign currencies in coordination with similar transactions by the U.S. Treasury. In approving the increase, the Committee took account of the views expressed by the Finance Ministers and Central Bank Governors of the Group of Seven countries at their meeting on September 23, 1989. These officials considered the rise of the dollar in recent months to be inconsistent with longer-run economic fundamentals, and they agreed that a rise of the dollar above current levels or an excessive decline could adversely affect prospects for the world economy. In this context, they agreed to cooperate closely in exchange markets.

Votes for this action: Messrs. Greenspan, Corrigan, Guffey, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: Messrs. Angell and Johnson.

In dissenting from this action, Messrs. Angell and Johnson indicated that they could not consent to an increase in the authorized limits for holding foreign currencies when such authorization facilitates exchange rate intervention to drive the dollar lower as compared with intervention to avoid disorderly conditions by stabilizing or limiting increases in the dollar exchange rate. Intervention of the former type confuses market participants concerning the policy commitment toward price level stability and can contribute to disorderly markets. It can increase inflation fears as can be seen in decreases in long-term bond prices and in increases in the price of inflation-sensitive commodities. Interest rate risk premiums also may increase. Finally, such intervention can work to limit flexibility in the exercise of fundamental monetary policy options that depend on evidence of improvement in the future inflation environment.

Meeting Held on October 3, 1989

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity continued to expand at a moderate pace in the third quarter and that rates of resource utilization remained at relatively high levels. Aggregate final demand appeared to be well sustained by a pickup in consumption at a time of somewhat reduced growth in business fixed investment. At the same time, price inflation had slowed, in large part because of a steep drop in energy costs and a continuing decline in prices of non-oil imports; wage data evidenced no deviation from recent trends.

Growth in total nonfarm payroll employment slowed noticeably in July and August from the pace of the second quarter. Nevertheless, adjusted for the depressing effects of strike activity, job gains remained appreciable on balance. Hiring was brisk in construction, trade, and services; in manufacturing industries, though, employment levels generally held steady or fell a bit, apart from temporary fluctuations in the auto industry. The civilian unemployment rate remained around 5¼ percent.

Industrial production rose in August, and revisions for earlier months suggested that the expansion of production had not been as weak as previously estimated. Much of the August gain reflected a rebound in automobile production after three months of decline and a pickup in coal mining as striking coal miners returned to work. Output of consumer goods other than autos edged down in August with small but widespread declines in nondurable goods. Despite a sizable jump in operating rates for coal mining, total industrial capacity utilization was unchanged in August at a relatively high level. In manufacturing, factory utilization edged further below its January peak, partly as a result of additional declines in primary processing industries, such as paper and chemicals, where utilization had been very high.

Consumer spending rose substantially in August, following a July increase that was somewhat larger than the sluggish gains of previous months. Much of the August pickup reflected a surge in outlays for cars and light trucks, but gains in spending for goods and services other than motor vehicles also appeared to be running somewhat above the relatively sluggish pace for the second quarter. Housing starts in July and August were slightly higher than their second-quarter average, and sales of new homes picked up noticeably in July. However, building permits had shown no discernible trend in recent months.

Recent indicators of business capital spending suggested somewhat slower growth in the third quarter after a substantial increase in the first half of the year. In July and August, shipments of nondefense capital goods excluding aircraft were only a little above the second-quarter level, and orders data suggested a further slowing in growth of spending in coming months. In July, office building remained a notable area of weakness in nonresidential construction and partially offset another strong rise in outlays for industrial structures. Inventory investment in manufacturing moderated in August after a sizable increase in July, with much of the increase in both months occurring at aircraft firms. In July, stocks also rose markedly at manufacturers of primary metals and of many types of machinery; the buildup at these industries, like that at aircraft firms, was concentrated in work-in-process. Excluding motor vehicles and aircraft, manufacturing stocks remained at relatively low levels compared with shipments. At the retail level, increases in inventories slowed in July and imbalances with sales remained limited.

The nominal U.S. merchandise trade deficit recorded a further decline in July relative to June and to the average for the second quarter as a whole. Exports in July fell below their strong June level and were little changed from the second-quarter average. While most categories of exports fell, deliveries of civilian aircraft increased sharply. Imports registered a further decline in July, as decreases in most categories of non-oil goods outweighed a small rise in the value of oil imports. Economic growth in the major foreign industrial countries slowed sharply in the second quarter from the very rapid rate of the first quarter, but this pattern appeared to be due largely to special factors rather than to a slackening of the underlying pace of activity.

Producer prices of finished goods declined in August for the third consecutive month, reflecting a further large drop in consumer energy prices; for the July-August period, price increases for nonfood, non-energy finished goods moderated from the pace of earlier months of the year. At earlier processing stages, prices of intermediate materials other than food and energy edged down further in August and had registered little net change over the previous six months, while prices of crude nonfood materials other than energy turned up after four months of declines. Consumer prices were unchanged in August following a small increase in July. Sharp reductions in energy prices and smaller increases for food items helped damp the rise in consumer prices in July and August, but prices for other consumer goods also rose more slowly. Average hourly earnings slipped a little in August after a sizable jump in the previous month, but on a year-over-year basis this decline did not indicate a change in trend.

At its meeting on August 22, the Committee adopted a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving special weight to potential developments that might require some slight easing during the intermeeting period. The Committee agreed that, in furtherance of the ultimate achievement of price stability, primary weight in considering the need for intermeeting changes in reserve conditions would continue to be given to the inflation outlook. Slightly greater reserve restraint might, or slightly lesser reserve restraint would, be acceptable in the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 9 and 7 percent respectively.

Reserve conditions remained essentially unchanged over the period since the August meeting. Adjustment plus seasonal borrowing averaged about $550 million for the two full reserve maintenance periods since the meeting, and federal funds traded mostly in the narrow range around 9 percent that had prevailed since late July. With federal funds rates steady and economic data released over the intermeeting period generally in line with market expectations, other interest rates changed little on balance over the intermeeting period. Some softening in interest rates took place through mid-September, owing at least partly to a market view that an easing of monetary policy might be in the offing given the strengthening dollar, but when the dollar subsequently declined against other G-10 currencies, interest rates generally rebounded. Most stock market indexes reached record highs in early September but partially retraced their increases as problems emerged in the "junk bond" market for a few prominent issuers.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose substantially early in the intermeeting period; better-than-expected U.S. job growth in August and U.S. trade data for July outweighed the effects of a slight decline in U.S. interest rates and some increase in rates abroad. The dollar fell sharply after the release on September 23 of the G-7 statement that the rise of the dollar in recent months was inconsistent with longer-run fundamentals, and the ensuing coordinated central-bank intervention in exchange markets. Also contributing to the slippage of the dollar were growing market expectations of some tightening of monetary policies abroad. On balance, the dollar depreciated somewhat over the intermeeting period.

Growth of the monetary aggregates slowed in August from their advanced July rates, which likely had been boosted by the replenishment of balances used to pay taxes last spring; their slower growth evidently carried over to September. Despite its deceleration, M2 still grew fairly briskly in August and apparently also in September, bringing its expansion thus far this year to somewhat above the lower end of the Committee's annual range. Continued rapid growth of the retail components of M2 reflected in part the lagged effects of earlier declines in market interest rates. M3 increased at a substantially reduced pace over the August–September period, and it had expanded for the year to date at a rate around the lower bound of the Committee's annual range. The sluggish growth of M3 apparently was related in part to the declining needs of savings and loan associations for managed-liability funds; undercapitalized institutions were shrinking their balance sheets as a means of complying with new, more stringent capital standards, and insolvent institutions were receiving funds from the Resolution Trust Corporation (RTC).

The staff projection prepared for this meeting suggested that the nonfarm economy was likely to grow over the remainder of 1989 at about the pace estimated for the first half of the year but that the expansion would slow in 1990. The projection assumed that fiscal policy would remain moderately restrictive and that the contribution of foreign trade to growth would be very limited, owing in part to the earlier appreciation of the dollar. Consumer demand was expected to be bolstered in the near term by continued growth in labor income and the positive effect on real purchasing power of the recent slowing of price increases, but over the rest of the projection period steadily mounting slack in labor markets would exert a restraining effect on real income and consumer demand. Declines in interest rates earlier in the year were expected to provide some temporary stimulus to residential construction activity over the next quarter or so. Expansion in business capital spending was projected to moderate substantially over the projection period from the pace in the first half of the year as output growth slowed, capacity pressures eased, and profits eroded. The recent weakening in food and energy prices pointed to a slower rise in consumer prices for the next few quarters; however, with margins of unutilized labor and other production resources still low, the underlying trend in inflation was not expected to show much improvement.

In the Committee's discussion of the economic situation and outlook, members commented that current indicators of business activity, including economic conditions in different parts of the country, presented a somewhat mixed picture. On the whole, however, members generally viewed the evidence as pointing to sustained expansion over the next several quarters, though many expected economic growth to slow somewhat from its recent pace. In assessing the chances of a different outcome, the members did not rule out the possibility of a slightly stronger economic performance, but they generally felt that the risks were tilted toward marginally greater slowing and a few expressed concern that a more pronounced weakening could emerge. With regard to the outlook for inflation, many commented that, given moderate economic growth and a sustained period of monetary restraint, underlying inflationary pressures were likely to ease a little over the next several quarters, but some anticipated somewhat greater progress in reducing inflation. Concern was expressed by some, however, that wage-cost pressures might intensify. The members agreed that progress against inflation would depend importantly on the behavior of the dollar in foreign exchange markets; a very substantial decline in the value of the dollar would put upward pressure on prices and make achievement of the Committee's price stability objective correspondingly more difficult.

With regard to developments in specific sectors of the economy, members commented that a key uncertainty in the business outlook related to the prospects for capital expenditures. Growth in such spending had slowed from a very high rate in the first half of the year, and it was not clear from the recent data whether business investment was weakening further or whether its growth had stabilized at a reduced pace. New orders for capital equipment had softened, but order backlogs remained substantial and suggested continued high levels of production for many firms. On the other hand, indications of declining business profits together with the financial difficulties of a number of firms pointed to more restrained investment spending. The key to actual capital spending, of course, would be the evolving demand for goods and services and in that regard consumer spending, while subject to some volatility stemming especially from purchases of motor vehicles, was likely to continue to provide support for sustained growth. Business inventories, with some notable exceptions such as stocks of motor vehicles, were reported to be at acceptable levels and were not likely to contribute to wide swings in production unless final demands differed greatly from current expectations. The members were more uncertain about the outlook for housing and net exports. In the housing sector, considerable weakness had emerged in several parts of the country, and some members questioned whether any improvement could be expected over the next several quarters even though interest rates had fallen since last spring. With regard to the prospects for foreign trade, the dollar's appreciation this year had retarded improvement in the trade balance and, barring a substantial real depreciation, was expected to continue to do so for some time. It was presumed that fiscal policy would remain moderately restrictive, but that there would be no dramatic turn in the federal budget deficit of the sort that would substantially reduce demand pressures in the domestic economy while accommodating significant improvement in the trade deficit.

In the Committee's discussion of the outlook for inflation, members observed that the recent improvement largely reflected a number of special factors—such as developments in the food and energy sectors and the appreciation of the dollar this year—that could not be projected to recur. Several saw only limited prospects for further improvement over the year ahead, given their expectations with regard to the overall performance of the economy and related pressures on resources. Others felt that the behavior of prices and wages might continue to be better than had been expected. They noted that reduced monetary growth over an extended period was continuing to restrain inflationary pressures and that the economy also was benefiting from ongoing cost-reducing measures induced by strong competition in domestic and international markets. A tendency for the prices of many commodities and intermediate materials to soften, if only marginally, also supported a relatively optimistic outlook for inflation. Moreover, there was a continuing pattern of restraint in labor settlements despite tight labor markets in many areas. Reflecting demographic factors, upward pressures on wages tended to be concentrated on entry-level jobs, while pressures in many of the more skilled job categories appeared to have diminished in various parts of the country. However, some members expressed concern that faster wage increases remained a threat, especially if the economy continued to operate at levels close to its potential.

In the Committee's discussion of monetary policy for the intermeeting period ahead, most of the members endorsed a proposal to maintain unchanged conditions of reserve availability and preferred or found acceptable a suggestion to retain the asymmetry toward ease that was incorporated in the latest directive. While noting that developments in the near term might alter the economic outlook, most members felt that prevailing conditions in the domestic economy did not warrant a policy change in either direction at this time. The focus of policy continued to be that of gradually reducing inflation over time and a steady policy course seemed consistent with that objective, at least for now.

Members also were concerned that an easing of policy so soon after the G-7 meeting would be misinterpreted as an attempt to use monetary policy to force the dollar lower. While the dollar was an important factor influencing the course of the U.S. economy and prices, monetary policy should not be used, in the judgment of the Committee, to attain particular levels for the foreign exchange value of the dollar that could conflict with domestic policy objectives. In current circumstances, an easing might well provoke an undesirable sharp decline in the external value of the dollar. The members also discussed the recent substantial intervention by G-7 and other nations against the dollar. Some members expressed concern that if this intervention resulted in a sizable depreciation of the dollar, the inflationary consequences could be viewed as inconsistent with the Committee's long run policy of achieving price stability.

In further discussion of an appropriate course for monetary policy, the Committee took account of a staff analysis that suggested that, on the assumption of unchanged conditions of reserve availability and steady interest rates, M2 growth would moderate somewhat over the balance of the year from its rapid pace in recent months; nonetheless, growth of this aggregate would continue to be supported to some extent by the lagged effects of earlier declines in market interest rates on the opportunity costs of holding M2 balances, and on a cumulative basis M2 was projected to rise somewhat further within the lower half of the Committee's range for the year. The expansion of M3 was expected to continue to be damped, though to a reduced extent, in the fourth quarter by further reductions in the assets and M3 liabilities of undercapitalized thrift institutions and by RTC outlays that substituted in part for managed liabilities in

M3; by year-end, this aggregate was projected to be a little above the lower bound of the Committee's range. The pickup in the growth of money and reserve aggregates since around midyear and the projected expansion of the broad money aggregates within the Committee's ranges for the year were cited as welcome developments that were consistent with the Committee's overall policy objectives.

In the Committee's consideration of possible adjustments in the degree of reserve pressure during the intermeeting period, a majority of the members supported a proposal to adjust operations more readily toward some easing than toward any firming. In the view of these members, the risks to the expansion were more heavily weighted toward a shortfall from current expectations than toward faster growth and greater inflationary pressures. Members who preferred a symmetrical instruction generally saw the risks to the economy as more evenly balanced, and some observed that the present dollar situation warranted extra caution before any easing was undertaken; however, a bias toward ease would not involve any change from the current directive and most of these members indicated that they could accept such an instruction.

It was noted in further discussion that seasonal borrowing was likely to drop in the weeks ahead, so that a declining total of adjustment plus seasonal borrowing would be associated with a given degree of reserve restraint and a given federal funds rate. It was understood that, subject to the Chairman's review, the necessary technical reductions in borrowing objectives would be made during the intermeeting period.

At the conclusion of the Committee's discussion, all but two of the members indicated that they preferred or could accept a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving particular weight to potential developments that might require some slight easing during the intermeeting period. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period, while some slight lessening of reserve restraint would be acceptable, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 6½ percent and 4½ percent respectively over the three-month period from September to December. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 7 to 11 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity continued to expand at a moderate pace in the third quarter. In July and August, total nonfarm payroll employment rose appreciably despite the depressing effect of strike activity. The civilian unemployment rate remained around 5¼ percent. Industrial production picked up in August, mainly because of a rebound in auto assemblies and coal mining. Consumer spending has registered larger gains in recent months, reflecting in part a surge in auto sales. Housing starts in July and August were slightly above their second-quarter average. Indicators of business capital spending suggest somewhat slower growth in the third quarter after the substantial increase in the first half of the year. The nominal U.S. merchandise trade deficit recorded a further decline in July relative to June and to the average for the second quarter as a whole. Sharp reductions in energy prices over the summer months damped increases in consumer prices and contributed to declines in producer prices. The latest wage data suggest no change in prevailing trends.

Interest rates generally show small mixed changes on balance since the Committee meeting on August 22. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies fell after the release of the G-7 statement on September 23; on balance, the dollar depreciated somewhat over the intermeeting period.

M2 grew fairly briskly in August and evidently also in September, lifting its expansion thus far this year to somewhat above the lower end of the Committee's annual range. M3 grew at a substantially reduced pace in this period, as assets of thrift institutions and their associated funding needs apparently contracted further; for the year to date, M3 has grown at a rate around the lower bound of the Committee's annual range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6½ to 10½ percent for the year. For 1990, on a tentative basis, the Committee agreed in July to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 6½ and 4½ percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Johnson, Keehn, Kelley, LaWare, Melzer, and Syron. Votes against this action: Mr. Guffey and Ms. Seger.

Mr. Guffey favored an unchanged policy for the period ahead, but he dissented because he could not support a directive that was biased toward easing during the intermeeting period. He remained concerned that the rate of inflation would continue to be undesirably high.

Ms. Seger dissented because she felt that some easing of monetary policy was desirable at this time. In her view developments in manufacturing, notably in the motor vehicles sector, along with potential softness in capital expenditures, housing construction, and exports signaled a weaker overall economy. In the circumstances, she believed that an easier monetary policy was needed to help sustain the expansion and that such a policy would be consistent with continuing progress in reducing the rate of inflation.

Meeting Held on November 14, 1989

Domestic Policy Directive

The information reviewed at this meeting suggested that the economy had continued to expand, though unevenly and at a somewhat slower pace than earlier in the year. While the service-producing sector appeared to be growing moderately, manufacturing had been weak, owing to sluggish demand and to strikes and other disruptions to production. Price increases had been smaller since midyear, but there had been no abatement of wage inflation.

Total nonfarm payroll employment increased appreciably in October, but its growth had been more moderate on balance over the past several months, especially in the private sector. Widespread job gains were apparent in the service-producing sector, but manufacturing payrolls declined further as a result of continued weakness in motor vehicles and other durable goods industries. In the public sector, hiring by state and local governments was robust in October and had contributed substantially to total employment growth over the past three months. The civilian unemployment rate remained within the narrow range around 5¼ percent that had prevailed since early 1989.

After three months of modest increases on balance, industrial production was depressed noticeably in October by strike activity and other disruptions; adjusted for these temporary influences, production was about unchanged. Output of consumer goods declined as the production of appliances and motor vehicles, particularly light trucks, fell sharply. Production of business equipment dropped substantially, reflecting the strike at a major aircraft manufacturer and the earthquake in northern California. Total industrial capacity utilization dropped in October, mostly because of the effects of temporary disruptions to production.

Retail sales fell appreciably in October from upward revised levels for August and September, as purchases of motor vehicles dropped sharply. Housing starts fell further in September, and the multifamily component registered its lowest level since mid-1982. For the third quarter as a whole, starts were about unchanged from their reduced second-quarter average.

Indicators of business capital spending continued to suggest that growth had moderated from its rapid pace in the first half of the year, primarily as a result of slower growth in outlays for information processing equipment. Shipments of nondefense capital goods edged lower in September, and orders data suggested that equipment outlays would remain sluggish in coming months. Nonresidential construction activity also fell, largely owing to a decline in commercial structures other than office buildings, and construction permits continued the downtrend evident over the past few months. The sparse data available on business inventories for September indicated that manufacturers' stocks had declined somewhat in that month after a sizable gain on balance over the previous two months. At the wholesale level, inventories fell for a second straight month.

The nominal U.S. merchandise trade deficit increased in August to its highest level thus far this year, as the value of non-oil imports surged. For July and August combined, the value of imports—especially of consumer goods and machinery—was somewhat above the second-quarter level. The quantity of imports rose even more strongly over that two month period as import prices declined on average. The value of exports in the July–August period was somewhat below the level in the second quarter; the quantity of exports rose appreciably, but the prices received fell. In most foreign industrial countries, indicators of economic activity suggested that the slower pace of the second quarter had continued in the third quarter. In Germany, however, industrial production had rebounded strongly from its second-quarter decline.

Producer prices for finished goods rose further in October, boosted by sizable jumps in the prices of a variety of food products. Excluding food and energy items, prices for finished goods were little changed. Consumer prices rose slightly in September after registering little change over the previous two months. Energy prices fell further, while a sharp increase in apparel prices contributed to a rebound in the prices of consumer goods. The latest data on labor compensation suggested no easing of labor cost pressures. Average hourly earnings jumped in October, although the year-over-year change remained within the range of recent experience. In the broader-based employment cost index, growth of wages and salaries continued to show a persistent updrift through the third quarter on a year-over-year basis in most industry and occupational groupings; growth of benefits had slowed but remained at a high rate mainly because of rising health insurance costs.

At its meeting on October 3, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that provided for giving particular weight to developments that might require some slight easing during the intermeeting period. The Committee agreed that slightly greater reserve restraint might be acceptable, or slightly lesser reserve restraint would be acceptable, in the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 6½ percent and 4½ percent respectively.

After the Committee meeting, open market operations were directed initially toward maintaining the existing degree of pressure on reserve positions. For a few days after the steep drop in stock prices on October 13, while financial markets remained highly sensitive and volatile, the Manager for Domestic Operations followed an accommodative approach in supplying reserves. Around the same time, a decision was made under the provisions of the October 3 directive to implement a slight easing of reserve conditions on a more permanent basis; a further slight easing was effectuated during the first part of November. These decisions were made in light of information that suggested some increase in the risk of a pronounced weakening in the growth of business activity. To reflect a decline in seasonal borrowing, several technical reductions also were made during the period in the assumed level of adjustment plus seasonal borrowing used in constructing the target paths for the provision of reserves, and actual borrowing fell from about $635 million in the first full maintenance period after the early October meeting to around $200 million in the week prior to this meeting. The federal funds rate declined from slightly above 9 percent at the time of the October meeting to around 8½ percent more recently.

Most short- and intermediate-term interest rates fell by amounts comparable to the decline in the federal funds rate, though Treasury bill rates dropped by less as a result of disruptions and supply pressures associated in part with delays in debt-ceiling legislation. Yields on most bonds and fixed-rate mortgages also fell somewhat less than the federal funds rate. Rates on lower-quality bonds rose appreciably, and stock prices were considerably lower on balance in this period. In the days following the October 13 break in stock prices, the Committee held a number of telephone conferences to assess developments in financial markets. At these and a subsequent consultation, the Committee also discussed the decisions to ease reserve conditions during the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly further on balance over the intermeeting period. During the first part of the period, the dollar had appreciated somewhat despite substantial intervention sales of dollars by central banks and increases in official interest rates in a number of major industrial countries. Following the drop in stock prices in mid-October, the dollar moved lower. Expectations of further increases in interest rates abroad and of lower rates in the United States apparently contributed to the dollar's decline.

Expansion of the monetary aggregates picked up in October. A surge in demand deposits in early October contributed to considerable strength in M1. The effects of this acceleration were offset to an extent by slower expansion of the retail-type components of M2, possibly reflecting the waning effects of earlier declines in market interest rates on the opportunity costs of holding liquid savings-type deposits included in M2. The faster growth of M3, while remaining well below that of M2, reflected an accelerated issuance of large-denomination CDs by banks to help finance substantially stronger expansion of bank credit. Runoffs of assets at capital-deficient thrift institutions and associated declines in RPs and large-denomination CDs continued to restrain growth of M3. For the period from the fourth quarter of 1988 through October, growth of M2 was within the lower half of the Committee's annual range, while expansion of M3 was near the lower end of its range.

The staff projection prepared for this meeting suggested that the economy was likely to grow at a slower pace over the next several quarters. The outlook for the near term was clouded by uncertainties associated with the effects of a major hurricane, a severe earthquake, and a strike at a large manufacturer of aircraft. On balance, those developments were projected to curb overall growth somewhat in the current quarter but to provide a temporary boost in the first quarter of next year. The projection assumed that the budget deficit would decline moderately and that net exports would make little contribution to domestic growth in 1990. Consumer demand was expected to buoy the near-term expansion of the economy, reflecting the strong growth of the real income of consumers in recent months and indications of a continued high level of consumer confidence. Over the rest of the projection period, however, steadily mounting slack in labor markets was expected to exert a restraining effect on consumer demand. The projection continued to indicate substantial slackening in the expansion of business capital spending from the pace in the first half of this year. With pressures on labor and other production resources expected to ease only marginally, little improvement was anticipated in the underlying trend of inflation over the next several quarters.

In the Committee's discussion of the economic situation and outlook, members commented that broad economic indicators and local conditions in different parts of the country pointed on balance to a sustained expansion in business activity, though at a somewhat slower pace than in recent quarters. Views differed to some extent regarding the risks of a different outcome, reflecting uncertainties concerning developments in such key sectors of the economy as business investment and net exports and in the demand for housing and consumer durables, notably motor vehicles. While some members regarded those risks as about evenly balanced in both directions, a number stressed that a period of minimal growth or even a downturn in activity could not be ruled out; others saw greater odds that the rate of economic growth and levels of resource utilization might be closer to the economy's potential. With regard to the outlook for inflation, several members observed that the prospects for significant progress were limited for the next several quarters, especially in light of the tendency for increases in labor costs to remain in a relatively high range. Other members expressed greater confidence that appreciable progress would be made, partly in the context of reduced growth in economic activity.

In their discussion of specific developments relating to the outlook for overall business activity, members noted that economic conditions had softened in some parts of the country, with manufacturing tending to weaken more generally, particularly in the automotive and automotive-related sectors. Many business contacts appeared to be less optimistic about prospects for sales and more cautious about investment decisions. Real estate markets and nonresidential construction ranged from quite weak to moderately strong in different sections of the country. On balance, local business conditions were characterized by steady activity or slow growth in many regions to continued fairly vigorous expansion in some others.

With regard to broad indicators of economic performance, members cited the continuing weakness, but absence of further deterioration, in new orders. Order backlogs, while below earlier highs, appeared consistent with sustained production. From a different perspective, it was noted that commodity prices remained high and did not suggest a slowdown in economic activity. Business investment was an area of major uncertainty in the economic outlook. Developments that could have adverse implications for investment included a squeeze on profit margins from rising costs, both interest and labor expenses, on the one hand and from competitive pressures that restrained price increases on the other. On the foreign side, the earlier appreciation of the dollar had arrested the improvement in the nation's trade balance, but further gains still might be forthcoming at current dollar levels, given expectations of relatively strong growth in business activity in foreign industrial countries. Such a development would have favorable implications for the manufacturing sector and for the domestic expansion more generally.

Views on the outlook for inflation differed to some extent, depending in part on somewhat varying expectations with regard to the level of business activity and associated pressures on production resources. Several members continued to expect that, in light of the behavior of labor costs, little or no progress would be made in reducing inflation over the quarters ahead, even assuming relatively slow growth in business activity. Labor markets might be softening in some areas, but data on labor compensation showed no changes from earlier trends, and some members remained concerned that underlying demand conditions would be associated with persisting upward pressures on labor costs. Other members were more optimistic. They noted that the behavior of prices had been better than might have been anticipated in recent quarters, apparently reflecting a variety of factors that were tending to arrest the momentum of inflation, including ongoing efforts to hold down costs in the context of strong competition in international and domestic markets.

In the Committee's discussion of policy for the weeks immediately ahead, nearly all of the members supported a proposal to maintain unchanged conditions of reserve availability. A majority favored and the others could accept a related suggestion to retain the current asymmetry toward ease that had been incorporated in recent directives. While current indicators of economic activity suggested a somewhat weaker expansion, most of the members agreed that a steady policy course was desirable at this point, especially in light of the stimulus provided by recent easing actions, whose effects on the economy would be felt only with some lag. In reconciling concerns about a cumulative weakening in the economy against a desire for progress in the fight against inflation, a steady policy seemed to give reasonable prospects for achieving both sustained expansion and declining inflation. Some members commented that these objectives could be attained with less pressure in credit markets if the federal budget deficit were to turn more definitely downward.

In the course of the Committee's discussion, a number of members observed that, as a result of the pickup in M2 over the course of the past several months, growth of the monetary aggregates seemed consistent with the Committee's long-run goals, and thus money growth did not in itself suggest the need for any current adjustment in reserve conditions. According to a staff analysis prepared for this meeting, growth of M2 was likely to remain relatively brisk, assuming unchanged reserve conditions and steady interest rates. Growth of this aggregate would be buoyed by the further decline that had occurred recently in market interest rates and in the related opportunity costs of holding M2 balances, and for the year as a whole M2 was likely to expand at a rate just below the midpoint of the Committee's range for 1989. M3 was projected to continue to grow at a slower pace than M2, reflecting the ongoing though waning effects on some M3 components of the disposition of assets by undercapitalized thrift institutions and the funding made available through RTC resolutions; for the year, the growth of M3 was projected to be somewhat above the lower bound of the Committee's range.

Turning to the instruction in the directive relating to possible adjustments in the degree of reserve pressure during the intermeeting period, a majority of the members expressed a preference for retaining the existing asymmetry that would permit any adjustments to be made more readily toward easing than toward firming. In this view, current tendencies toward weakening in the economy outweighed the sources of strength, and some further easing might be needed if the incoming information on business activity suggested more softening than most members currently expected. In these circumstances, an easing would be consistent with the Committee's long-run inflation objective. Other members, who saw the risks to the expansion as more evenly balanced, indicated a preference for a symmetric instruction in the directive; however, they could accept retention of the bias toward ease contained in the October 3 directive. Some of these members nonetheless stressed the desirability of not overreacting to possible indications of slower economic growth in the period ahead for fear of creating financial conditions and stimulating monetary growth that would prove to be inconsistent with the Committee's long-run goal of price stability. In light of these considerations and in the context of the recent easing actions, the members generally endorsed or found acceptable a proposal to approach with caution any further easing in the weeks ahead.

At the conclusion of the Committee's discussion, all but one of the members indicated that they preferred or could accept a directive that called for maintaining the existing degree of pressure on reserve positions and that provided for giving greater weight to developments that might require some slight easing during the intermeeting period. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period, while some slight easing of reserve restraint would be acceptable, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 7½ percent and 4½ percent respectively over the three-month period from September to December. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 7 to 11 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests continuing expansion in economic activity, though at a somewhat slower pace than earlier in the year. Total nonfarm payroll employment increased appreciably in October, but on balance its growth has been more moderate over the past several months, especially in the private sector. The civilian unemployment rate has remained around 5¼ percent. Strike activity and other disruptions depressed industrial production noticeably in October. Retail sales fell appreciably in October, reflecting a sharp drop in purchases of motor vehicles, but some upward revisions were made for August and September. Housing starts fell further in September and for the third quarter as a whole were about unchanged from their reduced second-quarter average. Indicators of business capital spending suggest slower growth after a substantial increase in the first half of the year. The nominal U.S. merchandise trade deficit widened in August from its July rate as non-oil imports increased markedly. Consumer prices have risen more slowly on balance since midyear, partly reflecting sharp reductions in energy prices, but the latest data on labor compensation suggest no significant change in prevailing trends.

Most interest rates have declined appreciably since the Committee meeting on October 3. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly on balance over the intermeeting period.

M2 continued to grow fairly briskly in October, largely reflecting strength in its M1 and other liquid components; thus far this year M2 has expanded at a pace somewhat below the midpoint of the Committee's annual range. Growth of M3 picked up in October but has remained much more restrained than that of M2, as assets of thrift institutions and their associated funding needs apparently continued to contract; for the year to date, M3 has grown at a rate around the lower bound of the Committee's annual range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6½ to 10½ percent for the year. For 1990, on a tentative basis, the Committee agreed in July to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 7½ and 4½ percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

> Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, Melzer, and Syron. Vote against this action: Ms. Seger.

Ms. Seger dissented because she felt that a further easing of monetary policy was needed at this time. In her view, the persisting weakness in the manufacturing sector, most notably in motor vehicles, along with a likely softening in construction activity and capital expenditures posed a substantial risk to the economy. In these circumstances, a moderate easing of policy could help forestall a slide into recession in the months ahead without adding to inflationary pressures.

Meeting Held on December 18–19, 1989

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity was expanding slowly in the fourth quarter, with the moderation from earlier in the year only partly attributable to strikes and other special factors. Abstracting from these factors, the growth of final demands had slowed, and the effects were especially evident in the manufacturing sector. By contrast, growth of the service sector appeared to be well sustained, and overall construction activity seemed relatively firm. Broad measures of inflation indicated that prices had risen more slowly on balance since midyear, partly reflecting sharp reductions in energy prices; recent wage data suggested no significant change in prevailing trends.

Total nonfarm payroll employment rose appreciably in November after a small gain in October. All of the November increase occurred at service, trade, and financial establishments. Job losses continued in manufacturing, especially in motor vehicle and related industries, but cutbacks were evident elsewhere, notably in electrical machinery. The civilian unemployment rate edged up to 5.4 percent in November, its highest level since January.

Industrial production rose slightly in November after a sizable decline in October that resulted from strike activity and other disruptions; adjusting for these temporary influences, production was down slightly, on balance, in recent months. Output of consumer goods declined in November as production of durables other than motor vehicles dropped sharply further. Output of business equipment increased appreciably, owing in part to a recovery in the production of computers in the aftermath of the earthquake in the San Francisco area. Total industrial capacity utilization slipped a bit in November and was nearly 1½ percent below its level a year earlier.

Nominal retail sales in November partially retraced the sharp October decline; sales for the month were little changed from the third-quarter average, reflecting continued weakness in motor vehicles. Outside of vehicles, sales rebounded for a wide range of goods, especially for apparel items. Housing starts declined in November as construction of multifamily units fell back to about the average pace that had prevailed since April. However, for the October–November period, starts were up somewhat on average from their third-quarter level because of a pickup in single-family units.

Recent indicators of business capital spending suggested a weakening in expenditures after a substantial increase earlier in the year. Shipments of nondefense capital goods fell in October for a second straight month. Part of the October decline stemmed from the effects of the strike at Boeing on shipments of aircraft; small declines were widespread elsewhere, and a considerable drop occurred in computing equipment. The orders data for October suggested continued weakness in equipment outlays in the near term. Nonresidential construction activity posted another gain, led by a sizable increase in non-office commercial construction; however, office vacancy rates, construction permits, and other indicators pointed to renewed weakness. Total manufacturing and trade inventories rose in October at about the third quarter pace. Accumulation of manufacturing inventories was moderate, and stocks remained at relatively low levels compared to shipments. Stocks at wholesalers jumped but, in relation to sales, remained in the middle of the range that has prevailed over the past two years. Retail inventories fell appreciably in October, reflecting a large decline in auto dealers' stocks. Excluding auto dealers, the retail inventory–sales ratio increased in October to a level well above its range over the past year.

The nominal U.S. merchandise trade deficit widened appreciably in October from an upward revised September rate. Much of the widening reflected a sharp increase in imports of industrial supplies, notably paper, steel, and textiles. The value of exports showed a small increase for the third straight month as larger shipments of automotive products and other industrial goods outweighed a substantial decline in exports of aircraft. Indicators of economic activity in the major foreign industrial countries suggested a mixed performance in the third quarter, although growth remained fairly strong on balance. Economic growth appeared to have rebounded strongly in Japan and, adjusted for special factors, to have remained firm in Germany.

Producer prices for finished goods edged down in November after sizable increases in the previous two months and, on balance, had risen at lower rates since midyear. Prices of finished energy products, especially gasoline, fell sharply; the drop more than offset a second month of increases in finished food prices. Consumer prices excluding food and energy items rose a little faster in October and November than in other recent months. Over the October–November period, food prices were boosted by sharp increases in dairy products, meats, and fresh produce while the rise in energy prices was held down by a net decline in the price of gasoline. Average hourly earnings slipped in November, and the large increase initially reported for October was revised downward. However, the results of recent collective bargaining activity suggested a continuation of the larger wage settlements evident earlier in the year.

At its meeting on November 14, the Committee had adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that provided for giving special weight to potential developments that might require some easing during the intermeeting period. The availability of reserves had been eased slightly earlier in November. With regard to the intermeeting period ahead, the Committee had agreed that slightly lesser reserve restraint would be acceptable, or slightly greater reserve restraint might be acceptable, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 7½ percent and 4½ percent respectively.

In the period since the November meeting, the Manager for Domestic Operations had directed open market transactions toward maintaining an unchanged degree of reserve availability. Conditions in reserve markets softened temporarily around Thanksgiving when operations to meet seasonal reserve needs were misread as signaling a further easing of monetary policy. Over most of the intermeeting period, however, federal funds traded around 8½ percent, the level prevailing at the time of the mid-November meeting. Adjustment plus seasonal borrowing fell to an average of around $150 million in the first half of December. To reflect a continuing decline in seasonal borrowing, technical reductions were made at the start of the intermeeting period and in the second week of December in the assumed level of adjustment plus seasonal borrowing used in constructing the target paths for the provision of reserves.

Against the background of an unchanged monetary policy and incoming information that generally was viewed as consistent with expectations of continuing but slow growth in economic activity, most market interest rates changed little on balance over the intermeeting period. Major indexes of stock prices generally rose over the period. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies fell substantially despite some easing of short-term interest rates in Germany and Japan. The decline of the dollar primarily reflected the buoyancy of the German mark as exchange market participants interpreted political developments in Eastern Europe as having favorable implications for the German economy. The dollar declined somewhat less against other European currencies linked to the mark in the European Monetary System and was little changed against the yen.

Growth of the broader monetary aggregates accelerated somewhat further in November and remained robust in early December, despite a contraction in demand deposits that resulted in considerably slower expansion of M1. The expansion of M2 continued to reflect the effects of earlier reductions in market interest rates and related opportunity costs, and it seemed likely that the velocity of M2 would decline substantially further in the fourth quarter. Assets of thrift institutions and their associated funding needs apparently continued to contract, keeping growth of M3 below that of M2, but the decline seemed to be at a reduced pace and in November M3 grew at its fastest rate since the summer. Through November, M2 had expanded at a pace near the midpoint of the Committee's annual range while M3 had grown at a rate a little above the lower bound of its annual range.

The staff projection prepared for this meeting continued to suggest that the economy would expand at a reduced pace over the next several quarters. Growth in the first quarter was expected to rebound from temporary disturbances to production stemming from strike activity and natural disasters in the fourth quarter, although the extent of the rebound would be limited by further reductions in the production of motor vehicles in the early months of the year. Over the remainder of 1990, a relatively moderate expansion in consumer spending was projected to be a key factor in sustaining overall demand and production. Business outlays for fixed investment also were expected to increase, but at a much reduced pace in an environment of slow revenue growth and deteriorating cash flows. Housing construction was forecast to expand at a relatively sluggish pace over the course of the year. The projection continued to assume that the federal budget deficit would decline moderately and that net exports would make little contribution to domestic economic growth in 1990. Pressures on labor and other production resources were expected to ease only marginally and the underlying trend of inflation was not projected to change significantly.

In the Committee's discussion of the economic situation and outlook, members emphasized that signs of a weaker expansion had accumulated and that the economy was likely to remain sluggish at least over the near term. While most members agreed that further economic growth was a reasonable expectation for the year ahead, several observed that recent developments suggested greater risks in the direction of a weaker economic performance. These members expressed concern that problems in some sectors of the economy such as motor vehicles and commercial and residential real estate might lead to greater caution in credit extensions and overall spending, especially given indications of some deterioration in business confidence, and to more widespread softening in the economy. Other members saw more favorable prospects for some strengthening of the expansion next year, though they did not anticipate a strong rebound in economic activity. These members recognized that there were imbalances in the economy, but they felt that, among other developments, prevailing patterns in orders and production, though softening, were not inconsistent with somewhat faster economic growth once current difficulties such as those in the automobile industry were worked through and the effects of the monetary policy easing over the past half year were felt more fully. It also was noted that certain forward-looking indicators, including commodity prices, monetary growth, foreign exchange rates, and the Treasury yield curve, were consistent with some pickup in economic expansion next spring. With regard to the outlook for inflation, those who believed the risks were on the side of a weaker economy and less pressure on production resources generally saw favorable prospects for further progress toward price stability next year. Some of the members who expected a somewhat stronger economy were less optimistic about the extent of such progress, if any, but they also believed that there was little risk of a pickup in the underlying rate of inflation.

In the course of the Committee's discussion, members reported more sluggish business conditions in a number of areas and some loss of business confidence, but overall economic activity appeared to be continuing to grow in most, if not all, parts of the country. With some notable exceptions, manufacturing activity had moderated across the country, with particular weakness in the production of motor vehicles, other durable consumer goods, and some types of capital equipment. Members observed that conditions in the automobile industry probably would continue to have a negative effect on overall economic activity in the months ahead, and some noted that the longer-term outlook was difficult to predict because structural problems related to changing demand patterns appeared to be involved. Construction activity also was cited as a source of weakness in many areas, though it remained relatively robust in others. In general, nonresidential construction seemed likely to be damped by overcapacity in office and other commercial structures. Overall demand for new housing appeared to be essentially flat, though with considerable local variations, despite earlier declines in mortgage interest rates. It was noted that the availability of financing for the construction of housing appeared to have been reduced by tighter supervisory regulations and some decrease in the number of traditional institutional lenders to this industry. In addition, the availability of such financing appeared to have been adversely affected by the weakness of real estate markets in a number of areas and the large resulting losses on loans.

On a more positive note, a number of members commented that consumer spending was likely to be sustained by continuing gains in incomes and the ample liquid assets of households that were available to support greater spending. Consumer spending on services was likely to continue to grow. The outlook for retail sales was somewhat uncertain, including at this point the still very limited information on holiday sales, but outside the most depressed areas retailers appeared to be relatively optimistic. The recent depreciation of the dollar would tend over time to boost overall demand and economic growth. More generally, the recent slowing in the expansion could be attributed in part to special or temporary factors and to the lagged effects of the tightening of monetary policy through early 1989. On the whole, current demand conditions were not seen by most members as suggesting a cumulative weakening in the economy.

With regard to the outlook for inflation, the views of the members continued to differ to some extent. Several anticipated that little or no progress was likely to be made in reducing inflation over the year ahead, in part because the effects of the recent decline of the dollar would tend to offset expected gains from diminished pressures on labor and other production resources. Some of these members also expressed concern that a possible resumption of economic growth at a pace closer to the economy's potential, perhaps later next year, would reverse any tendency for inflation to decline. Other members were somewhat more optimistic about the outlook for prices and wages. Some commented that they were encouraged by the performance of prices in the second half of 1989, and a number cited the strong competition for many products from both domestic and foreign producers, the behavior of industrial materials and commodity prices, and the growth of capacity in some key industries.

In the Committee's discussion of monetary policy for the intermeeting period ahead, the members focused on the possible need to ease reserve conditions slightly further to provide greater assurance that weaknesses in demand did not persist or deepen. The current slowdown in economic growth was to a considerable extent the result of the policy implemented much earlier to restrain emerging inflation pressures, and this policy seemed at least to have avoided an upsurge in inflation. Over time, a further damping of price pressures was needed if the economy was to realize the benefits of price stability, but that need not involve a downturn in the economy. Several members observed that the choice between some slight easing at this time or waiting for additional evidence that the economy might be weakening further was a close one. A majority indicated that on balance they viewed the risks of a shortfall in economic activity as sufficiently high to justify an immediate move to slightly easier reserve conditions, and one member expressed a preference for somewhat greater easing. In this regard, some noted that the next several months might be a critical period in terms of avoiding a recession and that some modest easing at this point might have a calming effect on financial markets and help to boost business confidence. Given downward pressures on many prices and softness in business conditions, some slight easing was not likely in this view to be inconsistent with the long-run objective of price stability or the public's perception of the importance that the System placed on that objective. These members recognized that an easing of reserve pressures immediately after the meeting would make the need for further easing less likely over the coming intermeeting period. As a consequence, they favored a directive that did not contain a tilt toward less restraint but one that gave equal weight to potential intermeeting adjustments in either direction.

Members who supported an unchanged policy commented that current reserve conditions appeared to be consistent with ongoing expansion in business activity at a pace that over time would serve to moderate pressures on labor and other production resources, and they were concerned that further easing might overcompensate for current weaknesses in the economy at the cost of delaying progress toward price stability. In current circumstances, an easing also might foster some concern about the System's commitment to achieving price stability and put undesirable downward pressure on the dollar in the foreign exchange markets. At the same time, these members recognized the risk of some further weakening in the economy, and several favored a directive that incorporated a strong presumption that indications of such a development would trigger a prompt adjustment of reserve conditions. Most of these members were willing to accept a slight immediate move toward easier reserve conditions but, in that case, they doubted that any further easing would be appropriate over the intermeeting period unless the economy, prices, or financial developments deviated very substantially from current expectations. Two members indicated that they could not accept any further easing at this time, in part because of their concerns about the consequences for growth of the monetary aggregates and, more generally, for inflation expectations and inflation over time. Members referred to the strong growth of M2 over the past several months and took note of a staff analysis that concluded that such growth would remain fairly strong over months ahead if reserve conditions stayed unchanged or were eased slightly. Earlier declines in short-term interest rates and typically slow adjustments of offering rates on M2-type deposits had tended to make such deposits relatively more attractive by reducing the opportunity costs of holding them. The outlook for M3 was subject to considerable uncertainty, but growth of that aggregate was expected to remain below that of M2. The extent of the shortfall would depend in important measure on the degree to which solvent but capital-deficient thrift institutions continued to reduce assets to meet new capital requirements and on the extent of RTC activity in resolving insolvent thrift institutions.

At the conclusion of the Committee's discussion, all but two of the members indicated that they favored or could accept a directive that called for a slight easing of reserve conditions. In keeping with the Committee's usual approach to policy, the conduct of open market operations would be subject to further adjustment during the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. On the basis of such developments, slightly greater or slightly lesser reserve restraint would be acceptable during the period ahead. The reserve conditions contemplated at this meeting were expected to be consistent with growth of M2 and M3 at annual rates of about 8½ and 5½ percent respectively over the four-month period from November 1989 through March 1990. In light of the easing of reserve conditions over the course of recent months and the further slight easing favored by a majority of the members at this meeting, the Committee decided to lower the intermeeting range for the federal funds rate by 1 percentage point to 6 to 10 percent. Such a reduction would center the range more closely around the average federal funds rate that was expected to prevail after this meeting.

At the conclusion of the Committee's meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity is expanding slowly in the current quarter. Total nonfarm payroll employment has increased at a reduced pace on average over the past several months, with declines continuing in the manufacturing sector. The civilian unemployment rate edged up to 5.4 percent in November. Industrial production rose slightly in November after a decline in October resulting from strike activity and other disruptions. Nominal retail sales excluding motor vehicles strengthened in November, but continued weak sales of vehicles held total retail sales for the month to a level that was little changed from the third-quarter average. Housing starts fell in November but for the October–November period were up somewhat on average from their third-quarter level. Indicators of business capital spending suggest a weakening in expenditures after a substantial increase earlier in the year. The preliminary data indicate that the nominal U.S. merchandise trade deficit widened appreciably in October from an upward revised September rate. Broad measures of inflation suggest that prices have risen more slowly on balance since midyear, partly reflecting sharp reductions in energy prices, but the latest data on labor compensation suggest no significant change in prevailing trends.

Interest rates have changed little on balance since the Committee meeting on November 14. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined substantially over the intermeeting period, with a particularly pronounced depreciation against the German mark and related European currencies in the last week of the period.

M2 continued to grow fairly briskly in November, largely reflecting strength in its retail deposit components; M2 has expanded this year at a pace near the midpoint of the Committee's annual range. Growth of M3 picked up in November but has remained more restrained than that of M2, as assets of thrift institutions and their associated funding needs apparently continued to contract; for the year to date, M3 has grown at a rate a little above the lower bound of the Committee's annual range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3½ to 7½ percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6½ to 10½ percent for the year. For 1990, on a tentative basis, the Committee agreed in July to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from November through March at annual rates of about 8½ and 5½ percent respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Guffey, Johnson, Keehn, Kelley, and LaWare, Ms. Seger, and Mr. Syron. Votes against this action: Messrs. Angell and Melzer.

Messrs. Angell and Melzer dissented because they did not believe that policy should be eased. Mr. Angell was concerned that the Committee was responding to indicators of recent weakness in economic activity, a weakness that was a consequence of somewhat cautious policy responses earlier. Policy decisions should rely mainly on leading indicators, including commodity prices, the exchange rate, the yield curve, and money supply growth. Attention to such indicators had served policy well in the past. During the spring and summer while the dollar was appreciating and commodity prices, including gold, were generally falling, easing of reserve conditions was accompanied by the lower long-term interest rates necessary to undergird housing and other long-term investments. At this meeting, price-level indicators were not signaling a need for further ease. In these circumstances, an additional drop in the federal funds rate, coming after two previous easing moves in the fourth quarter, could raise doubts about the System's commitment to its objective of price stability, especially given that the easing would further stimulate M2 growth. Under such conditions, further easing of reserve pressures would tend to accommodate rising prices, foster uncertainty in financial markets, and drive up long-term interest rates, thereby increasing the likelihood of economic instability. Steady policy in pursuit of price stability, using forward-looking indicators, would reduce uncertainty about price trends, bolster confidence in the dollar domestically and internationally, and bring about lower interest rates and higher economic growth.

Mr. Melzer dissented because he favored an unchanged degree of reserve restraint. He noted that policy had been eased considerably over the last six months in anticipation of prospective sluggishness in the economy and that ample liquidity was now being provided by the central bank. In addition, based on recent and projected growth in the monetary aggregates, he was concerned that long-term progress toward price stability would be jeopardized by a more accommodative short-run policy stance.

2. Foreign Currency Authorization

At this meeting, the Committee approved an increase in the limit on holdings of foreign currencies in the System Open Market Account. Paragraph 1D of the Committee's Authorization for Foreign Currency Operations permitted the Federal Reserve Bank of New York, for the System Open Market Account, to maintain an overall open position in all foreign currencies not exceeding $20 billion, based on historical costs. System purchases of foreign currencies, which were coordinated with similar transactions by the U.S. Treasury, had been relatively limited recently, but, with the accumulation of interest, total holdings were approaching the $20 billion limit. The Manager for Foreign Operations advised that even in the absence of new market purchases, continuing accruals of interest would raise total holdings to the current limit by February. The Committee agreed to raise the limit to $21 billion, effective immediately.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, and Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None. ■

Consumer and Community Affairs

The Community Reinvestment Act was the focus of much activity during the year. In March the Board and the other federal financial regulatory agencies issued a joint policy statement to guide insured depository institutions in helping to meet the credit needs of their local communities, including low- and moderate-income neighborhoods. The statement aims to turn the focus of attention away from the applications process as the primary means for the public to air concerns related to the act; it seeks instead to promote more lasting mechanisms for outreach and dialogue between institutions and their communities.

According to the policy statement, institutions should have appropriate community reinvestment policies in place, and working well, before filing an application to expand operations. Although commitments for future actions may be used to address specific problems in an otherwise satisfactory record, such commitments will not compensate for seriously deficient performance. In February the Board underscored the importance of an institution's current record when it denied, in part because of deficiencies in performance under the act, a proposal by Continental Illinois Bancorp, Inc., of Chicago, to acquire an Arizona bank.

The policy statement encourages institutions to develop an effective process for ascertaining and responding to community credit needs over time and lists examples of initiatives the agencies have found to be effective. The statement highlights the importance of dialogue between financial institutions and representatives of their communities and urges institutions to discuss in formal statements their record of meeting the community's needs as a way of facilitating such communication.

Other aspects of the Board's activities under the Community Reinvestment Act are discussed below.

Overall, this chapter presents the Board's implementation in 1989 of new statutory protections for consumers while minimizing regulatory burdens on financial institutions, reports on the System's examination of institutions for compliance with consumer laws and on the System's handling of consumer complaints, discusses the community affairs program of the Board and Reserve Banks, details the activities of the Board's Consumer Advisory Council, and reports on testimony and legislative recommendations.

Regulatory Matters

The Board amended Regulation B to give owners of small businesses certain rights related to notices and recordkeeping as required by the Women's Business Ownership Act of 1988. The Board amended Regulation C to implement statutory amendments that expand reporting requirements under the Home Mortgage Disclosure Act. The Board amended Regulation Z to implement the Fair Credit and Charge Card Disclosure Act of 1988, which requires credit and charge card issuers to give consumers early disclosures. The Board also amended Regulation Z to implement the Home Equity Loan Consumer Protection Act of 1988, which requires extensive new disclosures and imposes limitations on the terms of home equity loans. In other matters, the Board updated advertising rules and poster requirements to implement 1988 changes to the Fair Housing Act and issued a new brochure for consumers about home equity lines of credit.

Regulation B (Equal Credit Opportunity): Business Credit

In November the Board amended Regulation B to implement the Women's Business Ownership Act of 1988, which gives owners of small businesses some of the same rights under the Equal Credit Opportunity Act (ECOA) that are given to borrowers of consumer credit. Business credit has always been covered by the ECOA and Regulation B, but the regulatory requirements for retention of records and for written notice of credit denial differed significantly from those applicable to consumer credit.

Beginning April 1, 1990, creditors of small businesses must follow rules for written notice that are similar to requirements for consumer transactions. A small business is defined, for purposes of Regulation B, as one having revenues of $1 million or less.

Creditors will have three options for complying with the notice requirements regarding reasons for denial. Creditors may give all applicants, at the time of application, a written notice of their right to find out the reasons if credit is denied; they may give such notice to rejected applicants at the time of denial; or they may automatically give rejected applicants the specific reasons, in writing, upon denial.

Under the new rules, creditors will have to keep the records used in evaluating credit applications of small businesses for one year. For businesses with revenues greater than $1 million, creditors must keep records for at least sixty days after taking action on the application and up to one year upon request from the applicant.

Regulation C (Home Mortgage Disclosure)

In December the Board adopted revisions to Regulation C to carry out amendments to the Home Mortgage Disclosure Act approved by the Congress in August 1989. Previously, lenders covered by the law reported mortgages and home improvement loans they made or purchased by type of loan and by census tract. Beginning January 1, 1990, covered lenders must report the following additional material:

- Information from all applications they receive for mortgages and home improvement loans
- The race, sex, and income level of applicants for mortgage or home improvement loans
- For loans that they sell, the type of purchaser, such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or an affiliate of the lender.

To help institutions comply with the law and keep their costs to a minimum, the Board decided that institutions will use a loan register to report data. This approach allows institutions to provide raw data without cross-tabulating it by type of loan, census tract, location, and characteristics of the applicant or borrower. Institutions will keep a running log of the required information and at year-end send the registers to their supervisory agency. The Federal Financial Institutions Examination Council (FFIEC) will prepare the disclosure statements required by the new law and send copies to the individual institutions, which will in turn make them available to the public. The FFIEC will continue to prepare, and to make public, tables that aggregate for each metropolitan statistical area the data submitted by financial institutions.

Regulation Z (Truth in Lending): Credit Card Disclosures

In April the Board amended Regulation Z to implement the Fair Credit and Charge Card Disclosure Act of 1988. The amendments require that card issuers give consumers certain information early to allow credit shopping. After August 31, 1989, issuers that offer cards to consumers by mail must disclose, in a table accompanying the application, the annual percentage rate, annual fees, transaction charges, grace periods, and the method used to calculate the balance on which the finance charge is based. Previously, these disclosures could be made later, when the card was issued. Special rules apply to disclosures in telephone solicitations and to application forms placed in retail establishments and in magazines.

The law requires disclosures in two other circumstances. First, card issuers that impose fees to renew credit and charge card accounts must give cardholders renewal notices, including a new set of credit disclosures. Second, card issuers that offer credit insurance must inform their cardholders if they change insurance providers and must disclose any accompanying increase in rate or decrease in coverage.

Regulation Z: Home Equity Lines of Credit

In June the Board amended Regulation Z to carry out the Home Equity Loan Consumer Protection Act of 1988. The new rules expand the disclosures that lenders must give with applications; require that some disclosures be given a second time, when an account is opened; govern the advertising of home equity plans; and prohibit certain credit terms in home equity plans. Compliance with the rules became mandatory on November 7, 1989.

When a lender gives a prospective customer an application form, the lender must disclose payment terms, an example of the payments, fees the creditor charges to open or use the plan, an estimate of fees imposed by third parties such as appraisers, and information about any variable-rate features. A creditor also must alert consumers to the circumstances under which it may terminate the plan, prohibit additional credit extensions, or change specified terms. The creditor must provide much of this information again when the account is opened.

The rules spell out proper advertising of home equity plans. If an advertisement includes any payment information, for example, it must state certain costs such as points or other loan fees, the periodic rate used to compute the finance charge, and the maximum annual percentage rate for variable-rate plans. Special rules apply to the mention of balloon payments and tax implications.

The new rules set some restrictions on credit terms. Lenders generally may not terminate a plan or unilaterally change the loan terms except in specified circumstances (for example, if the consumer fails to honor the contract's repayment terms or commits fraud). If the plan has a variable-rate feature, the lender must use an index that is publicly available and not under its control. Lenders must refund all fees paid by the consumer if the consumer chooses to cancel because the terms disclosed (other than a variable rate) changed between the time the consumer received an application and the account was opened.

The Board issued a pamphlet for consumers that describes the features of home equity lines of credit and how they compare with other types of credit programs. This pamphlet, or one substantially similar, must be given to consumers along with the creditor's disclosures.

Regulation Z: Determination of Preemption

In December the Board determined that provisions of Wisconsin law that require disclosures and adjustment notices for certain variable-rate transactions are not inconsistent with Regulation Z and therefore are not preempted. The Board concluded that a creditor could comply with both sets of rules without violating either the state or federal law. The Board also concluded that Wisconsin's requirements for disclosing information not covered by the federal law, or for more detailed disclosures, do not contradict the federal rules.

Interpretations

In 1989 the Board continued to offer legal interpretations and guidance on Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), and Regulation Z (Truth in Lending) through official staff commentaries. Published by April 1 each year, these commentaries help financial institutions and others apply the regulations to specific situations.

Fair Housing Act

In March the Board revised advertising rules and poster requirements to implement 1988 amendments to the Fair Housing Act. Among other things, the amendments added two new categories of protected persons: those with handicaps and those with children under the age of 18. The revised housing poster is available free of charge from each of the Reserve Banks.

Community Reinvestment Act

The Community Reinvestment Act (CRA) requires the Board to encourage financial institutions under its jurisdiction to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, in a manner consistent with safe and sound banking practices. The Board assesses the CRA performance of state member banks during regular compliance examinations and takes the CRA record into account, along with other factors, when acting on applications from state member banks and bank holding companies. As reported at the outset of this chapter, the Board in March joined the other federal financial regulators in issuing an interagency policy statement to guide institutions in meeting their responsibilities under the act.

The Federal Reserve System maintains a three-faceted program for enforcing and fostering better bank performance under the CRA. The components are a compliance examination program, dissemination of information on community development strategies and techniques to bankers and members of the public through community affairs offices at the Reserve Banks, and analyses of CRA issues presented in bank and bank holding company applications.

Federal Reserve examiners review fair lending, community revitalization, and other areas relevant to assessing CRA performance. During the 1989 reporting period (July 1, 1988, through June 30, 1989), they examined 634 state member banks and, when appropriate, suggested ways to improve CRA performance.

During 1989 the number of applications in which adverse CRA examination ratings were at issue increased significantly. The Board received forty-two such cases, compared with twenty in 1988 and fifteen in 1987. But the number of applications protested because of CRA performance in 1989 fell to sixteen, a sharp decline from the record high of thirty-six in 1987 and thirty-one in 1988. At year-end, eleven of the protested applications had been approved, two had been returned to the applicant or withdrawn, and three were still pending.

Community Affairs

The Federal Reserve's Community Affairs Program continued to emphasize training, education, and dissemination of information to financial institutions and to community and government representatives about community development lending. Increased interest in the mechanics of public–private partnerships followed the release in March of the interagency policy statement on the CRA by the federal financial regulatory agencies.

Given the heightened emphasis on CRA, the Board joined with the Reserve Banks of Chicago and New York in developing an advanced CRA training program for System examiners in those two districts; plans are under way to train examiners in the other Reserve Bank districts in 1990.

The Board coordinated two training seminars for Community Affairs Officers and staff of the Reserve Banks: A conference on rural economic development at the Federal Reserve Bank of Atlanta and a week-long seminar on community-development lending at the Baltimore Branch of the Richmond Bank. The Board's staff also made forty-five speeches in 1989 before various groups.

Members of the Community Affairs staff at the Reserve Banks provided training for bankers and others involved in community development in their districts. Conferences, seminars, and workshops covered a variety of topics, including the interagency policy statement on CRA, bank holding company responsibilities in managing the CRA programs of their deposit subsidiaries, economic development, community development corporations, the development of low-income housing, and lending to small businesses. Many sessions included participation from agencies such as the Federal Home Loan Banks, the Federal National Mortgage Corporation, the Department of Housing and Urban Development, the Small Business Administration, and the Farmers Home Administration.

The informational brochures and papers produced under the Community Affairs program included several new profiles published by the Federal Reserve Banks of Philadelphia and San Francisco on local communities within their districts. The Federal Reserve Bank of Minneapolis published a technical manual on community development lending, a practical guide that takes the reader step by step through the process of credit analysis and decisionmaking. In addition, six Reserve Banks now publish regular newsletters on community development issues in their districts.

Financial institutions continued to express interest in forming community development corporations (CDCs). The Board's staff worked with the Economic Development Administration in promoting the formation of bank and bank holding company CDCs through technical assistance to institutions.

Compliance Examinations

The Federal Reserve System conducts separate examinations to monitor compliance of state member banks with consumer protection laws. The Office of Thrift Supervision (OTS) also has implemented a program of specialized compliance examinations under its Division of Compliance Programs; and OTS districts began using a new compliance handbook and a separate schedule for compliance examinations in April 1989.

The Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA) maintained their various enforcement policies and procedures to monitor the compliance of the institutions they supervise.

Examination Procedures for the CRA

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) amended the Community Reinvestment Act in two ways. First, it requires agencies to disclose to the public, for examinations that take place after July 1, 1990, written evaluations and performance ratings under CRA; the evaluations will state conclusions and supporting facts for each assessment factor set out in the CRA regulations. Second, the act contains a new four-point rating system that replaces the agencies' existing five-point system.

To implement these changes, the FFIEC assembled an interagency working group of Washington and field office representatives. The group developed a uniform rating system and methods for disclosing the CRA rating and presenting the written evaluations. In December, the FFIEC issued for public comment an interagency proposal to implement the new requirements.

Compliance with Consumer Regulations

This section summarizes compliance data from the five agencies that supervise financial institutions and from other federal regulators for the reporting period July 1, 1988, to June 30, 1989. The data indicate that compliance with consumer regulations declined from 1988 levels. Information about compliance with the Expedited Funds Availability Act, which became effective September 1, 1988, is reported for the first time.[1]

Truth in Lending Act (Regulation Z)

The Board, the FDIC, the OCC, the OTS, and the NCUA report that 30 percent of examined institutions were in full compliance with the regulation, down from 46 percent in 1988. The OCC, the FDIC, and the OTS noted declines in compliance, while the NCUA and the Board reported levels of compliance similar to those of 1988. Data from the Board, the OCC, and the NCUA (the agencies that provide frequency of violations) indicate that, of the financial institutions not in full compliance, half had no more than five violations.

The five most frequent violations of Regulation Z were the failure to disclose properly the finance charge; the annual percentage rate; the number, amounts, and timing of payments scheduled to repay the obligation; and the total of payments on closed-end credit; plus the failure to provide notice to consumers entitled to rescind certain credit transactions.

The FDIC and the OTS issued four cease-and-desist orders involving violations of Regulation Z. Under the Interagency Enforcement Policy on Regulation Z, a total of 425 institutions supervised by the Board, the OTS, the FDIC, and the OCC reimbursed about $8 million on 87,447 accounts during the 1989 reporting period, compared with

1. The federal agencies that regulate financial institutions do not all use the same method to compile information on compliance; however, the data support the general conclusions presented here.

approximately $2 million on 23,419 accounts in 1988. The increase in reimbursements is explained, in part, by one institution's reimbursement of $3.6 million on 59,297 credit card accounts.

The Federal Trade Commission (FTC) continued its program of voluntary compliance to enforce the credit-advertising requirements of Regulation Z, with an emphasis on those applicable to real estate and automobile credit. Companies contacted by the FTC that were not in full compliance with the Truth in Lending Act promptly brought their programs into compliance.

The FTC continued its enforcement program against certain deceptive telemarketing practices and other frauds involving credit card charges. The agency brought three actions in federal district court alleging violation of the Truth in Lending Act: The failure to disclose finance charges and other required information, misrepresentations, and unlawful billing and crediting procedures.

To heighten consumer and creditor awareness of the rights and responsibilities established by the act, the FTC continues to publish educational pamphlets. This year the FTC issued a new pamphlet entitled *Choosing and Using Credit Cards* and a revised edition of *Electronic Banking*. A news release outlined provisions of the Fair Credit Billing Act that would assist customers with canceled airline tickets.

The Department of Transportation (DOT) reports that they find a satisfactory level of overall compliance by foreign and domestic carriers under its jurisdiction. As a result of consumer inquiries, the DOT entered into a formal order with an air carrier that required prompt processing of refunds to credit card accounts.

The Farm Credit Administration (FCA) reports that they find a satisfactory level of compliance with Truth in Lending among the institutions that it supervises. As a result of examinations and other regulatory activities, the FCA took formal enforcement actions against five institutions. They are now in substantial compliance.

The Packers and Stockyards Administration of the Department of Agriculture reports that they find a satisfactory level of compliance among the entities they supervise.

Equal Credit Opportunity Act (Regulation B)

The five financial regulatory agencies report that 60 percent of all examined institutions were in full compliance with Regulation B in 1989, down from 67 percent in 1988. The Board, the OCC, and the NCUA (the three agencies that collect data on the frequency of violations) report that 72 percent of the institutions not in full compliance had no more than five violations. The most frequent violations involved the failure of the creditor to meet the following requirements:

- To notify the applicant of the action taken within thirty days after receiving a completed application
- To provide a written notice of adverse action that contains the information specified by the regulation
- To provide the specific reasons for credit denial and other adverse action
- To request information for monitoring purposes about race or national origin and sex on credit applications for the purchase or refinancing of a primary dwelling
- To note the race or national origin and sex, based on the lender's visual observation, if an applicant chooses not to provide the requested information.

The FTC continued an investigatory program in which testers pose as credit applicants to monitor compliance with the ECOA. The FTC settled one lawsuit involving practices that were in violation of the ECOA and obtained consent decrees in three other cases.

As part of its educational effort, the FTC published a manual that teaches creditors how to comply with the notification provisions of the ECOA and the Fair Credit Reporting Act.

The Farm Credit Administration reports that they find a satisfactory level of compliance with the ECOA by its institutions. As a result of examinations and other regulatory activities, the FCA took formal enforcement actions against four institutions. They are now in substantial compliance with the ECOA.

The other agencies that enforce the ECOA—the DOT, the Interstate Commerce Commission, the Small Business Administration, the Packers and Stockyards Administration, and the Securities and Exchange Commission (SEC)—report that they find substantial compliance among the entities they supervise.

Electronic Fund Transfer Act (Regulation E)

The five financial regulatory agencies report that 84 percent of examined institutions were in full compliance with Regulation E, a decline from the 88 percent reported last year. The five most frequent violations of Regulation E involved the failure to give the following disclosures:

- A written statement outlining the terms and conditions of the EFT service
- A summary of the customer's liability for unauthorized transfers
- A summary of the customer's right to stop payment of EFTs and the procedures for initiating a stop-payment order
- A statement for each monthly cycle in which an EFT occurred
- A periodic notice of the procedures for resolving alleged errors.

The other agencies responsible for enforcing the act—the FTC and the SEC—report that they find a satisfactory level of compliance among the entities they supervise.

Expedited Funds Availability Act (Regulation CC)

The Board, the OCC, and the FDIC report that 90 percent of examined institutions were in full compliance with the regulation. The Board and the OCC (the agencies that provide a breakdown of the violation frequency) report that 78 percent of the institutions not in full compliance had fewer than five violations. The five most frequent violations involved the failure to meet the following requirements:

- To provide next-day availability for certain items
- To notify customers when placing exception holds on their transactions
- To train employees and provide procedures for compliance
- To post availability policies at locations where employees accept deposits
- To notify customers when placing case-by-case holds on their transactions.

Economic Effect of the Electronic Fund Transfer Act

In keeping with statutory requirements, the Board monitors the effects of the Electronic Fund Transfer Act on the costs and benefits of EFT services to financial institutions and consumers. During 1989 the economic effect of the act increased because of continued growth in the availability and use of EFT services. About two-thirds of the depository institutions in the United States offer EFT services and are covered by the act and Regulation E.

Most of the nation's banks and thrifts offer customers access to automated teller machines. The number of installed ATMs increased in 1989 about 6 percent, to 87,000, from 82,000 in 1988; more than 85 percent of these ATMs are part of shared networks. In the same period, the number of ATM transactions increased about 4 percent, or 0.2 billion, to 5.2 billion.

Point-of-sale (POS) systems grew more rapidly than ATM systems during 1989. The number of terminals capable of supporting direct-debit POS transactions grew about 18 percent, from 43,400 in 1988 to 51,000 in 1989. The volume of POS transactions, however, remains below that of ATM transactions. About 70 million POS transactions were processed in 1989.

Direct deposit accounts for a large share of electronic payments. In the private sector, the direct deposit of salary and pension payments covers about 40 percent of commercial payments handled by automated clearinghouses. In the public sector, about half of social security payments and two-thirds of federal salary and retirement payments are made by direct deposit.

The benefits to consumers from the Electronic Fund Transfer Act are difficult to measure because they cannot be isolated from consumer protections that would have been provided in the absence of regulation. Statistics from examination reports do not suggest widespread violation of consumer rights established by the act. In 1989, according to reports by the federal agencies that regulate financial institutions, about 16 percent of institutions were not in full compliance with the regulation. The violations primarily involved the failure of institutions to provide one or more disclosures to consumers.

Data from the Board's Consumer Complaint Control System do not indicate serious consumer problems with electronic transactions. In 1989, forty-eight of the complaints processed involved electronic transactions. The Federal Reserve System forwarded nineteen, which did not involve state member banks, to other agencies for resolution. Of the remaining twenty-nine, two involved a possible violation of the regulation.

Because the industry practices that would have evolved in the absence of statutory requirements are unknown, the incremental costs associated with the act are difficult to quantify. Cost estimates from 1981 suggest that the ongoing compliance cost of electronic transactions was not high enough to compromise their cost advantage over check-based transactions. Since that time, the volume of transactions has increased, which has allowed financial institutions to exploit economies of scale.

There were no revisions to Regulation E in 1989. The Board is reviewing the regulation for possible changes under its Regulatory Improvement Program.

Complaints about State Member Banks

The Board and the Federal Reserve Banks investigate complaints against state member banks and forward to appropriate enforcement agencies complaints that involve other creditors or businesses. In 1989 the System received 2,146 complaints against state member banks, nonmember banks, and other creditors and businesses: 1,846 by mail, 294 by telephone, and 6 in person (see the accompanying table). The Board also received 963 written inquiries concerning consumer credit and banking policies and practices. In responding, the Board's staff gave consumers brochures on the general issues plus explanations of laws, regulations, and banking practices specific to their complaints or inquiries.

The Board's staff continues regularly to review the System's handling of complaints by sending follow-up questionnaires to complainants to assess perceptions of how well the System did. In 1989, 57 percent of the complainants returned the questionnaires. Approximately 63 percent reported that the explanations received were clear and understandable; 63 percent were satisfied with the promptness in handling; 96 percent said they were treated courteously by Federal Reserve staff; 93 percent said they would contact the Federal Reserve again if they had another problem with a bank; and 56 percent found the resolution of their complaints acceptable. The proportion of those satisfied with the outcome is lower relative to the proportion of those satisfied with the System's handling of complaints because many of the complaints involved practices that, while of concern to consumers, are permissible banking practices.

A second table summarizes the nature and resolution of complaints filed against state member banks in 1989, classified according to bank functions. Of the 839 complaints received about state member banks, 55 percent concerned loan functions: 7 percent alleged discrimination on a prohibited basis, and 48 percent concerned credit denial on nonprohibited bases (such as length of residency) and other unregulated lending practices (such as release or use of credit information). About 23 percent involved disputes about interest on deposits and general practices concerning deposit accounts.

Unregulated Practices

In 1989 the Board continued to monitor, under section 18(f) of the Federal Trade Commission Act, complaints about banking practices that are not subject to existing regulations to focus on those that may be unfair or deceptive. Four categories each accounted for 6 percent or less of the 1,120 complaints: credit denial based on credit history (sixty-eight), discrepancies in deposit accounts (sixty- one), debt collection practices (fifty- four), and miscellaneous other practices (seventy). Many of the complaints about credit denials based on credit history indicated that the applicant underestimated the importance lenders give to a poor credit history or a lack of borrowing experience when considering the applicant's creditworthiness. Complaints about discrep-

Consumer Complaints Received by the Federal Reserve System, by Subject, 1989

Subject	State member banks	Other lenders [1]	Total
Regulation B (Equal Credit Opportunity)	60	45	105
Regulation E (Electronic Fund Transfers)	29	19	48
Regulation M (Consumer Leasing)	4	4	8
Regulation Q (Interest on Deposits)	41	48	89
Regulation Z (Truth in Lending)	184	294	478
Regulation BB (Community Reinvestment)	0	5	5
Regulation CC (Expedited Funds Availability)	21	50	71
Fair Credit Reporting Act	23	67	90
Fair Debt Collection Practices Act	9	9	18
Fair Housing Act	0	2	2
Municipal Securities Dealer Regulation	0	2	2
Transfer agents	1	1	2
Unregulated bank practices	467	653	1,120
Other [2]	0	108	108
Total	**839**	**1,307**	**2,146**

1. Referred by the Federal Reserve to the appropriate agencies.

2. Primarily miscellaneous complaints against business entities.

ancies in deposit accounts usually involved cases in which consumers had noticed errors on their savings or checking account statements. Complaints about debt collection tactics usually involved objections to the manner in which banks were attempting to collect outstanding debts. Miscellaneous complaints covered a wide range of practices, including merchants' minimum-charge requirements on credit cards, the number of points charged on a mortgage loan, or a lender's failure to close on a mortgage loan by the agreed settlement date.

Consumer Advisory Council

The Consumer Advisory Council (CAC) met in March, June, and October to advise the Board on its responsibilities under the consumer credit protection laws and to discuss other issues dealing with financial services to consumers. The council's thirty members come from consumer organizations, financial institutions, academia, and state government. Council meetings are open to the public.

During the year, the council considered issues related to the Community

Consumer Complaints Received by the Federal Reserve System, by Function and Resolution, 1989

Type of resolution	Total	Type of complaint					
		Loan function		Deposit function	Electronic fund transfers	Trust services	Other
		Discrimination	Other				
Complaints about state member banks							
Number	839	60	400	192	29	8	150
Percent	100	7	48	23	3	1	18
Complaints about state member banks, by type							
Insufficient information[1]	23	0	15	3	0	0	5
Information furnished to complainant[2]	79	6	32	17	1	2	21
Bank legally correct							
No accommodation	252	26	118	53	11	3	41
Accommodation made[3]	93	4	53	17	1	0	18
Clerical error, corrected	103	3	45	31	10	0	14
Factual dispute[4]	44	0	18	12	0	1	13
Bank violation, resolved[5]	10	4	2	1	2	0	1
Possible bank violation, unresolved[6]	2	0	1	0	0	0	1
Customer error	21	2	4	11	0	0	4
Pending, December 31	212	15	112	47	4	2	32
Complaints referred to other agencies[7]	1,307	52	591	258	19	13	374
Total, all complaints	**2,146**	**112**	**991**	**450**	**48**	**21**	**524**

1. The staff has been unable, after follow-up correspondence with the consumer, to obtain sufficient information to process the complaint.

2. When it appears that the complainant does not understand the law and that there has been no violation on the part of the bank, the Federal Reserve System explains the law in question and provides the complainant with other pertinent information.

3. In these cases the bank appears to be legally correct but has chosen to make an accommodation.

4. These cases involve factual disputes not resolvable by the Federal Reserve System and contractual disputes that can be resolved only by the courts. Consumers wishing to pursue the matter may be advised to seek legal counsel or legal aid or to use small claims court.

5. In these cases a bank appears to have violated a law or regulation and has taken corrective measures voluntarily or as indicated by the Federal Reserve System.

6. When a bank appears to have violated a law or regulation, customers are advised to seek civil remedy through the courts. Cases that appear to involve criminal irregularity are referred to the appropriate law enforcement agency.

7. Complaints about nonmember institutions.

Reinvestment Act and the Home Mortgage Disclosure Act, disclosures for credit and deposit accounts, the restructuring of the savings and loan industry, and consumer use of financial services, among others. In March, CAC members offered views on the interagency policy statement on CRA; the statement calls for financial institutions to implement CRA programs, to be managed at the highest levels of the institution, that involve outreach and dialogue, and encourages institutions to fully document their CRA activities. The CAC also discussed the need for affordable housing and received an update about media reports of mortgage lending patterns by banks in Atlanta and Detroit that showed wide disparities between predominately white and predominately minority neighborhoods. In June the council discussed public disclosure of CRA ratings.

The council's Community Affairs Committee looked at ways to address community development needs by promoting partnerships among lenders, nonprofit development organizations, and government agencies. In June the committee presented a report on community development credit unions (CDCUs), financial cooperatives that primarily serve low-income communities. One member suggested that sponsoring CDCUs is one way that banks might meet obligations under CRA. In October the council passed a resolution suggesting specific mention of CDCUs in the interagency policy statement on CRA and in appropriate Federal Reserve programs and publications. The policy statement gives examples of approaches financial institutions might take to support community development lending and the provision of other financial services. The council asked that the Board consider listing CDCUs as one of those examples.

In October the council also discussed the Board's proposed revisions to Regulation C to implement amendments to the Home Mortgage Disclosure Act.

During the year, the CAC considered several issues related to disclosures given to consumers. The council discussed the Board's proposed amendments to Regulation Z, which require creditors to give consumers early disclosures about home equity lines of credit and set substantive limits on some aspects of these plans. The final regulation reflected council recommendations concerning the form and content of disclosures to consumers. In June the council discussed proposals for truth in savings legislation.

The council also discussed the use of credit cards in telemarketing operations. Consumers and financial institutions may encounter problems when goods purchased with a credit card from telemarketers are not delivered or are of unsatisfactory quality. (The Truth in Lending Act places certain limits on the right of consumers to withhold payment for faulty merchandise; for example, disputed sales have to occur in the same state or within 100 miles of the consumer's home.) Financial institutions face potential financial loss because they are responsible for responding to consumer claims and possibly reversing charges to their accounts. Banks are also at risk if they hold the account of a merchant who engages in fraudulent or deceptive practices. The council passed a resolution suggesting that the Congress hold hearings to determine whether legislative amendments to the claims and defenses section of the Truth in Lending Act are needed to address telemarketing fraud. The resolution also asked that the Congress consider both criminal and civil penalties for sales-draft laundering and telemarketing fraud.

The council received briefings on legislative proposals to restructure the savings and loan industry. It adopted a resolution urging the Congress to work immediately and cooperatively for rapid resolution of the crisis; the resolution also supported the timely and positive approach of the Bush administration in addressing this problem.

A roundtable discussion among members of the council and of the Board, known as the "Members Forum," was initiated this year to give council members the opportunity to offer their views on a variety of topics. Forum discussions focused on issues identified by the Board. During the year, council members discussed matters such as the state of community development lending in their cities and trends they have noticed in consumers' use of financial services. In a resolution, the council asked that the Board encourage banks to refer customers to nonprofit credit-counseling services that adhere to ethical and businesslike codes of operations.

Testimony and Legislative Recommendations

In 1989 the Board testified before Congress about truth in savings, flood insurance, the Community Reinvestment Act, basic banking and government-check cashing, and loan discrimination.

Truth in Savings

In May the Board testified before a subcommittee of the House Banking, Finance and Urban Affairs Committee about a proposed truth in savings bill that would require institutions to give certain information about the terms of deposit accounts to prospective and existing account holders. Institutions also would have to disclose rates and costs in advertisements and to inform account holders of changes in account terms.

The Board supported the concept of account disclosures but saw no compelling need for legislation. A majority of state member banks already give disclosures, and consumer surveys conducted by the Board show that most depositors say the information they receive is adequate. The Board believes the bill would add to an already heavy regulatory burden, particularly for small institutions.

The Board offered technical changes should the Congress decide to proceed with the bill. These include amendments to make more meaningful to consumers the disclosure of the interest yields on funds deposited for less than one year and to conform the civil liability provisions more closely to other consumer protection statutes.

Flood Insurance

In May the Board testified before a House Banking subcommittee on the Federal Reserve's enforcement of the Flood Disaster Protection Act, which prohibits federally regulated banks and savings and loan associations from making loans in a designated flood hazard area unless any improvements on real property that secures the loan is covered by flood insurance. The Board reported that specially trained examiners routinely review compliance during regularly scheduled examinations of state member banks. In 1988, 83 percent of the institutions examined had no flood insurance violations, compared with 78 percent in 1987 and 81 percent in 1986. Among banks with violations, most had failed to record the fact that they had checked the need for flood insurance; few violations involved a failure to obtain insurance when it was required.

Community Reinvestment Act

In June the Board testified before a subcommittee of the Senate Committee on Banking, Housing and Urban Affairs on legislative proposals relating to the

Community Reinvestment Act, and in July about the Federal Reserve's implementation of the CRA. The Board endorsed public disclosure of CRA performance through a written summary of the examiner's evaluation (with supporting information) but opposed other aspects of the proposals before the Congress.

The Board testified that, in enforcing the CRA, it has tried to balance the competing interests and responsibilities of banks and community groups. The Board outlined its CRA program, which integrates compliance examinations, a community affairs program, and an analysis of CRA performance in deciding applications by banks and bank holding companies. During CRA examinations, examiners collect information that, taken as a whole, represents the bank's CRA record. As part of the community affairs program, community affairs offices at the Reserve Banks share their expertise in community development financing with banks, bank holding companies, and the public sector through educational seminars and publications on the tools and techniques of community development lending. The Board also considers CRA performance when reviewing applications for mergers, acquisitions, or branching.

In the past, institutions often made commitments during the application process to address weaknesses in their records, commitments that the Board took into account in deciding the application. About one-third of some 150 CRA-protested applications were approved with such commitments. Under the recent interagency policy statement on CRA, commitments may be used to address specific problems in an otherwise satisfactory record but generally will not compensate for a seriously deficient record of performance. The Board's testimony reiterated the interagency policy that institutions should have a sound CRA performance before pursuing expansion.

Basic Banking and Check Cashing

The Board testified in June before the Senate Banking subcommittee (and in October before a subcommittee of the House Committee on Banking, Finance and Urban Affairs) about legislative proposals that would require institutions to offer specific banking services. The Board opposed legislation that mandates specific services, preferring instead a voluntary approach that lets institutions design products to meet the specific needs of their customers. Surveys by the Board, the General Accounting Office, and others support the view that basic accounts and check-cashing services are not so scarce as to warrant legislation. Moreover, alternatives like electronic delivery of government payments show strong promise for addressing the concerns prompting the bills and should be encouraged by the Congress.

The Board expressed the following concerns about the bills:

- Setting fees based on an average industry cost means that some institutions would not recover costs while others might exceed them. And, while financial institutions would have to offer these services at cost, stores and other check cashers could continue to offer them at a profit.
- Letting the Board suspend mandatory check cashing for certain types of checks would not effectively minimize fraud because of the time it takes to discover patterns of fraud.
- A single, federally mandated banking service could inhibit the development of different and possibly cheaper products tailored to the special and changing needs of low-income and elderly individuals (for example, savings accounts with a money-order feature, and accounts with

per-check fees in place of monthly maintenance charges).

Loan Discrimination

In October the Board testified before a Senate Banking subcommittee on its report to the Congress concerning mortgage loan discrimination. The main points of the report, which was required by the recent thrift legislation, are summarized below.

Profile of State Member Banks

The Board's enforcement authority is limited to state chartered banks that are members of the Federal Reserve System (about 8 percent of commercial banks). Most serve rural areas, and about 90 percent of them have total assets of less than $500 million. They originate less than 3 percent of all home purchase loans and thus are not a significant presence in the mortgage lending industry.

Detecting Loan Discrimination

To detect possible loan discrimination by state member banks, compliance examiners make a comprehensive assessment of lending practices, comparing the treatment of members of a class protected by the law with other applicants. But any discrimination that might exist in the financial system today is increasingly subtle and difficult to define and substantiate. Consequently, even these extensive examination procedures cannot totally guarantee the absence of isolated instances of discrimination. Flexible credit standards, the different factors used to gauge creditworthiness, and variations in pricing and structure that can occur for legitimate business reasons are among the factors that make substantiation difficult. As a result, examiners are seldom able to make a formal finding of actual lending discrimination. They do, however, fully explore questionable variations in lending practices with bank personnel to assure that illegal discrimination is not taking place.

The Federal Reserve's procedures give special guidance for handling complaints of loan discrimination by state member banks and authorize on-site investigations by Reserve Bank staff as needed. But the Federal Reserve receives few such complaints, which could mean several things: that discrimination rarely occurs; that discouraged loan applicants are unaware they have been discriminated against; that they do not know their rights under the antidiscrimination laws; or that they do not believe it is worth filing a complaint.

Racial Disparities in Home Mortgage Lending

Recent studies have examined the relationship between the racial make-up of neighborhoods and home mortgage lending in Atlanta, Boston, Cleveland, and Detroit. The studies have found differences in lending patterns across neighborhoods but draw no definitive conclusions about the presence or extent of racial discrimination. Regardless of the cause, such findings should prompt institutions to review their product offerings in minority neighborhoods, an action emphasized in the March 1989 interagency policy statement on CRA.

Mortgage Lending Initiative under Review

The Board discussed several initiatives currently under review by the Board and other member agencies of the FFIEC:

- Creating mortgage review boards representing consumer groups and lenders to give rejected loan applicants a second chance

- Producing educational pamphlets for consumers and lenders to help assure nondiscriminatory lending
- Sharing among the agencies of information obtained from community contacts and others to help enhance examiners' understanding of the local community and their ability to judge an institution's lending efforts
- Providing banks with information on their lending patterns to give management a more complete picture of the bank's mortgage lending efforts
- Reviewing examination and training procedures regarding loan discrimination.

Recommendations of Other Agencies

Each year the Board asks those agencies that have enforcement responsibilities under Regulations B, E, and Z for recommended changes to the regulations or to the underlying statutes. The FDIC recommended several revisions to the Equal Credit Opportunity Act and Regulation B.

The FDIC suggested that creditors' denial notices include the name, address, and telephone number of the office that the applicant could contact for further information about the reasons for denial of credit. Encouraging a credit applicant to contact the creditor for a more complete explanation of the reasons for denial, the FDIC believes, would help reduce the number of complaints and inquiries to the financial regulatory agencies.

In addition, to reduce confusion on the part of consumers who are turned down for credit, and to reduce the involvement of federal regulators, the FDIC also suggests a more detailed notice about rights under the Fair Credit Reporting Act.

The FDIC again recommended amending the ECOA to prohibit discrimination on the basis of handicap, a change that would bring it into conformity with recent amendments to the Fair Housing Act. ■

Litigation

During 1989 the Board of Governors was named in thirty-nine pending lawsuits, compared with forty-four in 1988. Of the fourteen new lawsuits filed in 1989, eight raised questions under the Bank Holding Company Act, compared with six in 1988. As of December 31, 1989, fifteen cases were pending, nine of which involved questions under the Bank Holding Company Act.

Bank Holding Companies – Antitrust Action

In 1989 no bank holding company acquisitions or mergers that had been approved by the Board were challenged by the Department of Justice under antitrust laws, and no such cases were pending from previous years.

Bank Holding Company Act – Review of Board Actions

In *CBC, Inc.* v. *Board of Governors,* No. 86-1001 (10th Circuit, filed January 2, 1986), petitioner sought review of the Board's amendment to Regulation Y requiring certified financial statements in annual reports for bank holding companies with assets of $150 million or more (50 Fed. Reg. 50,950, December 13, 1985). The Board's order was upheld by the Court of Appeals (855 F.2d 688) on August 30, 1988, and on March 27, 1989, the Supreme Court denied a petition for certiorari (109 S. Ct. 1568).

In *Lewis* v. *Board of Governors,* Nos. 87-3455 and 87-3545 (11th Circuit, filed June 25 and August 3, 1987), petitioner seeks review of Board orders dated May 29 and July 1, 1987, approving applications of Chemical New York Corporation and of Manufacturers National Corporation to expand activities of trust company subsidiaries in Florida (73 *Federal Reserve Bulletin* 609 and 735). The cases have been stayed pending Supreme Court review of *Continental Illinois Corp.* v. *Lewis,* 827 F.2d 1517 (11th Cir. 1987), *modified,* 838 F.2d 457, *prob.juris. noted,* 109 S. Ct. 2446 (1989).

In *National Association of Casualty and Surety Agents* v. *Board of Governors,* Nos. 87-1354 and 87-1355 (D.C. Circuit, filed July 29, 1987), the Court of Appeals upheld (856 F.2d 282) Board orders dated June 29, 1987, and July 2, 1987, permitting Sovran Financial Corporation and MNC Financial, Inc., to retain insurance agency activities (73 *Federal Reserve Bulletin* 672 and 740). Several other cases involved petitions for review of similar Board orders; all were denied review by court orders dated January 19, 1989. These cases are as follows: *National Association of Casualty and Surety Agents* v. *Board of Governors,* No. 87-1644 (D.C. Circuit, filed November 14, 1987), No. 87-1801 (D.C. Circuit, filed December 21, 1987), No. 88-1001 (D.C. Circuit, filed January 4, 1988), No. 88-1206 (D.C. Circuit, filed March 18, 1988), No. 88-1245 (D.C. Circuit, filed March 30, 1988), and No. 88-1270 (D.C. Circuit, filed April 7, 1988); and *Independent Insurance Agents of America, Inc.* v. *Board of Governors,* No. 87-1686 (D.C. Circuit, filed November 19, 1987). On May 30, 1989, the Supreme Court denied a petition for certiorari in these cases (109 S.Ct. 2430).

In *American Land Title Association* v. *Board of Governors,* No. 88-1872 (D.C. Circuit, filed December 16, 1988), petitioner sought review of a Board order dated November 17, 1988, approving the application by First Wisconsin Corporation to acquire a company engaged in title insurance agency activities (75 *Federal Reserve Bulletin* 31). The case involved the application of exemption G from the prohibition on insurance activities contained in section 4(c)(8) of the Bank Holding Company Act. The Court of Appeals upheld the Board's order on December 29, 1989 (892 F.2d 1059).

In *Independent Insurance Agents of America, Inc.* v. *Board of Governors,* No. 89-4030 (2nd Circuit, filed March 9, 1989), petitioner sought review of a Board order dated March 3, 1989, granted at the request of Merchants National Corporation, determining that the nonbanking prohibitions of the Bank Holding Company Act do not apply to activities of banks (75 *Federal Reserve Bulletin* 388). The Court of Appeals upheld the Board's order on November 29, 1989 (890 F.2d 1275). A second case raising the identical issue, *Independent Insurance Agents of America* v. *Board of Governors,* No. 89-4046 (2nd Circuit, filed April 6, 1989), has been held in abeyance.

In *Synovus Financial Corporation* v. *Board of Governors*, No. 89-1394 (D.C. Circuit, filed June 21, 1989), petitioner seeks review of a Board order dated May 22, 1989, approving the application of SouthTrust Corporation to acquire a national bank in Georgia by relocating an Alabama national bank subsidiary across state lines pursuant to 12 U.S.C. §30 (75 *Federal Reserve Bulletin* 516). The case is pending.

In *Executive National Bank* v. *Board of Governors*, Nos. 89-4831, 89-4852 (5th Circuit, filed November 6, 1989), petitioners sought a declaratory judgment that a pending application for approval to acquire the petitioner bank was deemed approved under the Bank Holding Company Act's ninety-one day rule. The action was dismissed on November 16, 1989.

In *Babcock and Brown Holdings, Inc.* v. *Board of Governors,* No. 89-70518 (9th Circuit, filed November 22, 1989), petitioners seek review of a Board order dated October 25, 1989, in which the Board requested the Federal Deposit Insurance Corporation to condition deposit insurance for a proposed District bank on Board approval of the acquisition of control of the bank by Babcock and Brown Holdings, Inc., a brokerage firm. The case is pending.

Other Litigation Involving Challenges to Board Procedures and Regulations

In 1989, ten actions were commenced, were pending, or were dismissed under the Financial Institutions Supervisory Act and the Glass-Steagall Act.

Financial Institutions Supervisory Act

In *Stoddard* v. *Board of Governors,* No. 88-1148 (D.C. Circuit, filed February 25, 1988), the Court of Appeals (868 F.2d 1308) vacated a removal order initiated by the Office of the Comptroller of the Currency against a former officer and director of Michigan National Bank, who had resigned before the institution of removal proceedings. Section 905 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) amended the statute to permit removal actions to be brought against nonincumbents.

In *Bonilla* v. *Board of Governors,* No. 88-1464 (7th Circuit, filed March 11, 1988), petitioner sought review of a Board order prohibiting him from participating in the affairs of any insured bank or bank holding company. The case was dismissed by stipulation on November 14, 1989.

In *Van Dyke* v. *Board of Governors,* No. 88-5280 (8th Circuit, filed July 18, 1988), the Court of Appeals (876 F.2d 1377) affirmed the Board's removal order against a national bank president and director who had engaged in check kiting involving an account in his bank.

In *MCorp* v. *Board of Governors,* No. 89-1677 (S.D. Texas, filed May 2, 1989), the district court (101 Bankr. 483) entered a preliminary injunction against the Board enjoining pending and future enforcement actions against a bank holding company that was in bankruptcy. The case is now awaiting decision on the Board's appeal to the Fifth Circuit (No. 89-2816). A related case, *MCorp* v. *Board of Governors,* No. CA3-88-2693-F (N.D. Texas, filed October 28, 1988), is stayed pending the outcome of the Fifth Circuit appeal.

In *Board of Governors* v. *Consolidated Bancorp,* No. W-89-CA251 (W.D. Texas, filed September 8, 1989), the Board sought to enforce an administrative subpoena permitting inspection of the records of a bank holding company in bankruptcy. In *Consolidated Bancorp* v. *Board of Governors,* No. AP-89-6081 (Bankr. W.D. Texas, filed September 15, 1989), the bank holding company sought to enjoin enforcement of the subpoena. Both cases were dismissed by stipulation on November 28, 1989.

Glass-Steagall Act

In *Chase Manhattan Corporation* v. *Board of Governors,* Nos. 87-1333 and 87-1580 (D.C. Circuit, filed July 20, 1987), petitioner and the applicant sought review of a Board order dated July 17, 1987, conditionally approving the application of Chase Manhattan Corporation to underwrite and deal in mortgage-related securities to a limited extent (73 *Federal Reserve Bulletin* 729). The cases were dismissed by stipulation on December 28, 1989.

In *Securities Industry Association* v. *Board of Governors,* No. 89-1127 (D.C. Circuit, filed February 16, 1989), the petitioner seeks review of a Board order dated January 18, 1989, at the request of J.P. Morgan & Co. Incorporated, The Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp, and Security Pacific Corporation, which expanded the scope of securities that could be underwritten and dealt in by bank holding companies to include all types of debt and equity securities, subject to certain conditions (75 *Federal Reserve Bulletin* 192). The case is pending.

In *Securities Industry Association* v. *Board of Governors,* No. 89-1730 (D.C. Circuit, filed November 29, 1989), the petitioner seeks review of a Board order dated October 30, 1989, approving an application by Bankers Trust New York Corporation for its subsidiary to act as agent in the placement of all types of securities and to buy and sell all types of securities on the order of investors as a "riskless principal" (75 *Federal Reserve Bulletin* 829). The case has been held in abeyance pending the determination in *Securities Industry Association* v. *Board of Governors,* No. 89-1127, discussed above.

Other Actions

In *Teichgraeber* v. *Board of Governors,* No. 87-2505-0 (D. Kansas, filed October 16, 1987), the court on March 20, 1989, granted the Board's motion for summary judgment with respect to the plaintiff's request for disclosure of documents under the Freedom of Information Act.

In *Cohen* v. *Board of Governors,* No. 88-1061 (D. New Jersey, filed March 7, 1988), plaintiff seeks to require disclosure of documents under the Freedom of Information Act. The case is pending. In *Fidata Trust Company New York* v. *Board of Governors,* No. 88-4846 (D. New Jersey, filed November 9, 1988), plaintiff seeks to enjoin the Board from disclosing certain documents involved in the *Cohen* case. The case was dismissed on January 30, 1990.

In *White* v. *Board of Governors,* No. 88-623 (D. Nevada, filed July 29, 1988), the plaintiff alleges discriminatory practices under the Age Discrimination in Employment Act. The case is pending.

In *First Savings Bank* v. *Board of Governors,* No. 89-4117 (D. South Dakota, filed August 31, 1989), the plaintiff sought to enjoin the Board from granting final approval of a branch application. The case was dismissed on November 21, 1989.

In *Consumers Union of U.S., Inc.* v. *Board of Governors,* No. 89-3008 (D.D.C. filed November 1, 1989), the plaintiff challenges various amendments to Regulation Z implementing the Home Equity Loan Consumer Protection Act. The case is pending. ▪

Legislation Enacted

In 1989 the Congress passed a bill to reform the structure and regulation of savings institutions. One of the most significant pieces of banking legislation in recent history, the law reaches beyond the thrift industry to affect all financial institutions and their regulators. The following discussion briefly summarizes each title of the act and then describes in more detail those with a significant bearing on the Federal Reserve and the institutions it regulates.

Financial Institutions Reform, Recovery, and Enforcement Act of 1989

Public Law 102–73, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), was enacted on August 9, 1989. Title I states the purposes of FIRREA, which include promoting a safe system of affordable housing finance, improving the supervision of savings associations and the safety and soundness of federal deposit insurance funds, and dealing expeditiously with failed savings associations.

Title II addresses the Federal Deposit Insurance Corporation (FDIC). The act increases the number of members of the Board of the FDIC from three to five. It makes the FDIC responsible for insuring the deposits of the savings and loan industry and gives the FDIC certain examination and regulatory responsibilities over thrift institutions. This title also clarifies the FDIC's powers as conservator or receiver of failed depository institutions under its jurisdiction and further defines the FDIC's authority to set up new or bridge banks to receive the assets and liabilities of failed institutions.

Title III amends the Home Owners' Loan Act to create the Office of Thrift Supervision (OTS) under the Department of the Treasury. This title gives the OTS general responsibility for the supervision and regulation of federal and state savings associations and savings and loan holding companies. Title III contains provisions intended to strengthen the liquidity and capitalization of thrifts; it also restricts the expansion of savings associations that do not maintain a minimum of 70 percent of their portfolios in certain assets related to housing finance, such as home loans or mortgage-backed securities. Title III extends to thrifts the restrictions on transactions with affiliates and loans to insiders that are already applicable to banks.

Title IV abolishes the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation (FSLIC) and provides for the transfer of certain regulations, functions, and employees to other agencies.

Title V establishes the Oversight Board and the Resolution Trust Corporation (RTC). The Oversight Board is to oversee and establish policy for the RTC, which is to act as conservator or receiver for failing savings and loan associations that were insured by the FSLIC before the enactment of FIRREA. The RTC will also liquidate the Federal Asset Disposition Association, which had been created by Federal Home Loan Bank Board to liquidate certain assets of failed thrifts. Title V also establishes the Resolution Finance Corporation (Refcorp) to provide funds to the RTC through the issuance of bonds in an amount up to $30 billion.

Title VI amends the Bank Holding Company Act to allow bank holding companies to acquire thrift institutions.

Title VII establishes the Federal Housing Finance Board to take over the supervision of the Federal Home Loan Banks from the Federal Home Loan Bank Board. This title also amends the Federal Home Loan Bank Act to deny advances to institutions that are not members of a Federal Home Loan Bank and to extend eligibility for membership to any depository institution meeting certain requirements for involvement in residential mortgage lending. In addition, title VII amends the Federal Home Loan Mortgage Corporation Act to restructure the Federal Home Loan Mortgage Corporation and makes technical amendments to numerous other federal statutes.

Through amendments to the Bank Conservation Act, title VIII grants more clearly articulated powers to the Comptroller of the Currency to appoint a conservator or receiver for a national bank; the title also extends such powers over all other federally chartered or federally licensed depository institution subject to the Comptroller's supervision.

Title IX increases the civil and criminal sanctions available to federal agencies that regulate financial institutions and otherwise enhances the powers of the agencies to supervise and control depository institutions.

Title X orders studies of federal deposit insurance jointly by the regulatory agencies and separately by the General Accounting Office; it also orders the Federal Reserve Board to study banking services and the Comptroller of the Currency to study the safety and soundness of government-sponsored enterprises.

Title XI amends the Federal Financial Institutions Examination Council Act to establish an appraisal subcommittee with members from each of the regulatory agencies, including the Federal Reserve, to monitor and review state and federal standards for appraisals made in connection with federally related transactions. Title XI also requires each of the regulatory agencies and the RTC to develop certain minimum appraisal standards for use in connection with transactions by the institutions each oversees.

Title XII creates a Credit Standards Advisory Committee, to include the Chairman of the Federal Reserve Board or his designee, to recommend consistent credit standards to be employed by all insured depository institutions. The title also simplifies the examination ratings specified in the Community Reinvestment Act and requires that ratings of institutions be made available to the public. In addition, title XII contains provisions concerning a General Accounting Office study of the credit union system and compensation of employees of federal financial regulatory agencies.

Title XIII authorizes state housing finance agencies and nonprofit organizations to purchase mortgage-related assets from the RTC or from institutions under the conservatorship or receivership of the FDIC. The agencies must invest any profits from such purchases in low- and moderate-income housing.

Title XIV provides a tax exemption for RTC and Refcorp, contains provisions relating to the taxation of transactions involving federal financial assistance, and requires reports and studies from the Secretary of the Treasury.

The following summary describes in more detail portions of titles II, III, VI, and IX that have particular relevance to the Federal Reserve System and to the institutions it regulates.

Title II

Under title II, the FDIC will now insure the deposits of savings and loan associations as well as of banks. The title creates two separately maintained insurance funds within the FDIC: the Bank Insurance Fund (BIF), essentially a continuation of the FDIC's current insurance fund, and the Savings Association Insurance Fund (SAIF), which replaces the FSLIC insurance fund. All institutions previously insured by the FDIC and the FSLIC will automatically be insured by the new units. Under the new law, the FDIC may suspend the insurance of any insured depository institution on 30 days' notice rather than the 120 days' notice previously required, and under certain circumstances it may temporarily suspend the insurance of an institution. When evaluating an institution's application for insurance, the FDIC must consider certain financial criteria and may deny the application on the basis of those criteria.

Conversion Transactions

Title II places a five-year moratorium on the conversion of deposit coverage between BIF and SAIF. The FDIC may waive the moratorim period when (1) the conversion is in connection with the acquisition of a SAIF member in danger of default, if the FDIC and the RTC agree that the benefits to SAIF or the RTC exceed the loss of assessment income to SAIF, or (2) the conversion occurs in connection with the acquisition of a BIF member in danger of default, if the FDIC finds that the benefits to BIF outweigh the loss of assessment income to BIF, or (3) where the conversion does not involve a substantial portion of the institution's deposits. Savings associations may convert to bank charters but must remain members of SAIF for the duration of the moratorium.

Any depository institution participating in a conversion transaction must pay an exit fee (to be determined by the FDIC and Treasury jointly) and entrance fee (to be determined by the FDIC) to the appropriate funds.

A bank holding company may merge a savings association subsidiary into a subsidiary bank, subject to the approval of the Federal Reserve Board, but the bank must pay assessments to SAIF on deposits attributable to the savings association. In order to approve such a merger, the Federal Reserve must consider the size of the bank holding company in relation to the savings association, the nature of the transaction, and whether applicable capital standards are met. In addition, the thrift institution must be deemed a bank at the time of the merger for purposes of considering the interstate banking provisions of the Bank Holding Company Act and of relevant state law.

Cross-Guarantees

Depository institutions shall be held liable for any losses incurred by the FDIC because of the default of any commonly controlled depository institution or because of any assistance provided to such an institution in danger of default. The FDIC may waive this provision under certain circumstances, and the new law provides an exclusion for institutions acquired in debt-collection proceedings or in connection with certain FSLIC-assisted transactions.

The title clarifies and details the powers of the FDIC as conservator or receiver, including its powers to establish new or bridge banks, repudiate contracts, and transfer assets. The title also covers the requirements for establishing a valid claim against the FDIC as receiver or conservator as well as procedures for the determination and review of claims.

The title generally prohibits banking agencies, including the Federal Reserve Board, from allowing any insured depository institution under their supervision to include any unidentifiable intangible asset acquired after April 12, 1989, in capital for the purpose of compliance with capital standards.

Title III

Title III brings savings associations under the requirements of sections 23A and 23B of the Federal Reserve Act, which prohibit or restrict certain transactions between member banks and their affiliates, including loans to or purchases of securities issued by the affiliate. In addition to these restrictions, savings associations may not (1) extend credit to an affiliate unless the affiliate engages in activities permissible for a bank holding company, (2) purchase or invest in securities issued by an affiliate, or (3) engage in any affiliate transaction that the Director of OTS has chosen to restrict for reasons of safety and soundness.

Savings associations are also now required to comply with the restrictions contained in section 22(h) of the Federal Reserve Act governing extensions of credit to executive officers, directors, and principal shareholders.

Title VI

Title VI amends section 4 of the Bank Holding Company Act to allow the Board to approve acquisitions of savings associations by bank holding companies as an activity closely related to banking.

Companies holding nonbank banks grandfathered under the Competitive Equity Banking Act will be allowed to acquire, as a passive investment, up to 15 percent of the outstanding shares of nonaffiliated banks or savings associations. Such companies may also make passive investments subject to less stringent conditions in certain troubled savings associations or savings and loan holding companies.

Title IX

Title IX broadens the class of persons subject to enforcement orders by any federal financial regulatory agency. The class now extends beyond directors, officers, and employees to include any "institution-affiliated party:" agents, persons required to file change-in-control notices, controlling shareholders, shareholders that participate in the affairs of the institution, and under certain circumstances, independent contractors.

Cease and Desist Orders

Title IX clarifies the power of federal banking agencies to issue cease and desist orders that require affirmative action. The title declares that such orders can include reimbursement, restitution, recision, or other actions the agency may consider appropriate. Federal banking regulators may also place limits on the growth of an institution.

The title reduces the standard for issuing a temporary cease and desist order to a showing of a "significant" rather than a "substantial" dissipation of assets. The title also declares that a temporary corrective cease and desist order may be issued whenever an institution's records are so incomplete or inaccurate that determining the true financial condition of the institution is impossible.

Removal and Prohibition

Whenever a person's conduct causes harm to a financial institution or prejudices the interests of depositors, the federal agencies regulating financial institutions may initiate proceedings to remove that person from any institution with which he or she is affiliated or to prohibit that person from participating in the affairs of any insured depository institution; the agencies need not quantify the harm caused by the person in order to initiate such proceedings.

The title intends orders to remove a person or to prohibit participation to be effective industry-wide. Generally, any person under such an order is prohibited from participating in the affairs of any insured bank, savings association, credit union, bank holding company or its subsidiary, foreign bank or bank holding company, or farm credit institution, and of certain governmental institutions. The title allows agencies to begin enforcement proceedings against an individual up to six years after the person has ceased to participate in the affairs of an institution, and it raises the penalty for violations of removal orders to the level of a felony punishable with a fine of up to $1 million and a prison term of up to five years.

Civil Money Penalties

The title expands the grounds on which a federal bank regulatory agency may impose civil money penalties to include the submission of late, inaccurate, false, or misleading reports or other information and unsafe and unsound banking practices and, in certain cases, breaches of fiduciary duty. The civil money penalties that may be assessed have been arrayed in three tiers, to a maximum of $1 million per day for violations that knowingly or recklessly cause substantial loss to the financial institution.

Other Provisions

Under title IX, federal banking agencies must make all supervisory records of a depository institution available to the FDIC when it acts as receiver for that institution.

The agencies must publish all their formal enforcement orders, but they may delay publication for a reasonable time if public disclosure would seriously threaten the safety and soundness of an institution. In addition, the agencies must submit annual reports to the Congress concerning enforcement actions and other enforcement efforts made during the year.

Title IX gives the regulatory agencies the authority to disapprove the appointment of directors and senior executive officers for any depository institution or depository institution holding company that has been chartered or undergone a change of control within the last two years, or that is not in compliance within minimum capital standards, or that is otherwise in troubled condition.

The federal banking agencies are required to develop uniform rules and procedures for administrative hearings within two years of enactment of FIRREA and are required to establish a task force to report to Congress on the desirability of delegating investigatory and enforcement authority to regional offices or banks.

Insured depository institutions that engage outside auditors must give to the auditors copies of their most recent reports of condition and examination reports and information concerning enforcement actions.

No insured institution may discriminate against or discharge an employee for giving to a banking agency or federal law enforcement agency information concerning possible violations of law by the institution or by its officers, directors, or employees. The regulatory agencies may pay rewards for information that leads to the imposition of criminal fines, or to the restitution of funds, or to civil penalties exceeding $50,000.

Title IX amends the Right to Financial Privacy Act to specify that the exemption in the act allowing the disclosure of bank customer records to federal supervisory authorities is applicable when the Federal Reserve Board is exercising its supervisory and regulatory functions with respect to a bank holding company, to its subsidiary, or to any institution-affiliated party. The amendments also specify that the Board is exempt from the act when exercising its authority to extend credit. ■

Banking Supervision and Regulation

Substantial change occurred in the supervisory and regulatory structure of the banking industry in the United States in 1989. Major features were the passage of the Financial Institutions Reform, Recovery, and Enforcement Act (the savings and loan rescue bill); final approval of risk-based capital guidelines; new examination guidelines for highly leveraged transactions; and the approval of new powers for bank holding companies in the securities field.

To address serious and widespread problems in the nation's savings and loan industry, the Congress passed and the President signed the Financial Institutions Reform Recovery and Enforcement Act (FIRREA) in August 1989. FIRREA created the Resolution Trust Corporation (RTC), a government agency charged with the responsibility for resolving insolvencies of thrift institutions, and established arrangements for financing the RTC. FIRREA also created the RTC Oversight Board, a government agency that is ultimately responsible for the operations of the RTC. Chairman Greenspan serves as one of the cabinet-level members of the RTC Oversight Board. Other members include the Secretary of the Treasury, Nicholas F. Brady, who serves as Chairman; the Secretary of the Department of Housing and Urban Development, Jack Kemp; and two "public" members of the Board.

FIRREA also transferred responsibility for thrift deposit insurance from the Federal Savings and Loan Insurance Corporation to the Federal Deposit Insurance Corporation and transferred responsibility for the supervision of thrift institutions from the Federal Home Loan Banks to a new office in the Treasury Department, the Office of Thrift Supervision. The act also set down capital standards and other requirements for thrift institutions and enhanced the enforcement powers of the supervisors of federally insured depositories. Other important provisions of FIRREA include the establishment of a subcommittee of the Federal Financial Institutions Examination Council charged with responsibility for establishing appraisal standards and monitoring state licensing standards for appraisers and the requirement that various studies be conducted by federal agencies on such matters as federal deposit insurance and the need for capital requirements for government sponsored enterprises.

Before passage of FIRREA, a large number of insolvent thrift institutions, at the direction of the President, were placed in conservatorships under the control of the Federal Deposit Insurance Corporation. The Federal Reserve contributed several examiners to assist in assessing the condition of these thrift institutions before they were placed in conservatorships. The Federal Reserve also provided, on a temporary basis, substantial resources in the initial staffing of the RTC Oversight Board. Staff members of the Federal Reserve are also participating on various boards established by FIRREA and in various studies required by the act.

During 1989, the Federal Reserve took several important steps relating to capital standards for banks and bank holding companies. Early in the year, the Board issued final guidelines implementing the risk-based capital framework adopted in July 1988 by the Basle Committee on Banking Regulations and Supervisory

Practices, which includes supervisory authorities from twelve industrial countries. Known as the Basle Accord, the risk-based capital framework encourages international banking organizations to strengthen their capital positions and reduces a source of competitive inequality arising from differences in supervisory requirements among nations.

The U.S. guidelines implementing the Accord provide a uniform capital framework applicable to all federally supervised banking organizations. The framework sets forth a definition of capital that includes tier 1 (primarily common equity and qualifying perpetual preferred stock less goodwill) and total capital, which consists of tier 1 capital plus tier 2 capital (perpetual preferred stock not eligible to be included in tier 1, hybrid capital instruments, subordinated debt, limited-life preferred stock, and loan loss reserves up to specified limits).

The guidelines also include a framework for assigning assets to one of four broad categories based on credit risk. In addition to on-balance-sheet assets, the guidelines also take into account significant off-balance-sheet risk exposure.

The risk-based capital standards will be phased in through the end of 1992. By year-end 1990, banking organizations are expected to meet an interim target ratio of tier 1 capital to risk-weighted assets of 3.62 percent, and total capital to risk-weighted assets of 7.25 percent. At year-end 1992, these percentages rise to 4.0 percent and 8.0 percent respectively.

The Board also published for comment a proposed leverage standard for bank and bank holding company capital. This standard would supplement the risk-based capital framework, which does not at present incorporate a comprehensive measure of interest rate risk, by imposing an overall limitation on the extent to which a banking organization could leverage its equity capital base. The proposed standard, which would become effective on adoption, specifies a minimum ratio of tier 1 capital to total assets of 3 percent for organizations that have the highest supervisory rating and no plans to expand. Banks with lower ratings or plans to expand would be expected to have a ratio of at least 100 to 200 basis points above the minimum level. This same general stance will also apply to the risk-based capital standards.

Besides requesting comment on the leverage standard of 3 percent, the proposal also requests comment on a transition standard for risk-based capital under which a banking organization could choose to conform either to the existing minimum capital adequacy ratios (5.5 percent primary capital and 6 percent total capital to total assets) or to the year-end 1990 risk-based capital standard of 7.25 percent.

Early in the year, the Federal Reserve issued examination guidelines for highly leveraged transactions (HLTs). These guidelines, which supersede those issued in 1984, were issued because of the increasing volume of these types of transactions and their implications for the quality of bank asset portfolios and the overall level of the risk exposure of banks. The guidelines define HLTs to include leveraged buyouts (LBOs) and similar transactions, including mergers and acquisitions funded by debt that results in high leverage. "High leverage" was initially defined as a ratio of total debt to total assets of 75 percent or more. This definition was expanded in October 1989 when the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve agreed on a common definition for HLTs. As an alternative HLT leverage criterion, the transaction must, at least, double the subject company's liabilities and result in a leverage ratio higher than 50 percent. In addition, the transaction may be designated as an HLT by a syndication agent.

In another significant action in 1989, the Board permitted several bank holding companies, by order, to underwrite and deal, on a limited basis, in all types of corporate debt securities. The Board also indicated that early in 1990 it would review whether to authorize the companies to engage in underwriting and dealing in equity securities based on a determination by the Board that the companies have established the managerial and operational infrastructure necessary to exercise this authority. In granting its permission, the Board specified that these activities must be conducted in nonbank subsidiaries of the companies and that the subsidiaries must not engage principally in underwriting and dealing in so-called ineligible securities – securities that member banks may not underwrite or deal in under section 16 of the Glass–Steagall Act. The Board further specified, as it had previously in authorizing securities subsidiaries of bank holding companies to underwrite and deal in other ineligible securities, that the securities subsidiaries are to be subject to a framework of structural and operating limitations designed to insulate commercial bank affiliates of the companies from the risks associated with the activities of these subsidiaries and to avoid conflicts of interest and unfair competition.

In another international effort, the Federal Reserve, in conjunction with the Basle Committee on Bank Supervision, issued a Statement of Principles for financial institutions designed to assist in eliminating money laundering in the international banking system. Efforts continue in working with the Basle Committee toward exploring attitudes on further supervisory convergence on such issues as foreign exchange and interest rate risk. Members of the staff of the Federal Reserve worked closely with enforcement authorities during the year to resolve several problem situations arising from the activities of branches, agencies, representative offices, and Edge corporations of foreign banks in the United States.

Also, staff members of the Division of Banking Supervision and Regulation provided technical assistance to other agencies throughout the year in selecting appropriate owners for failing institutions. Through this process, the agencies attempt to select bidders that will provide optimal financial and managerial resources to the successor at the least cost to the insurance funds.

Scope of Supervisory and Regulatory Responsibilities

The Federal Reserve is the primary federal supervisor and regulator of state chartered commercial banks that are members of the Federal Reserve System and of all U.S. bank holding companies. A principal concern of the Federal Reserve in its supervision of the general operations of these organizations is to promote their safety and soundness and their compliance with laws and regulations, including the Bank Secrecy Act and consumer and civil rights laws.[1] The following specialized activities of these institutions are also reviewed: electronic

1. The Board's Division of Consumer and Community Affairs is charged with the responsibility of coordinating the Federal Reserve's supervisory activities with regard to the compliance of banking organizations with consumer and civil rights laws. This supervision is accomplished mainly through examination by specially trained Reserve Bank examiners. These regulatory responsibilities are described in the section of this Report covering consumer and community affairs. Compliance with other statutes and regulations, which is treated in this section, is the responsibility of the Board's Division of Banking Supervision and Regulation and of the Reserve Banks, whose examiners check for safety and soundness.

data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing and clearing, and securities underwriting and dealing through Section 20 securities subsidiaries.

The Federal Reserve also has responsibility for the supervision of (1) all Edge and agreement corporations (organizations chartered by the Federal Reserve Board to provide all segments of the U.S. economy with a means of financing international trade, especially exporting); (2) the international operations of state member banks and U.S. bank holding companies; and (3) the operations of foreign banking companies in the United States.

Through its administration of the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act for bank holding companies and state member banks, the Federal Reserve also exercises important regulatory influence over the structure of the U.S. banking system. The Federal Reserve is also responsible for regulatory margin requirements on securities transactions.

Supervision for Safety and Soundness

The Federal Reserve conducts the following activities to ensure the safety and soundness of financial institutions: on-site examinations and inspections, surveillance and monitoring, and enforcement and other supervisory actions.

Examinations and Inspections

The on-site review of operations is an integral part of ensuring the safety and soundness of financial institutions. Examinations of state member banks and Edge corporations and inspections of bank holding companies and their subsidiaries entail (1) an appraisal of the quality of the institution's assets; (2) an evaluation of management, including internal policies, operations, and procedures; (3) an assessment of the key financial factors of capital, earnings, asset and liability management, and liquidity; and (4) a review for compliance with applicable laws and regulations.

State Member Banks

At the end of 1989 there were 1,047 state member banks. These banks represented about 8 percent of all insured commercial banks and accounted for about 17 percent of their assets.

The Federal Reserve in 1986 increased the frequency of scheduled examinations of state member banks. The guidelines call for state member banks to be examined at least annually either by a Reserve Bank or by a state banking agency. Large or troubled banks must be examined at least annually by a Reserve Bank. Because of the reassignment of examiners to thrift industry problems in 1989, the examinations of several healthy, well-managed banks were deferred into 1990. In 1989, 1,029 state member banks were examined at least once either by the Federal Reserve or by a state banking agency. Altogether, the Federal Reserve conducted 836 examinations, some of them jointly with the state agencies. The state agencies conducted 300 independent examinations of state member banks. Additionally, under policy guidelines, Reserve Bank officials held 293 meetings with directors of either the largest state member banks, or those that displayed significant weaknesses.

Bank Holding Companies

At year-end 1989 the number of bank holding companies totaled 6,444, 30 fewer than in 1988. These organizations control 8,846 commercial banks, which hold approximately 92 percent of the assets of all insured commercial banks in the United States.

Large bank holding companies and smaller companies with significant nonbank assets are to be inspected annually under the revised guidelines on frequency and scope. Medium-sized companies are inspected at least every three years. For the smallest companies without nonbank assets, inspections are conducted on a sample basis. The inspection focuses on the operations of the parent holding company and its nonbank subsidiaries. In judging the condition of bank subsidiaries, the examination reports of the federal and state banking authorities that have primary responsibility for their supervision are consulted. Of the 2,247 inspections conducted in 1989, System examiners made 2,182 on-site inspections and 169 off-site inspections. State examiners inspected sixty-five bank holding companies, sixteen more than in 1988. Because members of the examining staff were detailed to working with thrift industry problems in 1989, fifty-eight bank holding company inspections were deferred until 1990. During 1989, Reserve Bank officials held 540 meetings with bank holding company directorates to discuss supervisory concerns.

Enforcement Actions and Civil Money Penalties

In 1989, the Reserve Banks recommended, and the Board's staff initiated and worked on, one hundred twenty-five enforcement cases that involved two hundred seventy-nine separate actions such as cease-and-desist orders, removals, and prohibitions and civil money penalties, most dealing with unsafe or unsound banking practices and violations of law. Of these, twenty-four cases involving forty-two actions were completed by year-end. The Board completed eight civil money penalty actions and assessed a total of $3,340,000. By year-end 1989, the Board had collected $2,240,000, with most of the remainder of the assessments to be paid in accordance with agreed-upon schedules. A description of all formal supervisory actions undertaken during the year and the reasons for them are available to the public in the Board's twice-yearly "Report on Formal Enforcement Actions." In addition, in accordance with a provision of FIRREA, all final enforcement orders issued by the Board of Governors are available to the public.

Specialized Examinations

The Federal Reserve conducts specialized examinations in the following areas of bank activity: electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing and clearing, and securities underwriting and dealing through section 20 securities subsidiaries.

Electronic Data Processing

Under the Interagency EDP Examination Program, the Federal Reserve examines the electronic data processing (EDP) activities of state member banks, Edge and agreement corporations, and independent centers that provide EDP services to these institutions. In 1989, System examiners conducted 286 on-site EDP reviews. In addition, the Federal Reserve reviews reports of EDP examinations issued by other bank regulatory agencies on organizations that provide data processing services to state member banks.

Fiduciary Activities

The Federal Reserve System has supervisory responsibility for 292 state-chartered member banks that exercise trust powers and 179 trust companies and investment advisory companies that are subsidiaries of bank holding companies. These institutions hold more than $3 trillion of discretionary and nondiscretionary assets in various fiduciary capacities.

During 1989, Federal Reserve System examiners conducted trust examinations of 165 state member banks and state member trust companies and 31 inspections of bank holding company subsidiaries engaged in fiduciary activities. The institutions examined in 1989 held approximately $2 trillion in fiduciary assets.

On-site examinations are essential to ensure the safety and soundness of financial institutions that engage in fiduciary operations. The scope of these examinations includes (1) an evaluation of management, policies, audit procedures, and risk management; (2) an appraisal of the quality of trust assets; (3) an assessment of earnings; (4) a review for conflicts of interest; and (5) a review for compliance with laws, regulations, and general fiduciary principles.

Government Securities Dealers and Brokers

Under the Government Securities Act of 1986, the Board is responsible for examining the activities of state member banks and some foreign banks that are government securities dealers and brokers for compliance with the act and with the Treasury Department's regulations. Forty-three state member banks, three state branches of foreign banks, and one state agency of a foreign bank currently have on file with the Board notices that they are government securities dealers or brokers that are not otherwise exempt from Treasury Department regulations.

Municipal Securities Dealers and Clearing Agencies

The Securities Act Amendments of 1975 made the Board responsible for supervising state member banks and bank holding companies that act as municipal securities dealers or as clearing agencies. In 1989 the Board examined twenty-one state member banks that deal in municipal securities. There are currently forty-six such banks registered with the Board. A clearing agency acts as a custodian of securities involved in transactions settled by bookkeeping entries. The four agencies registered with the Board were examined in 1989.

Securities Subsidiaries of Bank Holding Companies

Section 20 of the Banking Act of 1933, commonly known as the Glass–Steagall Act, prohibits the affiliation of a member bank with a company that is "engaged principally" in underwriting or dealing in securities. The Board, in 1987, approved proposals by banking organizations to underwrite and deal, on a limited basis, in specified classes of bank "ineligible" securities (that is, commercial paper, municipal revenue bonds, conventional residential mortgage-related securities, and securitized consumer loans) in a manner consistent with the Glass–Steagall Act and the Bank Holding Company Act. At that time, the Board limited revenues from these newly approved activities to no more than 5 percent of total revenues for each securities subsidiary. In January 1989, the Board approved applications by five bank holding companies to underwrite and deal in corporate and sovereign debt and equity securities, in each case subject to managerial and operational infrastructure reviews and other conditions and requirements specified by the Board. Four of these organizations subsequently received authorization to underwrite and deal in corporate and sovereign debt securities. In September 1989, the Board increased the revenue limit of 5 percent previously imposed to 10 percent. Currently, twenty-two bank holding companies have section 20 subsidiaries that have received authority to underwrite and deal in "ineligible" securities. Specialized inspection procedures are being developed for use in reviewing the operations of these securities subsidiaries.

Transfer Agents

Federal Reserve System examiners conduct separate reviews of state member banks and bank holding companies that act as transfer agents. Transfer agents countersign and monitor the issuance of securities, register their transfer, and exchange or convert them. During 1989, System examiners conducted examinations of 92 of the 165 banks and bank holding companies registered as transfer agents with the Board.

Surveillance and Monitoring

The Federal Reserve monitors the financial condition of the state member banks and bank holding companies on a quarterly basis. This surveillance program supplements the Federal Reserve's on-site examination program with automated screening systems that identify organizations with poor or deteriorating financial profiles. These automated systems use financial statements submitted by the banking organizations and compute numerous financial ratios, which are then analyzed by the staff members of the Division and of the Reserve Banks to determine whether the organizations have potential emerging problems that require the commitment of examiner resources for on-site examinations or other appropriate supervisory responses.

International Activities

The Federal Reserve is responsible for supervising several international activities.

Edge and Agreement Corporations

Edge corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international trade, especially exports. An agreement corporation is a company that enters into an agreement with the Board not to exercise any power that is impermissible for an Edge corporation. In 1989 the Federal Reserve examined 110 Edge and agreement corporations.

Foreign-Office Operations of U.S. Banking Organizations

The Federal Reserve examines the international operations of state member banks, Edge corporations, and bank holding companies principally at their head offices in the United States because these offices have the ultimate responsibility for all their operations. Also, the Federal Reserve conducts on-site reviews of important foreign offices at least every three years to supplement the results of the examinations of head offices. In 1989, the Federal Reserve examined seventeen foreign branches of state member banks and thirty-six foreign subsidiaries of Edge corporations and bank holding companies. In 1989 the Federal Reserve, in coordination with the Office of the Comptroller of the Currency, conducted extensive on-site examinations of merchant banking activities of U.S. banking organizations in the United Kingdom and in Australia. All the examinations abroad were conducted with the cooperation of the supervisory authorities of the countries in which the examinations took place.

U.S. Activities of Foreign Banks

Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 1989, two hundred sixty-three foreign banks operated four hundred seventy-nine state-licensed branches and agencies, of which fifty-nine are insured by the Federal Deposit Insurance Corporation. At year-end these foreign banks also operated eighty-six branches and agencies licensed by the Office of the Comptroller of the Currency, of which nine have FDIC insurance. Foreign banks also directly owned sixteen Edge corporations and ten commercial lending companies. In addition, foreign banks held a 25 percent or more interest in one hundred and one U.S. commercial banks. Together, these foreign banks at year-end controlled approximately 22 percent of U.S. banking assets.

The Federal Reserve has broad authority to supervise and regulate foreign banks that engage in banking in the United States through branches, agencies, commercial lending companies, Edge corporations, or banks. In exercising this authority, the Federal Reserve relies on examinations conducted by the appropriate federal or state regulatory agency. Although states have primary authority for examining state-licensed uninsured branches and agencies, the Federal Reserve participated in the examination of 169 such offices during the past year.

Supervisory Policy

The following sections summarize the principal aspects of changes in supervisory policy. Additionally, these sections review activities carried out during the year to enhance the supervisory program.

FIRREA

Several provisions of FIRREA require the Federal Reserve to initiate actions or draft regulations to implement the law's requirements. Some of the more important provisions in FIRREA that affect the Federal Reserve are the following:

- Permitting bank holding companies to acquire healthy thrift institutions
- Requiring the federal banking agencies to establish, within one year, uniform accounting and capital standards
- Requiring the federal banking agencies to prescribe standards for real estate appraisals used in federally related transactions
- Removing tandem restrictions on the operations of bank holding companies and thrift institutions.

Members of the staff of the Federal Reserve have begun work to comply with FIRREA and will continue to work toward its successful implementation for several years. This process will include providing staff members to certain subcommittees, such as the newly established subcommittee of the FFIEC concerning the establishment of real estate appraisal standards.[2]

Highly Leveraged Transactions

As noted earlier, in 1989 the Board issued examination guidelines for highly leveraged transactions (HLTs). Besides specifying criteria for defining HLTs, the guidelines outline procedures to be followed by a banking organization's management and by bank examiners in assess-

2. The FFIEC consists of representatives from the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

ing the effect of such transactions on the condition of an organization. In general, banking organizations are expected to evaluate the adequacy and stability of the borrower's current and prospective cash flow under varying economic scenarios through the following actions:

- Setting reasonable "in-house" limits on a consolidated holding company basis regarding exposure to individual borrowers, total exposure to all HLT borrowers, and industry concentrations resulting from HLTs
- Establishing procedures for credit analysis, approval, and review that take into account the high levels of debt involved in these transactions
- Maintaining internal systems, controls, reporting procedures, and limits
- Establishing pricing policies and practices that take account in a prudent manner of the trade-off between risk and return
- Avoiding any compromise of sound banking practices in an effort to broaden market share or to realize substantial fees.

Examiners are responsible for reviewing the organization's operations to ensure that the foregoing policies and procedures are in place.

Asset Securitization

A Federal Reserve System Task Force was convened during 1989 to study the issue of asset securitization, an increasingly popular financial tool involving the issuance of securities by banking organizations as claims against a pool of assets held in trust. In general, the Task Force believed that supervisory efforts should continue to be left to the discretion of examiners; however, it also concluded that particular aspects of the securitization process and the market need closer scrutiny. The Task Force issued a three-volume report that includes background and educational materials, accounting standards, and examination guidelines. The report, as stated in the introduction, focused on the aspects of securitization "indigenous to all types of securitized assets—the motivations for the selling of assets, the mechanics generally employed in or associated with the process, and the potential risks and rewards of both issuing and investing in asset-backed securities."

Problem Loans in Agriculture

The policy of forbearance introduced by the federal banking agencies in 1986 for banks with problem loans in the agriculture and energy sectors was continued in 1989. This policy calls for the Reserve Banks to exercise appropriate forbearance in applying capital adequacy guidelines for banks that are essentially sound and well managed if they demonstrate a clear potential for restoring their capital position over a reasonable period. At year-end 1989, three state member banks were under the capital forbearance program.

The Competitive Equality Banking Act of 1987 required the federal banking agencies to issue regulations permitting agricultural banks with assets of less than $100 million to amortize losses on agricultural loans and related real or personal property over a period not to exceed seven years. Banks seeking to amortize losses on qualified agricultural loans must apply to their Reserve Bank for acceptance into the program, must have capital in need of restoration, and must have reasonable procedures for restoring capital to acceptable levels. At year-end 1989, four state member banks were under the loan loss amortization program.

Accounting Standards and Regulatory Reporting

The Board and the FFIEC are continuing to work on eliminating, to the extent possible, differences between regulatory reporting requirements and generally accepted accounting principles (GAAP). In 1989, a policy was adopted for regulatory reporting standards for push down accounting that is consistent among federal banking agencies and with GAAP. Also, for Call Report purposes, Financial Accounting Standards Board (FASB) Statement No. 96, which addresses accounting for income taxes, was accepted, and guidance for banking organizations in implementing this accounting standard is being developed. Progress also was made toward the adoption of a regulatory reporting standard on futures contracts that is consistent with GAAP.

Members of the Board's staff have served on various committees of the FASB as advisors to that group's projects on financial instruments and consolidations. Board staff members also provide commentary on proposals issued by FASB and by the American Institute of Certified Public Accountants that affect banking organizations.

Staff Training

The training of System staff members emphasizes analytical and supervisory themes common to the four areas of supervision and regulation—examinations, inspections, applications, and surveillance—and stresses the interdependence among these areas.

During 1989, the Federal Reserve conducted fifty-eight sessions of a variety of schools: Twenty-four were held in Washington, while thirty-four sessions were held regionally. Core banking courses included three sessions of an introductory course, Banking I; four sessions of an intermediate-level course, Banking II (two held regionally); and four of an advanced-level course, Banking III (one held regionally); each course lasted three weeks. Two sessions of a Senior Forum for Current Banking and Regulatory Issues were also conducted. The Senior Forum, an interactive seminar designed for commissioned examiners with at least five years' experience, is the foundation for a continuing education program for senior examiners and other senior personnel assigned to System supervision and regulation functions. Other schools conducted included seventeen sessions of Effective Writing for Banking Supervision Staff (fifteen held regionally), ten sessions of a credit analysis course (seven held regionally), two sessions of a bank holding company applications school, ten sessions of a bank holding company inspection school (nine held regionally), one basic trust and one advanced trust school, and three consumer compliance schools (one session of an introductory course and two sessions of an advanced course). Also, staff members attended four schools conducted jointly by a financial institutions regulator and the Federal Bureau of Investigation on bank fraud and bank failures.

In 1989, System staff members participated in eighty-five sessions of courses offered by the Federal Financial Institutions Examination Council (FFIEC) in specialized areas of income property lending, payment systems risk, white-collar crime, international banking, trust issues, off-balance-sheet risks, EDP technology, management training, conducting meetings with management, and instructor training.

System staff members also participated in ten sessions of training programs conducted by the FDIC and OCC in the specialized areas of activities of municipal securities dealers, electronic data processing, and foreign exchange activities.

During 1989, the Federal Reserve co-sponsored with the World Bank two training sessions for senior supervisors from developing nations. Seventy-eight representatives from twenty-five countries attended these programs.

Also, the Federal Reserve System provided scholarship assistance to the states for the training of their examiners in Federal Reserve and FFIEC schools. Through this program, 468 state examiners were trained: 232 in Federal Reserve courses, 235 in FFIEC programs, and 1 in an FDIC course.

In 1989, the Federal Reserve trained 1,218 persons in System schools, 773 in FFIEC schools and 49 in FDIC and OCC schools, for a total of 2,040 students, including 125 representatives from foreign central banks.

Federal Financial Institutions Examination Council

During 1989 the Federal Reserve adopted several policies recommended by the FFIEC. The Board joined the other constituent agencies of the FFIEC in approving a revision to the Monthly Report on Foreign Exchange Transactions (FFIEC 035) to collect data on various financial products, such as currency options, swaps, and futures.

In connection with the risk-based capital framework, the banking agencies developed changes to the FFIEC Call Report, which have been submitted to the Office of Management and Budget for final approval. Implementation of these changes is planned for March 1990 and will include a schedule of risk-based capital information, as will the revised schedule of off-balance-sheet transactions and positions (Schedule RC-L).

Finally, the FFIEC began a study on recourse arrangements, including the question of what constitutes a sale of assets without recourse and the appropriate accounting treatment for such sales. This study will continue into 1990. It is expected that an advance notice of proposed rulemaking will be published in the first quarter of 1990.

Regulation of the U.S. Banking Structure

The Board administers the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act for bank holding companies and state member banks. In doing so, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of U.S. banking at the local, regional, and national levels. The Board also has primary responsibility for regulating the international operations of domestic banking organizations and the overall U.S. banking operations of foreign banks, whether conducted directly through a branch or agency or indirectly through a subsidiary commercial bank or Edge corporation. In addition, the Board has established regulations that limit the interstate banking activities of these foreign banks and of foreign banks that control a U.S. subsidiary commercial bank.

Bank Holding Company Act

By law, a company must obtain the Board's approval to form a bank holding company by acquiring control of one or more banks. Moreover, once formed, a bank holding company must receive the Board's approval before acquiring additional banks or nonbanking companies.

In reviewing an application filed by a bank holding company, the Board considers factors relating to the financial and managerial resources and prospects of the applicant and the firm to be acquired, the convenience and needs of the community or the public benefits, and the competitive effects of the proposal.

In 1989 the Federal Reserve acted on 1,137 bank holding company and related applications. The System approved 336 proposals to organize bank holding companies and denied 2; approved 266 bank acquisitions by existing bank holding companies and denied 1; approved 63 bank holding company merger applications and denied 1; approved 447 requests by existing companies to acquire nonbank firms engaged in activities closely related to banking; and approved 21 other applications relating to bank service corporations and modifications of commitments. Data on these and related bank holding company decisions are shown in the accompanying table.

Bank Merger Act

The Bank Merger Act requires that all proposed mergers of insured depository institutions be acted upon by the appropriate federal banking agency. If the institution surviving the merger is a state member bank, the Federal Reserve has primary jurisdiction. Before acting on a proposed merger, the Federal Reserve considers factors relating to the financial and managerial resources and prospects of the existing and proposed institutions, the community's convenience and needs, and the competitive effects of the proposal. The Board must also consider the views of certain other agencies on the competitive factors involved in the transaction.

During 1989 the Federal Reserve System approved ninety-two merger applications. As required by law, each merger is described in this Report (in table 16 of the Statistical Tables section).

When the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Director of the

Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1989

Proposal	Direct action by the Board of Governors		Action under authority delegated by the Board of Governors					Total
			Staff Director of Division of Banking Supervision and Regulation		Office of the Secretary	Federal Reserve Banks		
	Approved	Denied	Approved	Denied	Approved	Approved	Permitted	
Formation of holding company	20	2	2[1]	0	3	311	0	338
Merger of holding company	10	1	0	0	2	51	0	64
Retention of bank	0	0	0	0	0	0	0	0
Acquisition								
Bank	25	1	3[1]	0	14	224	0	267
Nonbank	117	0	4[2]	0	14	123	189	447
Bank service corporation	1	0	0	0	0	0	1	2
Other	3	0	14	2	0	0	0	19
Total	**176**	**4**	**23**	**2**	**33**	**709**	**190**	**1,137**

1. These actions were specifically delegated by the Board to the Staff Director of the Division of Banking Supervision and Regulation and to the General Counsel of the Board for joint action.

2. Each of these actions represented the acquisition of a savings association that was subsequently merged into an existing subsidiary of a bank holding company, as permitted by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Office of Thrift Supervision has jurisdiction over a merger, the Board is asked to comment on the competitive factors to assure comparable enforcement of the antitrust provisions of the act. The Board and these agencies have adopted standard terminology for assessing competitive factors in merger cases to assure consistency in administering the act. On behalf of the Board, the Reserve Banks submitted 480 reports on competitive factors to the other federal banking agencies in 1989.

Change in Bank Control Act

The Change in Bank Control Act requires persons seeking control of a bank or of a bank holding company to obtain approval from the appropriate federal banking agency before the transaction occurs. Under the act, the Board is responsible for reviewing changes in the control of state member banks and of bank holding companies. In so doing, it must review in part the financial condition, competence, experience, and integrity of the acquiring person; also it must consider the effect on the financial condition of the bank or bank holding company to be acquired; and it must determine the effect on competition in any relevant market.

The appropriate federal banking agencies are required to publish notice of each proposed change in control and to invite public comment, particularly from persons located in the markets served by the institution to be acquired. The federal banking agencies are also required to assess the qualifications of each person seeking control; the Board routinely makes such a determination and verifies information contained in the proposal. In 1989 the Federal Reserve System acted on 250 proposed changes in control of state member banks and bank holding companies.

Public Notice of Board Decisions

Each decision by the Board that involves a bank holding company, bank merger, change in control, or international banking proposal is effected by an order or announcement. Orders state the decision along with the essential facts of the application and the basis for the decision; announcements state only the decision. All orders and announcements are released immediately to the public; they are also reported in the Board's weekly H.2 statistical release and in the monthly *Federal Reserve Bulletin*. The H.2 release also contains announcements of applications and notices that have been received by the System but not yet acted on.

Timely Processing of Applications

The Federal Reserve maintains target dates and procedures for the processing of applications. This practice promotes efficiency at the Board and at the Reserve Banks and reduces the burden on applicants. The time allowed for a decision is sixty days; during 1989, about 95 percent of the decisions met this standard.

Delegation of Applications

The Board has delegated certain regulatory functions—including the authority to approve, but not to deny, certain types of applications—to the Reserve Banks, to the Staff Director of the Board's Division of Banking Supervision and Regulation, and to the Secretary of the Board. The delegation of responsibility for applications permits greater efficiency by removing routine cases from the Board's agenda. During 1989, 90 percent of the applications were acted on under delegated authority.

Board Policy Decisions and Developments in Bank-Related Activities

In 1989, the Board amended its rules to permit bank holding companies to acquire healthy, as well as failed or failing, savings associations. The Board also approved several new financially related nonbanking activities for individual bank holding companies and had under consideration other nonbanking proposals.

Approval of Permissible Nonbanking Activities

In adopting its rule enabling the acquisition of savings associations, the Board expanded the scope of previous actions in which it had allowed individual bank holding companies to acquire failed or failing thrift institutions and certain healthy savings institutions in parts of New England. The Board's action broadened its rules to allow bank holding companies in general to acquire savings associations—regardless of their financial condition or location—subject to a case-by-case evaluation of the competitive, financial, and public interest considerations of each proposal. The Board also rescinded certain operating limitations between bank holding companies and their thrift subsidiaries.

The Board for the first time also approved the following activities for individual bank holding companies: (1) underwriting and dealing in, on a limited basis, corporate debt and equity securities; and (2) engaging in the private placement of all types of securities and in "riskless principal" transactions. The Board's actions contained several conditions aimed at avoiding conflicts of interest and other potential adverse effects and at ensuring the maintenance of safe and sound operations. The Board also deferred the effective date of the equity underwriting authority for one year to determine whether the proper managerial and operational infrastructures were in place.

During 1989 the Board also increased from 5 to 10 percent the amount of gross revenues of a bank holding company's underwriting subsidiary that may be derived from securities that member banks are prohibited from underwriting and dealing in under the Glass–Steagall Act. In addition, in early 1990, the Board approved, subject to many of the same limitations, the applications by three foreign banks to underwrite and deal in corporate debt and equity securities in the United States.

The Board for the first time also approved the following activities for individual bank holding companies: (1) acting as a specialist in certain foreign exchange options on a U.S. exchange and (2) acting as an originator and principal in interest rate swap and currency swap transactions and also for certain swap derivative products.

Proposals to Engage in New Nonbanking Activities

At year-end 1989, the Board was considering a proposal by a U.S. bank holding company to engage in leasing transactions in a manner consistent with expanded national bank leasing powers authorized by the Competitive Equality Banking Act of 1987. The Board was also considering proposals by several foreign banks to engage in the private placement of all types of securities.

Two rulemakings pertaining to bank-related activities were pending at year-end 1989. One was a proposal to rescind an existing rule that permits bank holding companies to establish or acquire indirectly, through their state-chartered bank subsidiaries, nonbank operations subsidiaries engaged in activities that may be conducted by the parent bank. If adopted, this proposal would require bank holding companies to obtain approval to acquire or to retain control of such nonbank operations subsidiaries. The Board had also requested comment on a proposal to permit retention of all or most existing operations subsidiaries without further action. The other proposed rulemaking would permit bank holding companies to engage in real estate investment activities within certain limitations.

Applications by State Member Banks

State member banks must obtain the permission of the Board to open new domestic branches, to make investments in bank premises that exceed 100 percent of capital stock, and to add to their capital bases from sales of subordinated debt. State member banks must also give six months' notice of their intention to withdraw from membership in the Federal Reserve System, although the Board may shorten or eliminate the notice period in specific cases. These matters are normally handled by the Federal Reserve Banks under delegated authority or, in the case of certain investments in bank premises or proposed sales of subordinated debt, by the Staff Director of the Board's Division of Banking Supervision and Regulation.

Stock Repurchases by Bank Holding Companies

A bank holding company sometimes purchases its own shares from its shareholders. When the company borrows the money to buy the shares, the transaction increases the debt of the bank holding company and simultaneously decreases its equity. Relatively larger purchases may undermine the financial condition of a bank holding company and its bank subsidiaries. The Board's regulations require holding companies to give advance notice of repurchases that retire 10 percent or more of their consolidated equity capital. The Board may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital guidelines. During 1989 the Federal Reserve reviewed 111 proposed stock repurchases by bank holding companies, all of which were acted on by the Reserve Banks on behalf of the Board.

International Activities of U.S. Banking Organizations

The Board has several statutory responsibilities in supervising the international operations of U.S. banking organizations. The Board must provide authorization and regulation of foreign branches of member banks; of overseas investments by member banks, Edge corporations, and bank holding companies; and of investments by bank holding companies in export trading companies. The Board is also required to charter and regulate Edge corporations and their investments.

Foreign Branches of Member Banks

Under provisions of the Federal Reserve Act and of Regulation K, member banks in most cases must seek Board approval to establish branches in foreign countries. In reviewing proposed foreign branches, the Board considers the requirements of the law, the condition of the bank, and the bank's experience in international business. In 1989 the Board approved the opening of ten foreign branches.

By the end of 1989, 133 member banks were operating 845 branches in foreign countries and overseas areas of the United States; 105 national banks were operating 724 of these branches, and 28 state member banks were operating the remaining 121 branches.

International Banking Facilities

The Board amended its Regulations D and Q to permit the establishment of international banking facilities (IBFs) in the United States as of December 3, 1981. An IBF is essentially a set of asset and liability accounts that is segregated from the accounts of the office establishing the IBF. Deposits from, and credits extended to, foreign residents or other IBFs generally can be booked at these facilities free from domestic reserve requirements and interest rate limitations. Subject to conditions specified by the Board, IBFs may be established by U.S. depository institutions, by Edge and agreement corporations, and by U.S. branches and agencies of foreign banks. By the end of 1989, 533 IBFs had been established.

Edge and Agreement Corporations

Under sections 25 and 25(a) of the Federal Reserve Act, Edge and agreement corporations may engage in international banking and foreign financial transactions. These corporations, which are usually subsidiaries of member banks, provide their owner organizations with the following powers: (1) They may conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions; and (2) their powers to make foreign investments are broader than those of member banks because they can invest in foreign financial organizations, such as finance companies and leasing companies, as well as in foreign banks. By the end of 1989, there were 110 Edge corporations, which had 47 branches. The Board requires each Edge corporation that is engaged in banking to maintain a ratio of equity to risk-adjusted assets of at least 7 percent.

Foreign Investments

Under authority of the Federal Reserve Act and the Bank Holding Company Act, U.S. banking organizations may engage in activities overseas with the authorization of the Board. To a significant extent, the Board's Regulation K permits such investments without prior Board review. In 1989 the Board reviewed and permitted forty foreign investments by member banks, Edge and agreement corporations, and bank holding companies. In most cases, the applicant requested permission to increase an existing investment.

Export Trading Companies

In 1982 the Bank Export Services Act amended Section 4 of the Bank Holding Company Act to permit bank holding companies, their subsidiary Edge or agreement corporations, and bankers' banks to invest in export trading companies, subject to certain limitations and after Board review. The purpose was to allow effective participation by bank holding companies in the financing and development of export trading companies. The Export Trading Company Act Amendments of 1988 provide additional flexibility for bank holding companies engaging in export trading company activities. Since 1982 the Board has acted affirmatively on notifications by forty-seven bank holding companies to establish export trading companies.

Enforcement of Other Laws and Regulations

This section describes the Board's responsibilities for the enforcement of laws, rules, and regulations other than those specifically related to bank safety and soundness and the integrity of the banking structure.

Bank Secrecy Act

The Federal Reserve is responsible for monitoring compliance with the requirements of the Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act) by institutions it supervises. The provisions of the Bank Secrecy Act were designed to create records of various transactions as an aid in detecting unlawful activity. The most important among these recordkeeping and reporting requirements is the filing of Currency Transaction Reports with the Internal Revenue Service for each transaction of cash in excess of $10,000.

During 1989, the Federal Reserve continued its efforts to promote compliance with the Bank Secrecy Act. In addition to continual Bank Secrecy Act compliance audits and the issuance of several forward enforcement orders addressing violations of the act, the Federal Reserve provides a quarterly report to the Department of the Treasury that details all violations of the Bank Secrecy Act discovered during the examinations of financial institutions under Federal Reserve supervision. Also, the Federal Reserve created a new position for an attorney with expertise in the Bank Secrecy Act and the investigation and prosecution of offenses related to the act. This individual will provide expertise in such areas as examinations and enforcement actions under the Bank Secrecy Act and will coordinate the Federal Reserve's efforts in this area with those of other federal agencies.

The Federal Reserve has supported new regulations as promulgated by the Department of the Treasury that create recordkeeping requirements by financial institutions for the purchase of monetary instruments in excess of $3,000 and allow for the Secretary of the Treasury to lower the Currency Transaction Report threshold in a defined geographic area. Similarly, the Federal Reserve offered its assistance to the Treasury Department in developing recordkeeping requirements for wire transfers.

Securities Regulation

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchase or carrying of securities. In fulfilling its responsibility under the act, the Board limits the amount of credit that may be provided by securities brokers and dealers (Regulation T), by banks (Regulation U), and by other lenders (Regulation G). Regulation X extends these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Several regulatory agencies enforce compliance with the securities credit regulations. Brokers and dealers are examined for compliance with Regulation T by the Securities and Exchange Commission, the National Association of Securities Dealers, and the national securities exchanges. The federal banking agencies examine banks under their respective jurisdictions for compliance with Regulation U. Other lenders are examined for compliance with Regulation G by the Board, the National Credit Union Administration, the Farm Credit Administration, or the Office of Thrift Supervision, according to the jurisdiction involved. At the end of 1989, there were 589 "G-lenders," of which 321 were subject to the Board's supervision. Of these 321, 188 were subject to regular inspection by the Federal Reserve System. During the year, Federal Reserve examiners inspected 36 G-lenders for compliance with the Federal Reserve's margin requirements (these lenders are inspected on either a biennial or triennial basis, according to the type of credit extended).

Regulations G and U, in general, impose credit limits on loans whose purpose is the purchasing or carrying of publicly held equity securities and that are collateralized by such securities. Regulation T limits the amount of credit that brokers and dealers may extend when securities serve as collateral for credit that is used to purchase or carry securities. This collateral must consist of stocks and bonds traded on national securities exchanges, of certain over-the-counter (OTC) stocks that the Board designates as having characteristics similar to those of stocks listed on national exchanges, or of bonds meeting certain requirements.

The staff of the Federal Reserve monitors the market activity of all OTC stocks to determine which of them are subject to the Board's margin regulations. The Board publishes the resulting "List of Marginable OTC Stocks" quarterly. In 1989, the list was revised in February, May, August, and November. The November list contained 2,893 stocks.

In the fall of 1989, the Board proposed for public comment amendments to Regulation T to accommodate the increasing international integration of the securities markets. The amendments would (1) permit certain foreign equity and debt securities to be eligible for margin at broker–dealers on the same basis as domestic margin securities; (2) eliminate the current requirement that all accounting be in U.S. dollars; (3) ease restrictions on payment for foreign securities to accommodate the settlement practices of the market where the trade occurs; and (4) allow a broker–dealer subject to Regulation T to arrange for credit on foreign securities. Final Board action is expected in 1990.

Under section 8 of the Securities Exchange Act, a nonmember domestic or foreign bank may lend to brokers or dealers posting registered securities as collateral only if the bank has filed an agreement with the Board that it will comply with all the statutes, rules, and regulations applicable to member banks regarding credit on securities. During the year, the Board processed five such agreements.

In 1989 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued seventy-six interpretations of the margin regulations. Those that presented sufficiently important or novel issues were published in the "Securities Credit Transactions Handbook," which is part of the Federal Reserve Regulatory Service. These interpretations serve as a guide to the margin regulations.

Financial Disclosure by State Member Banks

State member banks must disclose certain information of interest to investors,

Loans by State Member Banks to their Executive Officers, 1988–89

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
October 1–December 31, 1988	919	20,246,161	6.0–18.0
January 1–March 31, 1989	898	18,310,668	6.0–19.8
April 1–June 30, 1989	1,199	26,346,000	5.5–21.0
July 1–September 30, 1989	916	18,048,000	7.6–25.2

including financial reports and proxy statements, if they issue securities registered under the Securities Exchange Act of 1934. The Board's financial disclosure rules are required by statute to be substantially similar to those issued by the Securities and Exchange Commission. At the end of 1989, thirty-five state member banks, most of which are of small or medium size, were registered with the Board under the Securities Exchange Act.

Loans to Executive Officers

Under Section 22(g) of the Federal Reserve Act, each state member bank must include with each quarterly report of condition a report of all extensions of credit made by the bank to its executive officers since the date of the bank's previous report of condition. The accompanying table summarizes these data for the last quarter of 1988 and the first three quarters of 1989.

Federal Reserve Membership

At the end of 1989, 5,256 banks were members of the Federal Reserve System, a decrease of 196 from the previous year. Member banks operated 32,898 branches on December 31, 1989, a net increase of 1,431 for the year.

Member banks accounted for 42 percent of all commercial banks in the United States and for 64 percent of all commercial banking offices. ■

Regulatory Simplification

In 1978 the Board of Governors established the Regulatory Improvement Project, in the Office of the Secretary, to minimize the burdens imposed by regulation. In 1986 the Board reaffirmed its commitment to regulatory improvement, renaming the project the Regulatory Review Section and creating a subcommittee of the Board called the Regulatory Policy and Planning Committee. The regulatory simplification function works to ensure that the economic effect of regulation on small business is considered, to afford interested parties the opportunity to participate in designing regulations and to comment on them, and to ensure that regulations are written in simple and clear language. Board staff members periodically review all existing regulations for adherence to these objectives.

Community Reinvestment

In the spring the Board issued a policy statement in conjunction with the other federal banking agencies to help depository institutions meet their responsibilities under the Community Reinvestment Act (CRA). The Board's version provides guidance and clarification to banks and bank holding companies on how to make their CRA responsibilities part of their day-to-day operations. The statement sets out the basic components of a responsive CRA policy; discusses the role of examination reports, periodic review, and documentation by banking agencies; and addresses the role of commitments to the Board in the applications process (see the chapter on consumer and community affairs for further discussion of the policy statement).

Elimination of Tandem Restrictions

In August the Board approved an amendment to Regulation Y that eliminated many operating restrictions previously required of thrift institutions owned by bank holding companies. Known as the Regulation Y "tandem restrictions," the rules had prevented cooperative ventures and had limited operating efficiencies between thrift and bank subsidiaries of the same holding company. Eliminating the tandem restrictions substantially eased the acquisition of thrifts by bank holding companies as permitted by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which the President had signed earlier that month.

Home Mortgage Disclosure

In December the Board approved a revised format for the collection of data under the Home Mortgage Disclosure Act. In August, the Congress had expanded the act's scope and requirements for collection of data, prompting the Board to search for ways to meet the act's goals without unduly increasing burdens on regulated institutions. The Board approved a loan-register approach to reporting, which permits lenders to record the information during the course of the year without further processing; at the end of the year, the regulatory agencies produce each institution's report from the loan register submitted by the institution. Thus, the lender is recording more information but is freed from creating tables and reports.

Equal Credit Opportunity

In December the Board amended Regulation B to reflect changes required by the Women's Business Ownership Act of 1988, which amended the Equal Credit Opportunity Act (ECOA). The amendments require lenders to notify business owners of their right to the reasons for credit denial and require lenders to retain applications for at least one year. The legislative history of the ECOA amendments suggest that the new provisions are intended primarily to extend to owners of small businesses the same information afforded to applicants for consumer credit and that an exemption for large businesses would be acceptable because these firms are generally well informed about the credit process.

The Board considered several criteria that would exclude large firms, cover most small businesses, and simplify compliance with the ECOA amendments. The Board chose annual gross revenue as a measure of firm size because it is easy to understand and is readily available to both the credit applicant and the financial institution. To further aid the efforts of banks to comply with the amendments, the Board's staff summarized the new rules, described various courses of action that creditors could take to comply, and distributed the information to small banks and other interested parties.

Security Devices and Procedures

In December the Board approved for public comment a redraft of Regulation P. Regulation P implements the Bank Protection Act of 1968, which requires the federal financial supervisory agencies to establish minimum standards for the installation, maintenance, and operation of security devices and procedures in banking institutions. The new draft, prepared under the Board's regulatory review program, deletes certain reporting requirements, eliminates the appendixes, and simplifies the rest of the regulation. The proposed regulation highlights the security responsibilities of boards of directors and security officers of banks rather than the technological factors, which become obsolete and require frequent updating. The proposal allows management greater flexibility in designing security programs that include certain devices and procedures required by the act. ■

Federal Reserve Banks

Developments in Federal Reserve Services

Since it began pricing its services to depository institutions in 1981, the Federal Reserve System has generally narrowed the year-to-year variance between costs and revenues.[1] In 1989, revenues at the Reserve Banks from all priced services were $865.8 million, and costs were $865.0 million, for net revenue of $0.8 million and a recovery rate of 100.0 percent; in 1988, the System recovered 100.6 percent of its service costs. The average rate of recovery since 1983, the first year in which essentially all services were priced, is 102.7 percent. The results are discussed below and presented in the statements for priced services, at the end of this chapter.

Check Collection

The operating and imputed costs of check collection by the Federal Reserve in 1989 were $537.7 million (see the pro forma income statement for priced services, by service). Check operations for the year generated $535.1 million in revenue and a net of $14.3 million in other income and expenses. Income from operations after imputed costs was a negative $2.6 million, primarily because of losses sustained by one district as a result of implementing new services for processing returned checks. The number of checks that the Reserve Banks handled was 18.0 billion, an increase of 2.3 percent from 1988.

In March the Board approved revised prices for Reserve Bank returned check services, which became effective May 1, 1989. The action was taken in response to declining cost recovery rates that were primarily a function of lower-than-anticipated revenue from returned checks and higher-than-anticipated costs resulting partly from the poor quality of qualified returned-check deposits. The Reserve Banks began several initiatives during the year to address the quality issue, including developing guidelines to improve the quality of carrier envelopes and working with banks to reduce the number of misdirected qualified returned checks, improve the quality of endorsements, and reduce the reject rate of qualified deposits.

In November the Board issued for public comment proposed modifications to the Reserve Banks' notice of nonpayment service. The modifications will be adopted if the Board adopts an amendment to Regulation CC shortening the time in which the paying bank must notify the bank that first received the check (the depositary bank) when returning large-dollar checks.

Three Federal Reserve districts initiated pilot programs for accepting intermingled deposits of returned and forward collection checks and for presenting intermingled cash letters.

The Federal Reserve continued to investigate the use of digitized image technology in the check collection pro-

1. The Monetary Control Act of 1980 requires the Federal Reserve to price these services on the basis of the direct costs of the services and the indirect costs, which include overhead, the interest on items credited before actual collection (float), and the private sector adjustment factor (PSAF). The PSAF represents the taxes and costs of capital that the System would have incurred had it been a private-sector firm.

cess. The initial area of interest is the processing of U.S. government checks.

Electronic Payments

Under its strategic study of electronic payments services in the 1990s, the Federal Reserve is conducting pilot tests of two alternative production processes. One alternative uses fault-tolerant processors, and the other involves improving the existing architecture to reduce redundancies and otherwise streamline operations.

The Federal Reserve also has expanded its electronic network for the delivery of Federal Reserve services. Standardized intelligent-terminal software was deployed in late 1988, and the Reserve Banks have begun to implement the software Systemwide.

Automated Clearinghouse

Operating and imputed costs of providing automated clearinghouse (ACH) services in 1989 were $45.2 million; revenues were $48.9 million. The Reserve Banks processed 740.6 million commercial transactions during the year, an increase of 22.9 percent over 1988.

In February the Board published for public comment a proposal to modify the times at which the Federal Reserve grants finality to receivers of ACH credit transactions, finality to originators of ACH debit transactions, and credit for debit-item adjustments. In addition, under the proposal the Reserve Banks would advise depository institutions when a depository institution's inability to settle for the payments caused payments to be reversed. An advisory group representing commercial banks, corporations, and clearinghouse associations has offered information on alternatives to the proposed finality rules. The Board took no final action on this proposal in 1989.

Wire Transfer of Funds

The number of wire transfers originated during 1989 increased 7.7 percent over 1988, to 60.6 million. Operating and imputed costs totaled $67.6 million, and revenue was $76.8 million. On January 1, 1989, the basic fee for funds transfers was increased from $0.47 to $0.50.

In June the Board announced that surcharges would be assessed on funds and securities transfers in 1990 for depository institutions that have not converted their communication links to the System's standard protocols by April 1990, for funds transfers, and by July 1990, for securities transfers. By year-end 1989 the System had converted more than 80 percent of its high-volume electronic connections to standard protocols.

In November the Board published for public comment a proposal to standardize the operating hours for Fedwire transfers of funds and securities. The proposal recommended establishing a uniform deadline of 6:00 p.m. Eastern time for all third-party transfers of funds on Fedwire and requested comment on whether the Federal Reserve should establish uniform times at which Reserve Banks begin processing funds and book-entry securities transfers. The Board took no final action on the proposal in 1989. Federal Reserve staff is conducting a longer-term study to assess whether further modifications of operating hours are required by the continuing evolution of the payments system and financial markets.

Coin and Currency

A major activity in coin and currency operations in 1989 was an automation effort that enables the Board, the Reserve Banks, the Bureau of Engraving and Printing, and the U.S. Mint to better manage the supply of cash through the exchange of data and thus better ensure that the currency distributed to the public by Federal Reserve Banks is of high quality. The Federal Reserve also continued to work with the Departments of Treasury and Justice and with others to deter the counterfeiting and laundering of U.S. currency.

The revenue from priced cash services was $14.4 million in 1989, and the cost was $13.8 million. In 1989, four Federal Reserve Districts provided transportation of cash by armored carrier and four Districts provided wrapped coin to depository institutions.

Definitive Securities and Noncash Collection

The System received $17.0 million in revenue for definitive safekeeping and noncash collection services in 1989; the cost of these services was $16.4 million. The average number of definitive securities issues and deposits maintained in safekeeping accounts at the Reserve Banks decreased 20.3 percent in 1989 to 110,000. The number of noncash collection items processed decreased 4.7 percent, to 3.2 million. With the declining volumes, Reserve Banks continued to streamline and consolidate both definitive and noncash collection operations.

Securities and Fiscal Agency Services

The Federal Reserve provides book-entry (computerized) securities services for the Department of the Treasury and for certain federally sponsored agencies, such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Book-entry services for federal agency securities are treated as a Federal Reserve priced service; these services incurred costs of $8.9 million and earned revenue of $10.2 million in 1989. The Federal Reserve processed 2.5 million such transfers during the year, an increase of 13.4 percent compared to 1988.

The Federal Reserve sells savings bonds in its role as fiscal agent. Under a new program called the Regional Delivery System (RDS), developed by the Federal Reserve and the U.S. Treasury, depository institutions will, as in the past, receive applications from the public for Series EE savings bonds, but the institutions will no longer issue the bonds. Instead, the institutions will forward the applications to a regional Federal Reserve office, which will inscribe the bonds and deliver them. RDS, which originated as a pilot project in Ohio and was managed by the Pittsburgh Branch of the Federal Reserve Bank of Cleveland, is expected to be operational in parts or all of eight Federal Reserve Districts by the end of 1990. The Treasury expects that beginning in 1994, when the program is fully implemented, annual savings to U.S. taxpayers will amount to $18.5 million.

Float

Federal Reserve float increased to a daily average of $588 million in 1989, compared with $606 million in 1988. The costs of all Federal Reserve float associated with priced services are recovered each year.

Examinations

The Board's Division of Federal Reserve Bank Operations examines the twelve Reserve Banks and their twenty-five Branches each year, as required by section 21 of the Federal Reserve Act. The results of the audits are reported to the management and directors of the respective Banks and to the Board of Governors. Also, to assess conformance with the policies issued by the Federal Reserve System Open Market Committee, the division annually audits the accounts and holdings of the Federal Reserve System Open Market Account at the Federal Reserve Bank of New York and the foreign currency operations conducted by that Bank. The division furnishes copies of these reports to the Committee. The examination procedures used by the division are reviewed each year by a private firm of certified public accountants.

Income and Expenses

Income of the Federal Reserve Banks was $22,249 million in 1989 and $19,526 million in 1988 (see accompanying table). Total expenses were $1,422 million ($1,184 million in operating expenses, $148 million in earnings credits granted to depository institutions, and $90 million in assessment for expenditures by the Board of Governors). The cost of currency was $175 million. Income from financial services was $702 million.

The profit and loss account showed a net addition of $1,296 million, primarily a result of gains from the revaluation of assets denominated in foreign currencies to market exchange rates. Statutory dividends to member banks totaled $130 million, $4 million more than in 1988. The rise reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Reserve Banks.

Payments to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $21,646 million, compared with $17,364 million in 1988. The payments consist of all net income after the deduction of dividends and after the deduction of the amount necessary to bring the surplus of the Banks to the level of capital paid-in.

In the Statistical Tables section of this REPORT, table 6 details income and expenses of each Federal Reserve Bank for 1989, and table 7 shows a condensed statement for each Bank for 1914–89. A detailed account of the assessments and expenditures of the Board of Governors appears in the next chapter, "Board of Governors Financial Statements."

Federal Reserve Bank Premises

During 1989 the Board of Governors approved the site and the initial design for a new building for the Dallas Bank.

Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1989 and 1988[1]

Thousands of dollars

Item	1989	1988
Current income	22,249,276	19,526,431
Current expenses	1,332,161	1,205,960
Operating expenses[2]	1,184,253	1,081,684
Earnings credits granted	147,907	124,276
Current net income	20,917,115	18,320,471
Net addition to (deduction from) current net income	1,295,623	−489,058
Cost of unreimbursed services to Treasury	41,009	27,852
Assessments by the Board of Governors	264,623	248,656
For expenditures of Board	89,580	84,411
For cost of currency	175,044	164,245
Net income before payments to Treasury	21,907,105	17,554,905
Dividends paid	129,885	125,616
Payments to Treasury (interest on Federal Reserve notes)	21,646,417	17,364,319
Transferred to surplus	130,802	64,971

1. Details may not sum to totals because of rounding.
2. Operating expenses include a net periodic credit for pension costs of $47 million in 1989 and $70 million in 1988.

Construction of the new operations center for the New York Bank and of the new building for the Helena Branch of the Minneapolis Bank continued. Expansion of the main building of the Chicago Bank and construction of the new building for the Charlotte Branch of the Richmond Bank were completed. Vacated buildings and property of the Charlotte Branch and of the Los Angeles Branch were sold. Table 8, in the Statistical Tables section of this REPORT, shows the cost and book value of premises owned by the Federal Reserve Banks and Branches and of real estate acquired for future banking-house purposes.

Holdings of Securities and Loans

Average daily holdings of securities and loans by the Federal Reserve Banks during 1989 were $233,449 million, a decrease of $347 million from 1988 (see accompanying table). From 1988 to 1989, holdings of U.S. government securities increased $870 million and loans decreased $1,217 million; the average rate of interest increased from 7.85 percent to 8.64 percent on the securities and increased from 7.59 percent to 8.70 percent on the loans.

Volume of Operations

Table 9, in the Statistical Tables section of this REPORT, shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1986–89.

Financial Statements for Priced Services

The following tables show pro forma statements for priced services for 1989, including a balance sheet, income statements, and a breakdown of volumes.

Securities and Loans of Federal Reserve Banks, 1987–89

Millions of dollars, except as noted

Item and year	Total	U.S. government securities[1]	Loans
Average daily holdings[2]			
1987	217,392	216,722	670
1988	233,796	231,442	2,354
1989	233,449	232,312	1,137
Earnings			
1987	16,418	16,371	47
1988	18,358	18,180	179
1989	20,163	20,065	99
Average interest rate (percent)			
1987	7.55	7.55	6.99
1988	7.85	7.85	7.59
1989	8.64	8.64	8.70

1. Includes federal agency obligations.

2. Based on holdings at opening of business.

Pro forma balance sheet for priced services, December 31, 1989 and 1988[1]

Millions of dollars

Item	1989		1988	
Short-term assets[2]				
Imputed reserve requirement on clearing balances	203.8		201.7	
Investment in marketable securities	1,494.2		1,479.3	
Receivables	58.2		57.7	
Materials and supplies	6.4		6.4	
Prepaid expenses	11.1		10.9	
Items in process of collection	3,652.3		4,283.2	
Total short-term assets		5,426.0		6,039.2
Long-term assets[3]				
Premises	289.8		271.8	
Furniture and equipment	123.9		126.1	
Leases and leasehold improvements	6.2		6.1	
Prepaid pension costs	52.1		37.4	
Total long-term assets		472.1		441.4
Total assets		**5,898.0**		**6,480.6**
Short-term liabilities				
Clearing balances and balances arising from early credit of uncollected items	2,584.8		2,712.5	
Deferred availability items	2,765.5		3,251.7	
Short-term debt	75.7		75.0	
Total short-term liabilities		5,426.0		6,039.2
Long-term liabilities				
Obligations under capital leases	1.2		1.2	
Long-term debt	133.2		128.1	
Total long-term liabilities		134.4		129.3
Total liabilities		**5,560.4**		**6,168.5**
Equity		337.7		312.1
Total liabilities and equity[4]		**5,898.0**		**6,480.6**

1. Details may not sum to totals because of rounding.

2. The imputed reserve requirement on clearing balances held at Reserve Banks by depository institutions reflects a treatment comparable to that of compensating balances held at correspondent banks by respondent institutions. The reserve requirement imposed on respondent balances must be held as vault cash or as nonearning balances maintained at a Reserve Bank; thus, a portion of priced services clearing balances held with the Federal Reserve is shown as required reserves on the asset side of the balance sheet. The remainder of clearing balances is assumed to be invested in three-month Treasury bills, shown as investment in marketable securities. Receivables are (1) amounts due the Reserve Banks for priced services and (2) the share of suspense-account and difference-account balances related to priced services. Materials and supplies are the inventory value of short-term assets. Prepaid expenses include salary advances and travel advances for priced service personnel. Items in process of collection (CIPC) is gross Federal Reserve CIPC stated on a basis comparable to that of a commercial bank. It reflects adjustments for intra-System items that would otherwise be double-counted on a consolidated Federal Reserve balance sheet; for items associated with nonpriced items, such as those collected for government agencies; and for items associated with providing fixed availability or credit before items are received and processed. Among the costs to be recovered under the Monetary Control Act is that of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

3. Long-term assets used solely in priced services, the priced services portion of long-term assets shared with nonpriced services, and an estimate of the assets of the Board of Governors used in the development of priced services. Effective Jan. 1, 1987, the Reserve Banks implemented Financial Accounting Standards Board Statement No. 87, Employers' Accounting for Pensions. Accordingly, in 1989 the Reserve Banks recognized a credit to expenses of $14.7 million and a corresponding increase in this asset account.

4. Under the matched-book capital structure for assets that are not "self-financing," short-term assets are financed with short-term debt. Long-term assets are financed with long-term debt and equity in a proportion equal to the ratio of long-term debt to equity for the twenty-five largest bank holding companies, which are used in the model for the private sector adjustment factor (PSAF). The PSAF consists of the taxes that would have been paid and the return on capital that would have been provided had priced services been furnished by a private-sector firm. Other short-term liabilities include clearing balances maintained at Reserve Banks and deposit balances arising from float. Other long-term liabilities consist of obligations on capital leases.

Pro forma income statement for Federal Reserve priced services, calendar years 1989 and 1988[1]

Millions of dollars

Item	1989		1988	
Income from services provided to depository institutions[2]		702.4		667.7
Production expenses[3]		599.4		552.9
Income from operations		103.1		114.8
Imputed costs[4]				
Interest on float	50.8		43.4	
Interest on debt	16.9		16.2	
Sales taxes	7.6		8.4	
FDIC insurance	1.6	76.9	1.8	69.9
Income from operations after imputed costs		26.2		44.9
Other income and expenses[5]				
Investment income	163.4		134.0	
Earnings credits	147.1	16.2	123.0	11.0
Income before income taxes		42.4		55.9
Imputed income taxes[6]		8.7		18.1
Net income		**33.7**		**37.9**
MEMO				
Targeted return on equity[7]		32.9		32.7

1. Details may not add to totals because of rounding.

2. Income for priced services is realized from direct charges to an institution's account or from charges against accumulated earnings credits.

3. Production expenses include direct, indirect, and other general administrative expenses of the Reserve Banks for priced services and the expenses of staff members of the Board of Governors working directly on the development of priced services, which were $1.4 million in 1989 and $1.7 million in 1988. The credit to expenses under FASB 87 is reflected in production expenses (see the pro forma balance sheet, note 3).

4. Interest on float is derived from the value of float to be recovered, either explicitly or through per-item fees, during the period. Float costs include those for checks, book-entry securities, noncash collection, ACH, and wire transfers.

Interest is imputed on debt assumed necessary to finance priced service assets. The sales taxes and FDIC insurance assessment that the Federal Reserve would have paid had it been a private-sector firm are among the components of the PSAF (see the pro forma balance sheet, note 4).

The following list shows the daily average recovery of float by the Reserve Banks for 1989 in millions of dollars.

Total float	917.2
Unrecovered float	63.7
Float subject to recovery	853.5
Sources of recovery of float	
Income on clearing balances	102.4
As-of adjustments	329.5
Direct charges	130.7
Per-item fees	290.9

Unrecovered float includes that generated by services to government agencies or by other central bank services. Float recovered through income on clearing balances is the result of the increase in investable clearing balances; the increase is produced by a deduction for float for cash items in process of collection, which reduces imputed reserve require ments. The income on clearing balances reduces the float to be recovered through other means. As-of adjustments and direct charges are midweek closing float and interterritory check float, which may be recovered from depositing institutions through adjustments to the institution's reserve or clearing balance or by valuing the float at the federal funds rate and billing the institution directly. Float recovered through per-item fees is valued at the federal funds rate and has been added to the cost base subject to recovery in 1989.

5. Investment income is on clearing balances and represents the average coupon-equivalent yield on three-month Treasury bills applied to the *total* clearing balance maintained, adjusted for the effect of reserve requirements on clearing balances. Expenses for earnings credits granted to depository institutions on their clearing balances are derived by applying the average federal funds rate to the *required* portion of the clearing balances, adjusted for the net effect of reserve requirements on clearing balances.

6. Calculated at the effective tax rate derived from the PSAF model.

7. The after-tax rate of return on equity that the Federal Reserve would have earned had it been a private business firm, as derived from the PSAF model.

Pro forma income statement for Federal Reserve priced services, by service, 1989[1]
Millions of dollars

Item	Total	Commercial check collection	Wire transfer and net settlement	Commercial ACH	Definitive safekeeping and noncash collection	Book-entry securities	Cash services
Income from services....	702.4	535.1	76.8	48.9	17.0	10.2	14.4
Operating expenses	599.4	468.9	63.9	42.6	15.3	8.3	13.7
Income from operations .	103.1	66.2	12.9	6.3	1.8	1.9	.7
Imputed costs[2]..........	76.9	68.8	3.7	2.6	1.1	.6	.1
Income from operations after imputed costs ..	26.2	−2.6	9.2	3.7	.7	1.3	.6
Other income and expenses, net[3]......	16.2	14.3	.8	.6	.2	.1	.2
Income before income taxes........	42.4	11.7	10.0	4.3	.9	1.4	.8

1. Details may not sum to totals because of rounding. The effect of implementing FASB 87 (see the pro forma balance sheet, note 3) is reported only in the "total" column in this table and has not been allocated to individual priced services. Taxes and the aftertax targeted rate of return on equity, as shown on the overall pro forma income statement, have not been allocated among services because these elements relate to the organization as a whole.

2. Includes float, interest on debt, sales taxes, and the FDIC assessment. Float costs are based on the actual float incurred in each priced service. Other imputed costs are allocated among priced services according to the ratio of operating costs less shipping costs in each service to the total costs of all services less the total shipping costs of all services.

3. Income on clearing balances and the cost of earnings credits. Because clearing balances relate directly to the Federal Reserve's offering of priced services, the income and cost associated with these balances are allocated to each service based on the ratio of income from each service to total income.

Revenue and expenses of locally priced Federal Reserve services, by District, 1989[1]
Millions of dollars

District	Total revenue	Operating cost	Float cost	Total cost	Net revenue
	Commercial check collection				
Boston	38.2	33.3	3.4	36.7	1.5
New York	67.9	59.9	5.9	65.8	2.1
Philadelphia	24.8	20.9	.5	21.4	3.4
Cleveland	31.9	25.9	2.4	28.2	3.7
Richmond	52.2	42.6	5.3	47.9	4.2
Atlanta	65.7	58.6	1.4	60.0	5.6
Chicago	73.5	58.5	5.4	63.9	9.6
St. Louis	24.4	20.6	2.7	23.3	1.1
Minneapolis	29.9	26.7	.4	27.1	2.7
Kansas City	34.2	31.1	2.1	33.2	1.0
Dallas	36.4	32.2	2.2	34.5	1.9
San Francisco	56.1	65.7	7.7	73.4	−17.3
System total	**535.1**	**476.0**	**39.4**	**515.5**	**19.6**
	Definitive safekeeping and noncash collection				
Boston	.8	.6	*	.6	.2
New York	2.8	2.4	*	2.4	.4
Philadelphia	1.2	1.0	*	1.0	.2
Cleveland	2.0	1.7	.1	1.7	.3
Richmond	.9	.8	*	.8	.1
Atlanta	2.4	2.4	*	2.4	*
Chicago	2.4	2.1	*	2.1	.3
St. Louis	1.0	.9	*	.9	.1
Minneapolis	.8	.8	*	.8	*
Kansas City	1.3	1.2	*	1.2	.2
Dallas	1.4	1.4	.3	1.7	−.3
San Francisco	*	*	*	*	*
System total	**17.0**	**15.3**	**.3**	**15.6**	**1.4**
	Cash services				
Boston	.4	...	...	.4	*
New York	*	...	...	*	*
Philadelphia	1.7	...	...	1.6	.1
Cleveland	1.9	...	...	1.8	.1
Richmond	.1	...	...	.1	*
Atlanta	*	...	...	*	*
Chicago	.3	...	...	.3	*
St. Louis	.2	...	...	.2	*
Minneapolis	2.9	...	...	2.4	.4
Kansas City	.5	...	...	.5	*
Dallas	*	...	...	*	*
San Francisco	6.5	...	...	6.4	.1
System total	**14.4**	...	...	**13.7**	**.7**

1. Details may not sum to totals because of rounding; also, expenses related to research and development projects are reported at the System level, and therefore the sum of expenses for the twelve Districts may not equal the System total. The financial results for each Reserve Bank shown here do not include the dollars to be recovered through the PSAF and the net income on clearing balances. To reconcile net revenue by priced service shown in this table with that shown in the income statement by service, adjustments must be made for imputed interest on debt, sales taxes, FDIC assessment, Board expenses for priced services, and net income on clearing balances.

*Less than $50,000 in absolute value.

Activity in Federal Reserve priced services, calendar years 1989, 1988, and 1987[1]

Thousands of items, except as noted

Service	1989	1988	1987	Percent change	
				1989–88	1988–87
Fund transfers	60,645	56,334	53,278	7.7	5.7
Commercial ACH	740,623	602,406	475,114	22.9	26.8
Commercial checks	18,014,301	17,617,744	17,007,924	2.3	3.6
Securities transfers	2,536	2,236	2,061	13.4	8.5
Definitive safekeeping	110	138	163	−20.3	−15.3
Noncash collection	3,180	3,337	3,803	−4.7	−12.3
Cash transportation	322	341	357	−5.6	−4.5

1. Activity is defined as follows: for wire transfer of funds, the number of basic transactions originated; for ACH, total number of commercial items processed; for commercial checks, total number of commercial checks collected, including both processed and fine-sort items; for securities, number of basic transfers originated on-line; for definitive safekeeping, average number of issues or receipts maintained; for noncash collection, number of items on which fees are assessed; and for cash transportation, number of armored-carrier stops.

Board of Governors Financial Statements

The financial statements of the Board were examined by the independent public accountants Coopers & Lybrand for 1989 and Price Waterhouse for 1988.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of the
Federal Reserve System

We have audited the accompanying balance sheet of the Board of Governors of the Federal Reserve System (the Board) at December 31, 1989, and the related statements of revenues and expenses and fund balance and cash flows for the year then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Board of Governors of the Federal Reserve System for the year ended December 31, 1988, were audited by other auditors, whose report, dated February 24, 1989, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards and the financial audit standards in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System as of December 31, 1989, and the results of its operation and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand

Washington, D.C.
February 16, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

	As of December 31, 1989	1988
ASSETS		
CURRENT ASSETS		
Cash	$ 6,911,025	$ 7,312,846
Accounts receivable	830,753	602,478
Stockroom and cafeteria inventories, at cost	253,530	333,601
Prepaid expenses and other assets	679,246	654,077
Total current assets	8,674,554	8,903,002
PROPERTY, BUILDINGS AND EQUIPMENT, Net (Note 3)	53,297,829	58,487,676
Total assets	$61,972,383	$67,390,678
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable	$ 4,860,780	$ 4,020,776
Accrued payroll and related taxes	3,031,416	2,915,138
Accrued annual leave	4,338,262	4,288,264
Unearned revenues and other liabilities	903,140	833,578
Total current liabilities	13,133,598	12,057,756
COMMITMENTS (Note 5)		
FUND BALANCE	48,838,785	55,332,922
Total liabilities and fund balance	$61,972,383	$67,390,678

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND FUND BALANCE

	For the years ended December 31, 1989	1988
Board Operating Revenues		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$ 89,579,700	$ 84,410,500
Other revenues (Note 4)	4,474,753	3,460,332
Total operating revenues	94,054,453	87,870,832
Board Operating Expenses		
Salaries	61,281,560	56,229,044
Retirement and insurance contributions	8,269,511	7,095,176
Depreciation and net losses on disposals	7,432,273	7,601,609
Travel	3,345,743	3,171,355
Contractual services and professional fees	3,281,235	3,062,980
Utilities	3,113,889	3,169,953
Postage and supplies	2,986,854	3,035,304
Repairs and maintenance	2,787,101	3,099,672
Printing and binding	2,678,987	2,305,362
Software	2,599,191	2,461,366
Equipment and facility rentals	515,558	876,944
Other expenses (Note 4)	2,256,688	2,272,076
Total operating expenses	100,548,590	94,380,841
Board Operating Revenues (Under) Expenses	(6,494,137)	(6,510,009)
Issuance and Redemption of Federal Reserve Notes		
Assessments levied on Federal Reserve Banks for currency costs	174,313,207	164,975,182
Expenses for currency printing, issuance, retirement, and shipping	174,313,207	164,975,182
Currency Assessments (Under) Over Expenses	–	–
Total Revenues (Under) Expenses	(6,494,137)	(6,510,009)
Fund Balance, Beginning of year	55,332,922	61,842,931
Fund Balance, End of year	$ 48,838,785	$ 55,332,922

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

	For the years ended December 31, 1989	1988
CASH FLOWS FROM OPERATING ACTIVITIES		
Board operating revenues (under) expenses	$(6,494,137)	$(6,510,009)
Adjustments to reconcile operating revenues (under) expenses to net cash provided by operating activities:		
Depreciation and net losses on disposals	7,432,273	7,601,609
(Increase) decrease in accounts receivable, inventories and prepaid expenses, and other assets	(173,373)	324,593
Decrease in other non-current assets	–	429,357
Increase in accrued annual leave	49,998	103,038
Increase in accounts payable, accrued payroll and related taxes, and other liabilities	1,025,844	390,623
Net cash provided by operating activities	1,840,605	2,339,211
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals of furniture and equipment	2,453,537	42,608
Capital expenditures	(4,695,963)	(2,774,969)
Net cash used in investing activities	(2,242,426)	(2,732,361)
NET DECREASE IN CASH	(401,821)	(393,150)
CASH BALANCE, Beginning of year	7,312,846	7,705,996
CASH BALANCE, End of year	$ 6,911,025	$ 7,312,846

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1989 AND 1988

(1) SIGNIFICANT ACCOUNTING POLICIES

Board Operating Revenues and Expenses—Assessments made on the Federal Reserve Banks for Board operating expenses and capital expenditures are calculated based on expected cash needs. These assessments, other operating revenues, and operating expenses are recorded on the accrual basis of accounting.

Issuance and Redemption of Federal Reserve Notes—The Board incurs expenses and assesses the Federal Reserve Banks for the cost of printing, issuing, shipping and retiring Federal Reserve Notes. These assessments and expenses are separately reported in the statements of revenues and expenses because they are not Board operating transactions.

Property, Buildings, and Equipment—The Board's property, buildings and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and from 10 to 50 years for building equipment and structures. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is recognized.

(2) RETIREMENT BENEFITS

Substantially all of the Board's employees participate in either the Retirement Plan for Employees of the Federal Reserve System or the Civil Service Plan. The System's Plan is a multiemployer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office. Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the plan. The Civil Service Plan is a defined contribution plan.

Contributions to the System's Plan are actuarially determined and funded by participating employers at amounts prescribed by the Plan's administrator. No separate accounting is maintained of assets contributed by the participating employers and net pension cost for the period is the required contribution for the period. As of January 1, 1989, actuarial calculations showed that the fair value of the assets of the System's Plan exceeded the projected benefit obligations by 85 percent. Based on these calculations and similar calculations performed for 1988, it was determined that employer funding contributions were not required for the years 1989 and 1988 and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions.

Board contributions to the Civil Service Plan directly match employee contributions. The Board's contributions to the Civil Service Plan totaled $585,600 in 1989 and $555,700 in 1988.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Under the Thrift Plan, members may contribute up to a fixed percentage of their salary. Board contributions are based upon a fixed percentage of each member's basic contribution and were $1,751,100 in 1989 and $1,586,700 in 1988.

The Board also provides certain health benefits for retired employees. The cost of providing the benefits is recognized by expensing the insurance premiums which were $323,800 in 1989 and $245,400 in 1988.

(3) PROPERTY, BUILDINGS, AND EQUIPMENT

The following is a summary of the components of the Board's fixed assets, at cost, net of accumulated depreciation.

	As of December 31, 1989	1988
Land and improvements	$ 1,301,314	$ 1,301,314
Buildings	63,556,144	63,290,586
Furniture and equipment	30,920,877	38,865,250
	95,778,335	103,457,150
Less accumulated depreciation	42,480,506	44,969,474
Total property, buildings and equipment	$ 53,297,829	$ 58,487,676

(4) OTHER REVENUES AND OTHER EXPENSES

The following are summaries of the components of Other Revenues and Other Expenses.

	For the years ended December 31, 1989	1988
Other Revenues		
Subscription revenue	$1,736,244	$ 924,783
Contingency Processing Center fees	878,371	$1,672,667
Assistance to Federal agencies	551,000	–
Miscellaneous	1,309,138	862,882

(4) OTHER REVENUES AND OTHER EXPENSES – Cont.

Total other revenues	$4,474,753	$3,460,332
Other Expenses		
Cafeteria operations, net	$ 654,051	$ 598,004
Tuition, registrations and membership fees	524,934	571,271
Subsidies and contributions ...	413,020	697,237
Miscellaneous	664,683	405,564
Total other expenses	$2,256,688	$2,272,076

Through June 30, 1989, the Board operated on behalf of the Federal Reserve System a contingency processing center to handle data processing requirements during emergency situations. The Board recovered from the Federal Reserve Banks a proportionate amount of the operating expenses of the center in the form of fees. Beginning on July 1, 1989, the equipment and the responsibility for operating the center were transferred to the Federal Reserve Bank of Richmond. Effective July 1, 1989, the Board began reimbursing the Federal Reserve Bank of Richmond for the Board's share of the center's operating expenses.

(5) COMMITMENTS

The Board has entered into several operating leases to secure office, classroom and warehouse space for periods ranging from two to five years. Minimum future rental commitments under those operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1989, are as follows:

1990	$238,900
1991	257,800
1992	224,900
1993	189,400
1994	65,900
	$976,900

Rental expenses under these operating leases were $243,400 and $194,900 in 1989 and 1988, respectively.

(5) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1989 and 1988, the Board paid $259,780 and $187,200, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1989 and 1988.

The Board serves as custodian for the Council's cash account. This cash is not reflected in the accompanying financial statements. It also processes accounting transactions, including payroll for most of the Council employees, and performs other administrative services for which the Board was reimbursed $30,300 and $31,700 for 1989 and 1988, respectively.

The Board is not reimbursed for the costs of personnel who serve on the Council and on the various task forces and committees of the Council. ■

Statistical Tables

1. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1989[1]

Thousands of dollars

ASSETS				
Gold certificate account				11,059,129
Special drawing rights certificate account				8,518,000
Coin				456,342
Loans and securities				
Loans to depository institutions			480,585	
Federal agency obligations				
Bought outright			6,524,611	
Held under repurchase agreement			525,000	
U.S. Treasury securities				
Bought outright				
Bills	104,580,590			
Notes	91,381,098			
Bonds	30,813,595			
Total bought outright		226,775,283		
Held under repurchase agreement		1,592,000		
Total securities			228,367,283	
Total loans and securities				235,897,479
Items in process of collection				
Transit items			7,309,113	
Other items in process of collection			1,548,718	
Total items in process of collection				8,857,831
Bank premises				
Land		110,561		
Buildings (including vaults)	623,533			
Building machinery and equipment	177,837			
Construction account	90,452			
Total bank premises		891,822		
Less depreciation allowance		212,485	679,337	
Bank premises, net				789,898
Other assets				
Furniture and equipment		659,117		
Less depreciation		390,668		
Total furniture and equipment, net			268,449	
Denominated in foreign currencies[2]			31,332,540	
Interest accrued			3,149,884	
Premium on securities			1,493,006	
Due from Federal Deposit Insurance Corporation			1,513,650	
Overdrafts			563,913	
Prepaid expenses			205,240	
Suspense account			139,060	
Real estate acquired for banking-house purposes			15,648	
Other			164,866	
Total other assets				38,846,255
Total assets				304,424,934

1.—Continued

LIABILITIES		
Federal Reserve Notes		
Outstanding (issued to Federal Reserve Banks)	279,664,679	
Less held by Federal Reserve Banks	37,925,546	
Total Federal Reserve notes, net		**241,739,133**
Deposits		
Depository institutions		**38,326,523**
U.S. Treasury, general account		**6,216,516**
Foreign, official accounts		**589,487**
Other deposits		
Officers' and certified checks	22,090	
International organizations	76,238	
Other[3]	1,203,430	
Total other deposits		**1,301,758**
Deferred credit items		**7,771,590**
Other liabilities		
Discount on securities	2,781,906	
Sundry items payable	49,054	
Suspense account	25,811	
All other	1,137,436	
Total other liabilities		**3,994,207**
Total liabilities		**299,939,214**
CAPITAL ACCOUNTS		
Capital paid in		**2,242,860**
Surplus		**2,242,860**
Other capital accounts[4]		**0**
Total liabilities and capital accounts		**304,424,934**

1. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.
2. Of this amount $6,960.4 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.
3. In closing out the other capital accounts at year-end, the Reserve Bank earnings that are payable to the Treasury are included in this account pending payment.
4. During the year, includes undistributed net income, which is closed out on Dec. 31.

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1989 and 1988

Millions of Dollars[1]

Item	Total 1989	Total 1988	Boston 1989	Boston 1988
ASSETS				
Gold certificate account	11,059	11,060	699	680
Special drawing rights certificate account	8,518	5,018	531	314
Coin	456	395	26	20
Loans				
To depository institutions	481	2,170	5	42
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	6,525	6,966	406	423
Held under repurchase agreements	525	2,101	0	0
U.S. Treasury securities				
Bought outright[2]	226,775	233,662	14,112	14,181
Held under repurchase agreements	1,592	4,760	0	0
Total loans and securities	235,898	249,659	14,523	14,646
Items in process of collection	8,903	8,739	470	480
Bank premises	790	750	91	92
Other assets				
Denominated in foreign currencies[3]	31,333	9,129	1,097	301
All other	7,465	8,924	311	312
Interdistrict Settlement Account	0	0	2,705	605
Total assets	**304,422**	**293,674**	**20,453**	**17,450**
LIABILITIES				
Federal Reserve notes	241,739	229,640	17,166	14,322
Deposits				
Depository institutions	38,327	39,347	2,510	2,386
U.S. Treasury, general account	6,217	8,656	0	0
Foreign, official accounts	590	347	5	5
Other	1,298	548	52	20
Total deposits	46,430	48,898	2,567	2,411
Deferred credit items	7,773	7,453	376	373
Other liabilities and accrued dividends[4]	3,994	3,457	178	194
Total liabilities	**299,935**	**289,448**	**20,286**	**17,300**
CAPITAL ACCOUNTS				
Capital paid in	2,243	2,113	83	75
Surplus	2,243	2,113	83	75
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**304,423**	**293,674**	**20,453**	**17,450**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	279,665	271,492	19,741	16,862
Less: Held by Bank	37,926	41,852	2,575	2,540
Federal Reserve notes, net	**241,739**	**229,640**	**17,166**	**14,322**
Collateral for Federal Reserve notes				
Gold certificate account	11,059	11,060	...	...
Special drawing right certificate account	8,518	5,018	...	...
Other eligible assets	...	...	...	...
U.S. Treasury and federal agency securities	222,162	213,562	...	...
Total collateral	**241,739**	**229,640**	...	...

For notes see end of table.

2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1989	1988	1989	1988	1989	1988	1989	1988
3,410	3,310	400	389	661	655	943	917
2,896	1,489	247	162	508	314	745	461
13	14	33	29	35	25	78	62
27	34	45	168	261	890	3	122
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2,300	2,381	188	197	375	402	541	541
525	2,101	0	0	0	0	0	0
79,934	79,855	6,544	6,624	13,046	13,498	18,794	18,142
1,592	4,760	0	0	0	0	0	0
84,378	89,131	6,778	6,989	13,682	14,790	19,338	18,805
1,070	1,235	442	421	311	244	534	459
47	32	46	46	34	32	127	124
8,398	2,411	1,535	438	1,692	502	1,817	511
2,125	2,049	254	172	305	291	408	390
−928	114	862	470	1,214	−559	3,702	3,132
101,408	**99,785**	**10,597**	**9,116**	**18,441**	**16,294**	**27,692**	**24,861**
81,921	78,077	7,703	6,655	15,566	13,704	23,180	20,096
8,130	9,199	1,943	1,777	2,107	1,894	3,456	3,836
6,217	8,656	0	0	0	0	0	0
480	237	7	7	8	8	9	9
498	310	38	6	62	14	88	45
15,324	18,402	1,988	1,790	2,178	1,916	3,553	3,890
822	795	619	375	288	266	447	387
2,126	1,379	87	90	163	178	233	242
100,192	**98,653**	**10,397**	**8,910**	**18,194**	**16,064**	**27,413**	**24,615**
608	566	100	103	124	115	139	123
608	566	100	103	124	115	139	123
0	0	0	0	0	0	0	0
101,408	**99,785**	**10,597**	**9,116**	**18,441**	**16,294**	**27,692**	**24,861**
86,003	84,057	9,601	10,019	17,776	16,071	26,559	23,687
4,082	5,980	1,898	3,364	2,210	2,367	3,379	3,591
81,921	**78,077**	**7,703**	**6,655**	**15,566**	**13,704**	**23,180**	**20,096**
...	...	...	...	...	...	...	...
	...	...	...				
	...	...					
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1989 and 1988—Continued

Millions of Dollars[1]

Item	Atlanta 1989	Atlanta 1988	Chicago 1989	Chicago 1988
ASSETS				
Gold certificate account	508	584	1,361	1,394
Special drawing rights certificate account	330	203	1,100	656
Coin	46	36	36	44
Loans				
To depository institutions	27	35	10	44
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	298	325	775	846
Held under repurchase agreements	0	0	0	0
U.S. Treasury securities				
Bought outright[2]	10,358	10,895	26,940	28,367
Held under repurchase agreements	0	0	0	0
Total loans and securities	10,682	11,255	27,725	29,257
Items in process of collection	763	721	851	774
Bank premises	59	59	110	100
Other assets				
Denominated in foreign currencies[3]	2,914	803	4,042	1,168
All other	241	273	612	3,017
Interdistrict Settlement Account	−3,167	360	1,787	−1,715
Total assets	**12,376**	**14,294**	**37,624**	**34,695**
LIABILITIES				
Federal Reserve notes	7,315	8,889	32,241	29,658
Deposits				
Depository institutions	3,773	4,189	3,710	3,413
U.S. Treasury, general account	0	0	0	0
Foreign, official accounts	14	13	19	19
Other	73	5	189	107
Total deposits	3,860	4,207	3,918	3,539
Deferred credit items	630	657	561	565
Other liabilities and accrued dividends[4]	132	149	343	387
Total liabilities	**11,938**	**13,902**	**37,062**	**34,149**
CAPITAL ACCOUNTS				
Capital paid in	219	196	281	273
Surplus	219	196	281	273
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**12,376**	**14,294**	**37,624**	**34,695**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	11,148	12,528	35,397	32,902
Less: Held by Bank	3,833	3,639	3,156	3,244
Federal Reserve notes, net	**7,315**	**8,889**	**32,241**	**29,658**

1. Components may not add to totals because of rounding.
2. Includes securities loaned—fully guaranteed by U.S. Treasury securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale-purchase transactions.
3. Valued monthly at market exchange rates.
4. Includes exchange-translation account reflecting the monthly revaluation at market exchange rates of foreign-exchange commitments.

2. – Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1989	1988	1989	1988	1989	1988	1989	1988	1989	1988
370	368	198	168	494	490	613	676	1,402	1,429
290	160	153	66	362	216	433	307	922	670
30	29	12	11	30	30	39	28	77	67
53	95	9	12	15	30	28	688	0	10
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
201	205	110	99	261	262	274	391	796	894
0	0	0	0	0	0	0	0	0	0
6,982	6,875	3,818	3,329	9,069	8,789	9,528	13,105	27,652	30,002
0	0	0	0	0	0	0	0	0	0
7,235	7,175	3,936	3,440	9,345	9,081	9,829	14,184	28,447	30,906
387	422	434	383	1,478	1,542	754	696	1,409	1,362
23	21	27	24	52	47	25	22	150	151
877	256	1,003	283	1,285	374	2,350	785	4,324	1,296
153	156	85	88	202	198	1,736	1,300	1,032	679
−140	742	−405	1,010	−2,110	712	−1,511	−2,813	−2,008	−2,058
9,226	**9,329**	**5,444**	**5,473**	**11,138**	**12,690**	**14,268**	**15,185**	**35,756**	**34,502**
7,420	7,847	4,147	4,124	8,052	9,758	11,166	11,664	25,863	24,846
1,201	874	686	807	1,316	1,122	1,949	2,401	7,547	7,449
0	0	0	0	0	0	0	0	0	0
4	4	5	5	6	6	11	13	21	21
31	8	31	2	44	4	62	0	129	27
1,236	886	721	814	1,367	1,132	2,022	2,414	7,697	7,497
360	389	390	353	1,428	1,507	617	616	1,235	1,170
87	91	52	48	115	119	121	173	357	407
9,103	**9,213**	**5,309**	**5,339**	**10,962**	**12,516**	**13,927**	**14,867**	**35,152**	**33,920**
61	58	67	67	88	87	171	159	302	291
61	58	67	67	88	87	171	159	302	291
0	0	0	0	0	0	0	0	0	0
9,226	**9,329**	**5,444**	**5,473**	**11,138**	**12,690**	**14,268**	**15,185**	**35,756**	**34,502**
9,009	9,425	5,003	4,928	10,306	12,204	14,620	14,640	34,502	34,169
1,589	1,578	857	804	2,254	2,446	3,454	2,976	8,639	9,323
7,420	**7,847**	**4,147**	**4,124**	**8,052**	**9,758**	**11,166**	**11,664**	**25,863**	**24,846**

3. Federal Reserve Open Market Transactions, 1989[1]

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
U.S. TREASURY SECURITIES				
Outright transactions (excluding matched transactions)				
Treasury bills				
Gross purchases	0	0	0	3,077
Gross sales	154	3,688	0	0
Exchanges	0	0	0	0
Redemptions	600	1,600	0	0
Others within 1 year				
Gross purchases	0	0	0	172
Gross sales	0	0	0	0
Maturity shift	620	5,418	2,646	1,657
Exchanges	−2,703	−2,308	−2,322	−110
Redemptions	0	0	0	0
1 to 5 years				
Gross purchases	0	0	0	1,436
Gross sales	3	225	0	0
Maturity shift	−541	−5,319	−2,646	−1,532
Exchanges	2,492	2,008	2,322	0
5 to 10 years				
Gross purchases	0	0	0	287
Gross sales	20	0	0	0
Maturity shift	−79	−100	0	−125
Exchanges	212	200	0	110
More than 10 years				
Gross purchases	0	0	0	284
Gross sales	0	0	0	0
Maturity shift	0	0	0	0
Exchanges	0	100	0	0
All maturities				
Gross purchases	0	0	0	5,255
Gross sales	177	3,913	0	0
Redemptions	600	1,600	0	0
Matched transactions				
Gross sales	94,204	110,393	83,677	77,349
Gross purchases	94,252	112,472	82,821	78,259
Repurchase agreements[2]				
Gross purchases	17,208	0	0	22,244
Gross sales	21,969	0	0	12,547
Net change in U.S. Treasury securities	−5,489	−3,434	−856	15,863
FEDERAL AGENCY OBLIGATIONS				
Outright transactions				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Redemptions	148	40	0	125
Repurchase agreements[2]				
Gross purchases	8,980	0	0	7,207
Gross sales	11,081	0	0	3,366
Net change in agency obligations	−2,249	−40	0	3,716
Total net change in System Open Market Account	**−7,738**	**−3,474**	**−856**	**19,579**

1. Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Details may not add to totals because of rounding.

2. In July 1984 the Open Market Trading Desk discontinued accepting bankers acceptances in repurchase agreements.

*Less than $500,000 in absolute value.

3. – Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
311	0	0	0	0	219	8,794	1,883	14,284
321	571	5,517	934	0	1,633	0	0	12,818
0	0	0	0	0	0	0	0	0
1,200	1,200	2,400	800	0	1,400	3,530	0	12,730
0	0	0	0	0	0	155	0	327
0	0	0	0	0	0	0	0	0
2,863	1,828	1,749	4,200	1,832	852	3,915	1,268	28,848
−3,628	−1,434	−1,073	−4,025	0	−2,678	−5,502	0	−25,783
0	0	0	0	0	500	0	0	500
0	0	0	0	0	0	0	0	1,436
75	0	13	150	0	24	0	0	490
−2,036	−1,828	−1,584	−3,321	−1,832	−758	−2,869	−1,268	−25,534
3,328	1,434	787	3,425	0	2,552	4,902	0	23,250
0	0	0	0	0	0	0	0	287
0	0	9	0	0	0	0	0	29
258	0	−165	−879	0	−95	−1,046	0	−2,231
200	0	286	400	0	126	400	0	1,934
0	0	0	0	0	0	0	0	284
0	0	0	0	0	0	0	0	0
−1,086	0	0	0	0	0	0	0	−1,086
100	0	0	200	0	0	200	0	600
311	0	0	0	0	219	8,949	1,883	16,617
396	571	5,539	1,084	0	1,657	0	0	13,337
1,200	1,200	2,400	800	0	1,900	3,530	0	13,230
123,029	128,139	123,373	146,611	116,502	111,430	105,696	103,077	1,323,480
113,041	138,141	118,221	147,228	120,144	111,893	105,243	104,827	1,326,542
31,419	6,203	4,961	0	9,396	0	15,350	22,737	129,518
41,117	6,203	4,961	0	9,396	0	15,350	21,145	132,688
−20,971	8,232	−13,091	−1,267	3,642	−2,875	4,966	5,225	−10,055
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	45	0	54	30	0	0	442
12,732	1,666	1,137	0	4,011	0	1,247	2,992	39,972
16,573	1,666	1,137	0	4,011	0	1,247	2,467	41,548
−3,841	0	−45	0	−54	−30	0	525	−2,018
−24,812	**8,232**	**−13,136**	**−1,267**	**3,588**	**−2,905**	**4,966**	**5,750**	**−12,073**

4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities, December 31, 1987–89[1]

Millions of dollars

Description	December 31			Increase or decrease (−)	
	1989	1988	1987	1989	1988
U.S. Treasury securities, total	**228,367**	**238,422**	**222,551**	**−10,055**	**15,871**
By term					
1–15 days[2]	9,413	9,935	11,364	−522	−1,429
16–90 days	55,523	58,448	46,112	−2,925	12,336
91 days to 1 year	70,687	75,236	76,827	−4,549	−1,591
1–5 years	53,509	55,326	47,512	−1,817	7,814
5–10 years	12,529	12,568	15,313	−39	−2,745
More than 10 years	26,707	26,909	25,424	−203	1,485
By type of holding					
Held outright					
Treasury bills[3]	104,580	112,782	107,691	−8,202	5,091
Treasury notes	91,381	90,950	82,973	431	7,977
Treasury bonds	30,814	29,929	28,242	885	1,687
Held under RPs	1,592	4,760	3,645	−3,168	1,115
Federal agency obligations, total	**7,050**	**9,067**	**8,869**	**−2,017**	**198**
By term					
1–15 days[2]	678	2,271	1,561	−1,593	710
16–90 days	568	697	691	−129	6
91 days to 1 year	1,346	1,492	1,653	−146	−161
1–5 years	3,198	3,419	3,416	−221	3
5–10 years	1,071	1,000	1,358	71	−358
More than 10 years	188	189	189	−1	0
By type of holding					
Held outright					
Federal Farm Credit Banks	1,630	1,997	2,294	−367	−297
Federal Home Loan Banks	2,251	2,251	2,251	0	0
Federal Home Loan Financing Corporation	0	0	0	0	0
Federal Home Loan Mortgage Corporation	0	0	0	0	0
Federal Intermediate Credit Banks[4]	0	0	0	0	0
Federal Land Banks	130	130	200	0	−70
Federal Home Administration	0	35	99	−35	−64
Federal National Mortgage Association	2,347	2,387	2,490	−40	−103
Federal National Sinking Fund	0	0	0	0	0
Government National Mortgage Association participation certificates[4]	0	0	51	0	−51
U.S. Postal Service	37	37	37	0	0
Washington Metropolitan Area Transit Authority	117	117	117	0	0
General Services Administration	13	14	14	−1	0
Held under RPs	525	2,101	1,315	−1,576	786

1. Details may not add to totals because of rounding.
2. Includes the effects of temporary transactions (repurchase agreements and matched sale-purchase agreements).
3. Includes the effects of matched sale-purchase agreements.
4. There were no outstanding issues as of December 31, 1989.

5. Number and Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1989

Federal Reserve Bank (including) Branches	President	Other officers		Employees			Total	
	Annual salary (dollars)	Number	Annual salaries (dollars)	Number: Full-time	Number: Part-time	Annual salaries (dollars)	Number	Annual salaries (dollars)
Boston	140,000	55	4,312,827	1,264	287	39,685,437	1,607	44,138,264
New York	214,400	157	14,091,700	3,718	59	116,314,710	3,935	130,620,810
Philadelphia	158,000	54	4,174,400	1,176	151	33,252,902	1,382	37,585,302
Cleveland	151,000	62	4,441,050	1,334	68	33,055,092	1,465	37,647,142
Richmond	163,500	81	5,799,300	1,824	149	44,791,854	2,055	50,754,654
Atlanta	177,000	72	5,191,000	2,187	81	54,490,289	2,341	59,858,289
Chicago	188,000	87	6,296,960	2,427	31	66,629,596	2,546	73,114,556
St. Louis	160,000	49	3,297,700	1,082	90	26,988,982	1,222	30,446,682
Minneapolis	142,500	50	3,495,700	964	132	25,744,070	1,147	29,382,270
Kansas City	160,000	61	4,272,100	1,592	57	40,606,090	1,711	45,038,190
Dallas	152,000	60	4,357,200	1,575	45	41,366,156	1,681	45,875,356
San Francisco	185,000	101	7,774,495	2,393	74	69,109,743	2,569	77,069,238
Total	**1,991,400**	**889**	**67,504,432**	**21,536**	**1,224**	**592,034,920**	**23,661**	**661,530,752**

6. Income and Expenses of Federal Reserve Banks, 1989

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Loans	396,923,632	1,917,148	4,067,423	2,486,347	555,846
U.S. Treasury and federal agency securities	20,064,562,087	1,232,848,634	7,085,347,122	572,880,876	1,149,099,468
Foreign currencies	1,037,446,163	36,218,306	277,850,953	50,788,707	56,068,247
Priced services	702,420,500	48,019,383	97,924,772	33,690,691	42,968,475
Other	47,923,342	545,043	27,754,280	632,802	592,146
Total	**22,249,275,725**	**1,320,201,179**	**7,493,515,660**	**659,956,484**	**1,251,157,967**
CURRENT EXPENSES					
Salaries and other personnel expenses	702,343,680	45,741,163	141,549,646	37,168,497	40,478,835
Retirement and other benefits[2]	103,831,827	9,496,360	26,962,994	8,619,597	8,732,225
Fees	14,425,046	2,467,740	2,566,400	391,970	2,459,927
Travel	27,374,825	1,138,712	4,075,861	1,328,074	2,052,039
Postage and other shipping costs	82,162,042	4,368,042	10,597,656	4,583,369	5,755,630
Communications	11,104,424	1,092,675	2,279,076	543,587	607,479
Materials and supplies	54,387,876	2,900,561	9,890,886	3,048,591	3,189,798
Building expenses					
Taxes on real estate	23,301,795	3,944,075	3,711,959	1,646,227	1,111,292
Property depreciation	30,711,596	2,411,148	3,475,158	1,699,726	1,542,938
Utilities	24,831,536	2,005,864	3,411,492	2,568,479	1,654,855
Rent	21,244,887	586,314	14,574,167	36,330	370,464
Other	20,394,726	1,014,015	4,058,080	1,481,866	683,790
Equipment					
Purchases	4,840,730	188,451	0	343,646	188,811
Rentals	22,961,085	309,916	4,368,470	635,181	1,521,689
Depreciation	80,576,559	6,614,121	16,404,776	4,440,742	5,198,600
Repairs and maintenance	49,828,850	3,258,749	7,706,126	2,239,597	3,326,715
Earnings-credit costs	147,907,312	9,605,023	14,270,137	10,190,699	11,691,875
Other	74,323,442	3,539,209	11,676,508	5,861,309	3,430,283
Shared costs, net[3]	3	(467,700)	(156,826)	2,026,802	170,142
Recoveries	(34,608,399)	(8,239,219)	(3,975,441)	(2,614,856)	(3,172,267)
Expenses capitalized[4]	(2,710,550)	(135,888)	(5,676)	(82,412)	(384,240)
Total	**1,436,381,379**	**91,839,331**	**277,441,449**	**86,157,021**	**90,610,880**
Reimbursements	(127,072,580)	(5,389,318)	(25,920,952)	(15,833,562)	(12,539,943)
Net expenses	1,332,160,712	86,450,013	251,520,497	70,323,459	78,070,937

For notes see end of table.

6. – Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,736,475	3,712,153	179,483,497	3,662,935	2,553,425	5,393,686	16,924,161	1,844,655
1,624,011,524	916,622,952	2,384,805,935	606,577,478	321,298,501	784,485,967	917,443,350	2,469,140,280
60,079,568	96,251,719	133,784,400	29,048,493	33,152,122	42,535,293	78,316,165	143,352,190
62,099,088	81,636,420	94,098,692	31,105,362	38,513,000	45,602,797	48,078,870	78,682,950
748,780	876,593	12,103,973	494,681	475,992	487,056	1,014,884	2,197,113
1,748,551,212	**1,096,973,751**	**2,773,052,735**	**674,238,536**	**399,612,814**	**876,312,278**	**1,256,582,936**	**2,699,120,173**
52,953,840	64,130,085	78,186,918	33,756,833	31,023,681	47,377,576	47,485,784	82,490,822
11,998,717	14,701,240	17,149,911	7,569,598	6,647,428	10,340,594	9,785,998	18,520,020
636,654	1,098,638	590,735	570,863	1,658,271	463,514	461,428	1,058,906
1,973,281	2,313,837	3,530,894	1,441,024	1,382,420	2,085,543	2,366,414	3,686,726
6,957,585	9,135,271	9,181,604	3,960,198	5,284,518	5,851,122	4,176,386	12,310,661
705,776	1,258,214	1,201,722	483,147	433,394	767,454	900,296	831,604
4,929,425	5,694,784	6,125,744	3,235,493	2,264,959	3,714,096	3,943,450	5,450,089
2,311,403	1,754,300	2,201,064	453,113	2,358,598	888,129	640,369	2,281,266
3,686,711	2,473,825	3,927,170	1,054,299	1,072,098	2,327,959	1,402,580	5,637,984
2,344,676	2,207,438	2,581,138	1,510,575	777,746	1,508,910	1,112,086	3,148,277
572,323	453,156	2,405,007	436,211	150,599	251,039	1,192,882	216,395
1,809,317	2,174,585	4,030,790	747,074	814,002	757,024	730,102	2,094,081
472,582	396,177	408,101	408,513	622,198	152,248	524,685	1,135,318
1,256,814	1,883,428	5,260,930	466,125	600,223	1,368,026	2,345,039	2,945,244
6,877,521	8,301,286	9,779,601	2,896,430	3,840,206	3,319,130	4,752,179	8,151,967
4,917,125	6,054,119	7,680,036	1,927,024	2,460,865	2,274,162	2,569,296	5,415,036
12,053,257	14,584,038	27,038,513	6,108,728	7,371,329	11,665,008	7,743,599	15,585,106
4,642,494	5,719,186	7,464,461	2,899,951	2,929,654	3,268,273	4,197,168	18,694,946
(1,403,855)	959,965	(6,253,459)	1,208,006	1,784,185	855,455	939,560	337,727
(4,538,132)	(2,384,773)	(2,128,224)	(1,246,663)	(446,237)	(689,274)	(1,508,024)	(3,665,289)
(253,062)	(286,551)	(463,540)	(79,332)	(47,152)	(499,483)	(401,279)	(71,935)
114,904,452	**142,622,248**	**179,899,116**	**69,807,210**	**72,982,985**	**98,046,505**	**95,359,999**	**186,254,951**
(7,784,795)	(9,350,029)	(12,548,912)	(7,052,269)	(4,177,436)	(7,165,316)	(6,061,211)	(13,248,837)
107,119,657	133,272,219	167,350,204	62,754,941	68,805,549	90,881,189	89,298,788	173,006,114

6. Income and Expenses of Federal Reserve Banks, 1988 – Continued

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	20,917,115,014	1,233,751,166	7,288,688,019	589,633,025	1,173,087,030
Additions to and deductions from current net income					
Profits on sales of U.S. Treasury and federal agency securities	80,065,694	823,379	4,735,164	374,603	68,403,659
Profit on foreign exchange transactions	1,204,173,436	45,075,533	341,954,948	62,602,870	702,956
Other additions	12,300,866	3,291,177	25,923	3,556	3,270
Total additions	1,296,539,996	49,190,089	346,716,034	62,981,029	69,109,885
Total deductions	(917,412)	(1,241)	(641,832)	(15,084)	(1,190)
Net additions to or deductions(−) from current net income	1,295,622,584	49,188,848	346,074,202	62,965,945	69,108,695
Cost of unreimbursed Treasury services	41,009,218	1,776,930	5,487,856	4,032,471	3,338,604
Assessments by Board					
Board expenditures[5]	89,579,700	3,207,100	24,011,500	4,399,100	4,877,500
Cost of currency	175,043,736	10,871,391	59,997,193	5,051,423	10,402,141
Net income before payment to U.S. Treasury	21,907,104,945	1,267,084,593	7,545,265,672	639,175,976	1,223,577,480
Dividends paid	129,885,339	4,737,306	34,813,338	6,070,853	7,054,527
Payments to U.S. Treasury (interest on Federal Reserve notes)	21,646,417,306	1,254,035,287	7,468,561,334	635,905,173	1,207,926,053
Transferred to surplus	130,802,300	8,312,000	41,891,000	(2,800,050)	8,596,900
Surplus, January 1	2,112,057,800	74,955,100	565,787,250	102,778,950	114,903,250
Surplus, December 31	2,242,860,100	83,267,100	607,678,250	99,978,900	123,500,150

1. Details may not add to totals because of rounding.
2. The effect of the 1987 implementation of Financial Accounting Standards Board Statement No. 87 – Employers' Accounting for Pensions – is recorded in the Total column only and has not been distributed to each District. Accordingly, the sum of the Districts will not equal the Total column for this category or for Total net expenses, and New York will not add to current net income. The effect of FASB 87 on the Reserve Banks was a reduction in expenses of $46,692,855.
3. Includes distribution of costs for projects performed by one Bank for the benefit of one or more other Banks.
4. Includes expenses for labor and materials temporarily capitalized and charged to activities when the products are consumed.
5. For additional details, see the last four pages of the preceding section: Board of Governors, Financial Statements.

6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,641,431,556	963,701,533	2,605,702,530	611,483,594	330,807,264	785,431,089	1,167,284,148	2,526,114,059
1208,662	531,242	1,377,332	428,615	299,159	577,983	25,293	1,280,603
74,329,418	119,684,327	164,355,514	35,613,425	40,980,433	52,148,230	92,319,971	174,405,808
6,538,983	951,609	12,704	4,689	61,127	2,979	15,693	1,389,157
82,077,064	121,167,178	165,745,551	36,046,730	41,340,719	52,729,192	92,360,956	177,075,569
(53,116)	(88,491)	(6,949)	(455)	(37,427)	(38,031)	(1,283)	(32,315)
82,023,948	121,078,687	165,738,602	36,046,275	41,303,293	52,691,161	92,359,674	177,043,253
2,919,938	3,099,228	4,132,680	2,368,717	1,681,810	2,703,004	2,776,689	6,691,289
5,258,200	8,420,900	11,605,300	2,480,400	2,823,400	3,678,300	6,562,300	12,315,700
15,253,971	6,747,839	22,512,552	5,956,456	3,130,489	7,407,095	8,853,543	18,859,643
1,700,023,395	1,066,512,253	2,733,190,600	636,724,296	364,474,858	824,333,851	1,241,451,289	2,665,290,681
7,902,912	12,610,959	16,791,352	3,611,424	4,026,093	5,224,277	9,328,249	17,714,049
1,676,145,633	1,030,846,694	2,708,899,298	629,990,373	359,912,165	817,783,874	1,219,589,590	2,636,821,832
15,974,850	23,054,600	7,499,950	3,122,500	536,000	1,325,700	12,533,450	10,754,800
123,455,850	195,767,650	273,006,400	58,459,650	66,845,800	86,911,700	158,031,050	291,155,150
139,430,700	218,822,250	280,506,350	61,582,150	67,382,400	88,237,400	170,564,500	301,909,950

7. Income and Expenses of Federal Reserve Banks, 1914–89[1]

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (−)	Assessments by Board of Governors: Board expenditures	Assessments by Board of Governors: Costs of currency
All Banks					
1914–15	2,173,252	2,018,282	5,875	302,304	...
1916	5,217,998	2,081,722	−193,001	192,277	...
1917	16,128,339	4,921,932	−1,386,545	237,795	...
1918	67,584,417	10,576,892	−3,908,574	382,641	...
1919	102,380,583	18,744,815	−4,673,446	594,818	...
1920	181,296,711	27,548,505	−3,743,907	709,525	...
1921	122,865,866	33,722,409	−6,314,796	741,436	...
1922	50,498,699	28,836,504	−4,441,914	722,545	...
1923	50,708,566	29,061,539	−8,233,107	702,634	...
1924	38,340,449	27,767,886	−6,191,143	663,240	...
1925	41,800,706	26,818,664	−4,823,477	709,499	...
1926	47,599,595	24,914,037	−3,637,668	721,724	1,714,421
1927	43,024,484	24,894,487	−2,456,792	779,116	1,844,840
1928	64,052,860	25,401,233	−5,026,029	697,677	805,900
1929	70,955,496	25,810,067	−4,861,642	781,644	3,099,402
1930	36,424,044	25,357,611	−93,136	809,585	2,175,530
1931	29,701,279	24,842,964	311,451	718,554	1,479,146
1932	50,018,817	24,456,755	−1,413,192	728,810	1,105,816
1933	49,487,318	25,917,847	−12,307,074	800,160	2,504,830
1934	48,902,813	26,843,653	−4,430,008	1,372,022	1,025,721
1935	42,751,959	28,694,965	−1,736,758	1,405,898	1,476,580
1936	37,900,639	26,016,338	485,817	1,679,566	2,178,119
1937	41,233,135	25,294,835	−1,631,274	1,748,380	1,757,399
1938	36,261,428	25,556,949	2,232,134	1,724,924	1,629,735
1939	38,500,665	25,668,907	2,389,555	1,621,464	1,356,484
1940	43,537,805	25,950,946	11,487,697	1,704,011	1,510,520
1941	41,380,095	28,535,547	720,636	1,839,541	2,588,062
1942	52,662,704	32,051,226	−1,568,208	1,746,326	4,826,492
1943	69,305,715	35,793,816	23,768,282	2,415,630	5,336,118
1944	104,391,829	39,659,496	3,221,880	2,296,357	7,220,068
1945	142,209,546	41,666,453	−830,007	2,340,509	4,710,309
1946	150,385,033	50,493,246	−625,991	2,259,784	4,482,077
1947	158,655,566	58,191,428	1,973,001	2,639,667	4,561,880
1948	304,160,818	64,280,271	−34,317,947	3,243,670	5,186,247
1949	316,536,930	67,930,860	−12,122,274	3,242,500	6,304,316
1950	275,838,994	69,822,227	36,294,117	3,433,700	7,315,844
1951	394,656,072	83,792,676	−2,127,889	4,095,497	7,580,913
1952	456,060,260	92,051,063	1,583,988	4,121,602	8,521,426
1953	513,037,237	98,493,153	−1,058,993	4,099,800	10,922,067
1954	438,486,040	99,068,436	−133,641	4,174,600	6,489,895
1955	412,487,931	101,158,921	−265,456	4,194,100	4,707,002
1956	595,649,092	110,239,520	−23,436	5,339,800	5,603,176
1957	763,347,530	117,931,908	−7,140,914	7,507,900	6,374,195
1958	742,068,150	125,831,215	124,175	5,917,200	5,973,240
1959	886,226,116	131,848,023	98,247,253	6,470,600	6,384,083
1960	1,103,385,257	139,893,564	13,874,702	6,533,700	7,455,011
1961	941,648,170	148,253,719	3,481,628	6,265,100	6,755,756
1962	1,048,508,335	161,451,206	−55,779	6,654,900	8,030,028
1963	1,151,120,060	169,637,656	614,835	7,572,800	10,062,901
1964	1,343,747,303	171,511,018	725,948	8,655,200	17,229,671
1965	1,559,484,027	172,110,934	1,021,614	8,576,396	23,602,856
1966	1,908,499,896	178,212,045	996,230	9,021,600	20,167,481
1967	2,190,403,752	190,561,166	2,093,876	10,769,596	18,790,084
1968	2,764,445,943	207,677,768	8,519,996	14,198,198	20,474,404
1969	3,373,360,559	237,827,579	−557,553	15,020,084	22,125,657

For notes see end of table.

7.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
217,463	...	...	...	...	...
1,742,775	...	...	...	...	...
6,804,186	1,134,234	...	...	...	1,134,234
5,540,684	...	...	...	...	48,334,341
5,011,832	2,703,894	...	...	...	70,651,778
5.654,018	60,724,742	...	...	...	82,916,014
6,119,673	59,974,466	...	...	...	15,993,086
6,307,035	10,850,605	...	...	...	−659,904
6.552.717	3.613.056	...	...	...	2,545,513
6,682,496	113,646	...	...	...	−3,077,962
6,915,958	59,300	...	...	...	2,473,808
7,329,169	818,150	...	...	...	8,464,426
7,754,539	249,591	...	...	...	5,044,119
8,458,463	2,584,659	...	...	...	21,078,899
9,583,911	4,283,231	...	...	...	22,535,597
10,268,598	17,308	...	...	...	−2,297,724
10,029,760	...	...	...	...	−7,057,694
9,282,244	2,011,418	...	...	...	11,020,582
8,874,262	...	...	...	...	−916,855
8,781,661	...	...	...	−60,323	6,510,071
8,504,974	...	297,667	...	27,695	607,422
7,829,581	...	227,448	...	102,880	352,524
7,940,966	...	176,625	...	67,304	2,616,352
8,019,137	...	119,524	...	−419,140	1,862,433
8,110,462	...	24,579	...	−425,653	4,533,977
8,214,971	...	82,152	...	−54,456	17,617,358
8,429,936	...	141,465	...	−4,333	570,513
8,669,076	...	197,672	...	49,602	3,554,101
8,911,342	...	244,726	...	135,003	40,327,237
9,500,126	...	326,717	...	201,150	48,409,795
10,182,851	...	247,659	...	262,133	81,969,625
10,962,160	...	67,054	...	27,708	81,467,013
11,523,047	...	35,605	75,283,818	86,772	8,366,350
11,919,809	...	...	166,690,356	...	18,522,518
12,329,373	...	...	193,145,837	...	21,461,770
13,082,992	...	...	196,628,858	...	21,849,490
13,864,750	...	...	254,873,588	...	28,320,759
14,681,788	...	...	291,934,634	...	46,333,735
15,558,377	...	...	342,567,985	...	40,336,862
16,442,236	...	...	276,289,457	...	35,887,775
17,711,937	...	...	251,740,721	...	32,709,794
18,904,897	...	...	401,555,581	...	53,982,682
20,080,527	...	...	542,708,405	...	61,603,682
21,197,452	...	...	524,058,650	...	59,214,569
22,721,687	...	...	910,649,768	...	−93,600,791
23,948,225	...	...	896,816,359	...	42,613,100
25.569,541	...	...	687,393,382	...	70,892,300
27,412,241	...	...	799,365,981	...	45,538,200
28,912,019	...	...	879,685,219	...	55,864,300
30,781,548	...	...	1,582,118,614	...	−465,822,800
32,351,602	...	...	1,296,810,053	...	27,053,800
33,696,336	...	...	1,649,455,164	...	18,943,500
35,027,312	...	...	1,907,498,270	...	29,851,200
36,959,336	...	...	2,463,628,983	...	30,027,250
39,236,599	...	...	3,019,160,638	...	39,432,450

7. Income and Expenses of Federal Reserve Banks, 1914-89 – Continued

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (−)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
1970	3,877,218,444	276,571,876	11,441,829	21,227,800	23,573,710
1971	3,723,369,921	319,608,270	94,266,075	32,634,002	24,942,528
1972	3,792,334,523	347,917,112	(49,615,790)	35,234,499	31,454,740
1973	5,016,769,328	416,879,377	(80,653,488)	44,411,700	33,826,299
1974	6,280,090,965	476,234,586	(78,487,237)	41,116,600	30,190,288
1975	6,257,936,784	514,358,633	(202,369,615)	33,577,201	37,130,081
1976	6,623,220,383	558,128,811	7,310,500	41,827,700	48,819,453
1977	6,891,317,498	568,851,419	(177,033,463)	47,366,100	55,008,163
1978	8,455,309,401	592,557,841	(633,123,486)	53,321,700	60,059,365
1979	10,310,148,406	625,168,261	(151,148,220)	50,529,700	68,391,270
1980	12,802,319,335	718,032,836	(115,385,855)	62,230,800	73,124,423
1981	15,508,349,653	814,190,392	(372,879,185)	63,162,700	82,924,013
1982	16,517,385,129	926,033,957	(68,833,150)	61,813,400	98,441,027
1983	16,068,362,117	1,023,678,474	(400,365,922)	71,551,000	152,135,488
1984	18,068,820,742	1,102,444,454	(412,943,156)	82,115,700	162,606,410
1985	18,131,982,786	1,127,744,490	1,301,624,294	77,377,700	173,738,745
1986	17,464,528,361	1,156,867,714	1,975,893,356	97,337,500	180,779,673
1987	17,633,011,623	1,146,910,699	1,796,593,917[2]	81,869,800	170,674,979
1988	19,526,431,297	1,205,960,134	(516,910,320)	84,410,500	164,244,653
1989	22,249,275,725	1,332,160,712	1,295,622,583	89,579,700	175,043,736
Total, 1914–89	**260,759,760,307**	**19,073,996,934**	**3,294,866,788**	**1,360,594,408**	**2,142,554,746**
Aggregate for each Bank, 1914–89					
Boston	13,325,298,022	1,260,555,762	104,323,390	48,986,386	125,789,311
New York	76,869,638,072	3,777,000,569	880,241,305	352,695,286	552,362,532
Philadelphia	10,496,789,614	1,005,530,769	149,136,563	66,499,618	95,627,033
Cleveland	17,531,985,980	1,276,304,240	136,314,156	103,000,190	134,760,176
Richmond	20,536,936,637	1,500,901,394	174,207,621	71,427,476	200,410,547
Atlanta	10,995,255,027	1,658,117,365	303,252,709	103,195,260	127,745,146
Chicago	37,511,095,602	2,502,306,078	391,960,548	191,962,972	297,703,894
St. Louis	8,861,525,563	1,011,653,152	81,196,393	42,164,372	81,187,907
Minneapolis	4,712,877,540	884,907,520	107,981,247	40,649,815	37,455,680
Kansas City	11,224,699,526	1,217,374,670	139,371,190	58,033,009	102,375,522
Dallas	15,020,463,816	1,101,579,357	301,969,932	89,485,073	125,515,905
San Francisco	33,673,194,909	1,973,661,401	524,911,730	192,494,951	261,621,093
Total	**260,759,760,307**	**19,073,996,934**[4]	**3,294,866,788**	**1,360,594,408**	**2,142,554,746**

1. Details may not add to totals because of rounding.
2. For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.
3. The $2,371,553,299 transferred to surplus was reduced by direct changes of $500,000 for charge-off on Bank premises (1927), $139,299,557 for contributions to capital of the Federal Deposit Insurance Corporation (1934) and $3,657 net upon elimination of sec. 13b surplus (1958); and was increased by transfer of $11,131,013 from reserves for contingencies (1945), leaving a balance of $220,619,072 on Dec. 31, 1989.
4. See note 2, table 6.

7. – Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
41,136,551	. . .	. . .	3,493,570,636	. . .	32,579,700
43,488,074	. . .	. . .	3,356,559,873	. . .	40,403,250
46,183,719	. . .	. . .	3,231,267,663	. . .	50,661,000
49,139,682	. . .	. . .	4,340,680,482	. . .	51,178,300
52,579,643	. . .	. . .	5,549,999,411	. . .	51,483,200
54,609,555	. . .	. . .	5,382,064,098	. . .	33,827,600
57,351,487	. . .	. . .	5,870,463,382	. . .	53,940,050
60,182,278	. . .	. . .	5,937,148,425	. . .	45,727,650
63,280,312	. . .	. . .	7,005,779,497	. . .	47,268,200
67,193,615	. . .	. . .	9,278,576,140	. . .	69,141,200
70,354,516	. . .	. . .	11,706,369,955	. . .	56,820,950
74,573,806	. . .	. . .	14,023,722,907	. . .	76,896,650
79,352,304	. . .	. . .	15,204,590,947	. . .	78,320,350
85,151,835	. . .	. . .	14,228,816,297	. . .	106,663,100
92,620,451	. . .	. . .	16,054,094,674	. . .	161,995,900
103,028,905	. . .	. . .	17,796,464,292	. . .	155,252,950
109,587,968	. . .	. . .	17,803,894,710	. . .	91,954,150
117,499,115	. . .	. . .	17,738,879,542	. . .	173,771,400
125,616,018	. . .	. . .	17,364,318,571	. . .	64,971,100
129,885,339	. . .	. . .	21,646,417,306	. . .	130,802,300
2,289,915,830	**149,138,300**	**2,188,893**	**236,623,679,128**	**(3,657)**	**2,371,553,299**[3]
93,742,302	7,111,395	280,843	11,797,881,147	135,411	93,361,925
620,906,530	68,006,262	369,116	71,824,445,161	(433,412)	644,934,821
123,007,176	5,558,901	722,406	9,230,348,020	290,661	114,309,122
182,831,595	4,842,447	82,930	15,826,415,917	(9,906)	136,733,943
116,859,613	6,200,189	172,493	18,667,013,483	(71,517)	145,310,508
159,979,024	8,950,561	79,264	9,013,247,738	5,491	224,088,790
315,118,268	25,313,526	151,045	34,270,520,898	11,682	295,835,104
72,344,483	2,755,629	7,464	7,663,543,975	(26,515)	66,722,778
64,850,455	5,202,900	55,615	3,714,730,505	64,874	71,259,613
95,226,712	6,939,100	64,213	9,788,985,809	(8,674)	92,377,350
141,324,291	560,049	102,083	13,686,192,985	55,337	174,841,978
303,725,380	7,697,341	101,421	31,140,353,490	(17,089)	311,777,367
2,289,915,830	**149,138,300**	**2,188,893**	**236,623,679,128**	**(3,657)**	**2,371,553,299**

8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1989[1]

Dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate[4]
	Land	Buildings (including vaults)[2]	Building machinery and equipment	Total[3]		
BOSTON	22,036,681	80,834,172	5,360,169	108,231,022	90,796,444	...
Annex	27,840	91,092	44,538	163,470	144,188	...
NEW YORK	3,436,277	35,013,736	21,735,584	60,185,597	42,961,060	...
Annex	477,863	1,136,219	745,855	2,359,936	784,227	...
Buffalo	887,844	2,714,398	2,265,777	5,868,019	3,076,497	...
PHILADELPHIA	1,876,601	53,799,827	5,903,704	61,580,131	45,870,427	...
CLEVELAND	1,074,281	7,668,170	6,742,717	15,485,168	10,074,467	1,224,363
Cincinnati	2,246,599	13,693,245	7,618,302	23,558,146	12,775,797	...
Pittsburgh	1,658,376	8,390,480	3,321,583	13,370,439	10,786,426	...
RICHMOND	3,912,575	56,828,288	14,314,313	75,055,176	54,649,526	...
Annex	522,733	3,725,466	3,924,584	8,172,784	3,755,797	...
Baltimore	6,476,335	26,826,903	3,842,189	37,145,427	31,862,732	...
Charlotte	1,471,529	35,529,494	0	37,001,023	36,728,497	...
ATLANTA	1,202,255	14,762,133	3,564,698	19,529,086	14,206,492	13,071,576
Birmingham	3,031,888	1,905,770	1,067,791	6,005,449	4,156,649	...
Jacksonville	1,652,056	16,259,535	2,418,745	20,330,337	19,209,176	909,313
Miami	3,717,791	11,978,362	2,136,599	17,832,752	14,603,968	...
Nashville	592,342	1,474,678	1,434,027	3,501,048	1,525,135	...
New Orleans	3,087,693	3,031,265	1,476,257	7,595,215	4,902,313	292,710
CHICAGO	4,511,942	103,723,344	15,487,743	123,723,029	102,259,054	...
Annex	53,066	904,562	426,419	1,384,047	1,215,238	...
Detroit	797,734	3,323,021	4,049,085	8,169,840	6,288,871	...
ST. LOUIS	700,378	11,285,257	5,283,870	17,269,505	12,814,230	...
Little Rock	1,148,492	2,116,765	1,003,022	4,268,280	2,525,381	...
Louisville	700,075	2,886,531	1,131,238	4,717,844	2,745,151	...
Memphis	1,135,623	4,435,493	2,128,684	7,699,799	4,792,596	...
MINNEAPOLIS	1,394,384	26,664,805	7,829,924	35,889,112	21,204,551	...
Helena	1,595,886	4,676,874	68,689	6,341,449	6,123,035	226,682
KANSAS CITY	1,798,804	19,293,282	8,839,833	29,931,919	21,515,937	149,948
Denver	3,187,962	4,096,303	3,577,637	10,861,902	8,272,522	...
Oklahoma City	646,386	2,370,331	2,162,878	5,179,594	4,254,688	...
Omaha	6,534,583	11,053,589	1,401,083	18,989,255	17,952,696	...
DALLAS	3,772,638	8,962,282	3,737,706	16,475,627	13,656,104	...
El Paso	262,477	1,436,467	393,301	2,092,245	2,027,344	...
Houston	2,049,064	3,535,122	1,133,316	6,538,502	5,852,198	...
San Antonio	482,284	2,609,708	1,332,801	4,424,793	3,820,369	...
SAN FRANCISCO	15,541,937	67,475,175	17,386,765	100,403,878	83,614,738	...
Los Angeles	3,891,887	49,020,125	8,334,890	61,246,902	57,002,828	...
Portland	207,381	2,299,414	983,879	3,490,673	2,923,776	...
Salt Lake City	480,222	3,998,031	1,389,875	5,868,128	3,460,762	...
Seattle	274,772	2,334,457	1,836,988	4,446,217	2,685,989	...
Total	**110,560,536**	**713,985,173**	**177,837,057**	**1,002,382,766**	**789,897,875**	**15,874,592**

1. Details may not add to totals because of rounding.
2. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.
3. Excludes charge-offs of $17,698,968 before 1952.
4. Covers acquisitions for banking-house purposes and bank premises formerly occupied and being held pending sale.

9. Operations in Principal Departments of Federal Reserve Banks, 1986–89

Operation	1989	1988	1987	1986
Millions of pieces (except as noted)				
Loans (thousands)	22	22	25	19
Currency received and counted	19,857	17,580	16,881	15,408
Currency verified and destroyed	6,319	5,910	5,217	5,584
Coin received and counted	12,668	17,137	19,871	20,461
Checks handled				
U.S. government checks	541	547	568	585
Postal money orders	147	144	146	140
All other	18,014	17,623	17,006	16,226
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities [1,2]	40	186	191	204
Transfer of funds	60	56	52	50
Food stamps redeemed	2,334	2,327	2,210	2,216
Millions of dollars				
Loans	229,358	537,952	151,323	193,424
Currency received and counted	246,598	195,647	216,151	197,516
Currency verified and destroyed	59,985	47,184	44,907	47,842
Coin received and counted	1,828	3,684	3,517	3,088
Checks handled				
U.S. government checks	635,064	608,307	610,678	606,029
Postal money orders	14,284	13,189	12,511	11,103
All other	12,321,576	11,789,787	11,453,158	10,546,900
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities [1,3]	98,130,603	89,516,419	90,056,338	75,447,899
Transfer of fund [4]	182,575,303	160,730,050	152,453,528	125,028,070
Food stamps redeemed	11,714	10,748	10,322	10,475

1. Before 1988, data included book-entry securities transfers both sent and received. After 1987, the data include only the transfers sent.
2. Agents' savings bonds transactions are not included in the 1989 data.
3. Agents' savings bonds transactions, although excluded from the 1989 data, are small in dollar amounts.
4. Before 1987, funds transfer dollar volume data were compiled using a different methodology.

10. Federal Reserve Bank Interest Rates, December 31, 1989

Bank	Loans to depository institutions		
	Adjustment credit and seasonal credit[1]	Extended credit[2]	
		First 30 days of borrowing	After 30 days of borrowing[3]
All Federal Reserve Banks . .	7.0	7.0	8.9

1. Adjustment credit is available on a short-term basis to help depository institutions meet temporary needs for funds that cannot be met through reasonable alternative sources. After May 19,1986, the highest rate established for loans to depository institutions may be charged on adjustment credit loans of unusual size that result from a major operating problem at the borrower's facility.

Seasonal credit is available to help smaller depository institutions meet regular, seasonal needs for funds that cannot be met through special industry lenders and that arise from a combination of expected patterns of movement in their deposits and loans. See sections 201.3(a) and 201.3(b)(1) of Regulation A.

2. Extended credit is available to depository institutions, if similar assistance is not reasonably available from other sources, when exceptional circumstances or practices involve only a particular institution or when an institution is experiencing difficulties adjusting to changing market conditions over a longer period of time.

3. For extended-credit loans outstanding more than 30 days, a flexible rate somewhat above rates on market sources of funds ordinarily will be charged, but in no case will the rate charged be less than the basic discount rate plus 50 basis points. The flexible rate is reestablished on the first business day of each two-week reserve maintenance period. At the discretion of the Federal Reserve Bank, the time period for which the basic discount rate is applied may be shortened. See section 201.3(b)(2) of Regulation A.

11. Reserve Requirements of Depository Institutions[1]

Type of deposit, and deposit interval[2]	Depository institution requirements after implementation of the Monetary Control Act	
	Percent of deposits	Effective date
Net transaction accounts[3,4]		
$0 million–$40.4 million	3	12/19/89
More than $40.4 million	12	12/19/89
Nonpersonal time deposits[5]		
By original maturity		
Less than 1½ years	3	10/6/83
1½ years or more	0	10/6/83
Eurocurrency liabilities		
All types	3	11/13/80

1. Reserve requirements in effect on Dec. 31, 1989. Required reserves must be held in the form of deposits with Federal Reserve Banks or vault cash. Nonmembers may maintain reserve balances with a Federal Reserve Bank indirectly on a pass-through basis with certain approved institutions.

For previous reserve requirements, see earlier editions of the *Annual Report* and of the *Federal Reserve Bulletin*. Under provisions of the Monetary Control Act, depository institutions include commercial banks, mutual savings banks, savings and loan associations, credit unions, agencies and branches of foreign banks, and Edge corporations.

2. The Garn–St Germain Depository Institutions Act of 1982 (Public Law 97-320) requires that $2 million of reservable liabilities (transaction accounts, nonpersonal time deposits, and Eurocurrency liabilities) of each depository institution be subject to a zero percent reserve requirement. The Board is to adjust the amount of reservable liabilities subject to this zero percent reserve requirement each year for the succeeding calendar year by 80 percent of the percentage increase in the total reservable liabilities of all depository institutions, measured on an annual basis as of June 30. No corresponding adjustment is to be made in the event of a decrease. On Dec. 20, 1988, the exemption was raised from $3.2 million to $3.4 million. In determining the reserve requirements of depository institutions, the exemption shall apply in the following order: (1) net NOW accounts (NOW accounts less allowable deductions); (2) net other transaction accounts; and (3) nonpersonal time deposits or Eurocurrency liabilities starting with those with the highest reserve ratio. With respect to NOW accounts and other transaction accounts, the exemption applies only to such accounts that would be subject to a 3 percent reserve requirement.

3. Transaction accounts include all deposits on which the account holder is permitted to make withdrawals by negotiable or transferable instruments, payment orders of withdrawal, and telephone and preauthorized transfers in excess of three per month for the purpose of making payments to third persons or others. However, MMDAs and similar accounts subject to the rules that permit no more than six preauthorized, automatic, or other transfers per month, of which no more than three can be checks, are not transaction accounts (such accounts are savings deposits subject to time deposit reserve requirements).

4. The Monetary Control Act of 1980 requires that the amount of transaction accounts against which the 3 percent reserve requirement applies be modified annually by 80 percent of the percentage change in transaction accounts held by all depository institutions, determined as of June 30 each year. Effective Dec. 19, 1989, for institutions reporting quarterly and Dec. 26, 1989, for institutions reporting weekly, the amount was decreased from $41.5 million to $40.5 million.

5. In general, nonpersonal time deposits are time deposits, including savings deposits, that are not transaction accounts and in which a beneficial interest is held by a depositor that is not a natural person. Also included are certain transferable time deposits held by natural person and certain obligations issued to depository institution offices located outside the United States. For details, see section 204.2 of Regulation D.

12. Initial Margin Requirements under Regulations T, U, G, and X[1]

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only[2]
1934, Oct. 1	25–45	...	...
1936, Feb. 1	25–55	...	...
Apr. 1	55	...	...
1937, Nov. 1	40	...	50
1945, Feb. 5	50	...	50
July 5	75	...	75
1946, Jan. 21	100	...	100
1947, Feb. 21	75	...	75
1949, Mar. 3	50	...	50
1951, Jan. 17	75	...	75
1953, Feb. 20	50	...	50
1955, Jan. 4	60	...	60
Apr. 23	70	...	70
1958, Jan. 16	50	...	50
Aug. 5	70	...	70
Oct. 16	90	...	90
1960, July 28	70	...	70
1962, July 10	50	...	50
1963, Nov. 6	70	...	70
1968, Mar. 11	70	50	70
June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50

1. These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry "margin securities" (as defined in the regulations) when such credit is collateralized by securities. Margin requirements on securities other than options are the difference between the market value (100 percent) and the maximum loan value of collateral as prescribed by the Board. Regulation T was adopted effective Oct. 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective Mar. 11, 1968; and Regulation X, effective Nov. 1, 1971.

On Jan. 1, 1977, the Board of Governors for the first time established in Regulation T the initial margin required for writing options on securities, setting it at 30 percent of the current market value of the stock underlying the option. On Sept. 30, 1985, the Board changed the required initial margin, allowing it to be the same as the option maintenance margin required by the appropriate exchange or self-regulatory organization; such maintenance margin rules must be approved by the Securities and Exchange Commission. Effective Jan. 31, 1986, the SEC approved new maintenance margin rules, permitting margins to be the price of the option plus 15 percent of the market value of the stock underlying the option.

2. From Oct. 1, 1934, to Oct. 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

13. Principal Assets and Liabilities and Number of Insured Commercial Banks, by Class of Bank, June 30, 1989 and 1988[1]

Asset and liability items shown in millions of dollars

Item	Total	Member banks			Nonmember banks
		Total	National	State	
	June 30, 1989				
Loans and investments	2,259,427	1,670,844	1,356,464	314,381	588,583
Gross loans	1,757,409	1,327,557	1,087,994	239,563	429,852
Net loans	1,743,883	1,317,868	1,080,100	237,769	426,014
Investments	502,018	343,287	268,469	74,818	158,731
U.S. Treasury and federal agency securities	341,394	229,814	183,443	46,371	111,580
Other	160,624	113,473	85,026	28,446	47,151
Cash assets, total	216,225	168,094	134,473	33,621	48,131
Deposits, total	2,093,121	1,520,354	1,235,203	285,151	572,767
Interbank	52,659	45,443	33,406	12,037	7,216
Other transaction	579,742	429,729	344,286	85,443	150,013
Other nontransaction	1,650,150	1,176,079	967,559	208,520	474,071
Equity capital	202,419	146,170	113,775	32,395	56,250
Number of banks	12,874	5,306	4,270	1,036	7,568
	June 30, 1988				
Loans and investments	2,130,609	1,578,755	1,272,420	306,335	551,854
Gross loans	1,650,128	1,252,073	1,016,003	236,070	398,055
Net loans	1,637,127	1,242,918	1,008,842	234,076	394,209
Investments	480,481	326,682	256,417	70,266	153,799
U.S. Treasury and federal agency securities	311,925	207,957	166,270	41,688	103,968
Other	168,556	118,725	90,147	28,578	49,830
Cash assets, total	209,739	160,954	128,303	32,651	48,785
Deposits, total	1,990,055	1,442,088	1,158,607	283,481	547,967
Interbank	59,954	52,181	36,755	15,427	7,773
Other demand	583,863	434,551	343,689	90,863	149,312
Other time and savings	1,535,293	1,084,794	886,477	198,316	450,499
Equity capital	184,490	132,574	102,691	29,883	51,916
Number of banks	13,334	5,530	4,460	1,070	7,804

1. All insured commercial banks in the United States.

Details may not add to totals because of rounding.

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items – Year-End 1918–89, and Month-End 1989[1]

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	Total			
	Total	Bought outright	Held under repurchase agreement								
1918	239	239	0	1,766	199	294	0	2,498	2,873	...	1,795
1919	300	300	0	2,215	201	575	0	3,292	2,707	...	1,707
1920	287	287	0	2,687	119	262	0	3,355	2,639	...	1,709
1921	234	234	0	1,144	40	146	0	1,563	3,373	...	1,842
1922	436	436	0	618	78	273	0	1,405	3,642	...	1,958
1923	134	80	54	723	27	355	0	1,238	3,957	...	2,009
1924	540	536	4	320	52	390	0	1,302	4,212	...	2,025
1925	375	367	8	643	63	378	0	1,459	4,112	...	1,977
1926	315	312	3	637	45	384	0	1,381	4,205	...	1,991
1927	617	560	57	582	63	393	0	1,655	4,092	...	2,006
1928	228	197	31	1,056	24	500	0	1,809	3,854	...	2,012
1929	511	488	23	632	34	405	0	1,583	3,997	...	2,022
1930	739	686	43	251	21	372	0	1,373	4,306	...	2,027
1931	817	775	42	638	20	378	0	1,853	4,173	...	2,035
1932	1,855	1,851	4	235	14	41	0	2,145	4,226	...	2,204
1933	2,437	2,435	2	98	15	137	0	2,688	4,036	...	2,303
1934	2,430	2,430	0	7	5	21	0	2,463	8,238	...	2,511
1935	2,431	2,430	1	5	12	38	0	2,486	10,125	...	2,476
1936	2,430	2,430	0	3	39	28	0	2,500	11,258	...	2,532
1937	2,564	2,564	0	10	19	19	0	2,612	12,760	...	2,637
1938	2,564	2,564	0	4	17	16	0	2,601	14,512	...	2,798
1939	2,484	2,484	0	7	91	11	0	2,593	17,644	...	2,963
1940	2,184	2,184	0	3	80	8	0	2,274	21,995	...	3,087
1941	2,254	2,254	0	3	94	10	0	2,361	22,737	...	3,247
1942	6,189	6,189	0	6	471	14	0	6,679	22,726	...	3,648
1943	11,543	11,543	0	5	681	10	0	12,239	21,938	...	4,094
1944	18,846	18,846	0	80	815	4	0	19,745	20,619	...	4,131
1945	24,252	24,252	0	249	578	2	0	15,091	20,065	...	4,339
1946	23,350	23,350	0	163	580	1	0	24,093	20,529	...	4,562
1947	22,559	22,559	0	85	535	1	0	23,181	22,754	...	4,562
1948	23,333	23,333	0	223	541	1	0	24,097	24,244	...	4,589
1949	18,885	18,885	0	78	534	2	0	19,499	24,427	...	4,598
1950	20,778	20,725	53	67	1,368	3	0	22,216	22,706	...	4,636
1951	23,801	23,605	196	19	1,184	5	0	25,009	22,695	...	4,709
1952	24,697	24,034	663	156	967	4	0	25,825	23,187	...	4,812
1953	25,916	25,318	598	28	935	2	0	26,880	22,030	...	4,894
1954	24,932	24,888	44	143	808	1	0	25,885	21,713	...	4,985
1955	24,785	24,391	394	108	1,585	29	0	26,507	21,690	...	5,008
1956	24,915	24,610	305	50	1,665	70	0	26,699	21,949	...	5,066
1957	24,238	23,719	519	55	1,424	66	0	25,784	22,781	...	5,146
1958	26,347	26,252	95	64	1,296	49	0	27,755	20,534	...	5,234
1959	26,648	26,607	41	458	1,590	75	0	28,771	19,456	...	5,311
1960	27,384	26,984	400	33	1,847	74	0	29,338	17,767	...	5,398
1961	28,881	30,478	159	130	2,300	51	0	31,362	16,889	...	5,585
1962	30,820	28,722	342	38	2,903	110	0	33,871	15,978	...	5,567
1963	33,593	33,582	11	63	2,600	162	0	36,418	15,513	...	5,578
1964	37,044	36,506	538	186	2,606	94	0	39,930	15,388	...	5,405

For notes see last two pages of table.

14. – Continued

Factors absorbing reserve funds

Currency in circulation	Treasury cash holdings[7]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[4]	Member bank reserves[8]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10]
4,951	288	51	96	25	118	0	0	1,636	0	1,585	51
5,091	385	51	73	28	208	0	0	1,890	0	1,822	68
5,325	218	57	5	18	298	0	0	1,781	0	0	0
4,403	214	96	12	15	285	0	0	1,753	0	1,654	99
4,530	225	11	3	26	276	0	0	1,934	0	0	0
4,757	213	38	4	19	275	0	0	1,898	0	1,884	14
4,760	211	51	19	20	258	0	0	2,220	0	2,161	59
4,817	203	16	8	21	272	0	0	2,212	0	2,256	−44
4,808	201	17	46	19	293	0	0	2,194	0	2.250	−56
4,716	208	18	5	21	301	0	0	2,487	0	2,424	63
4,686	202	23	6	21	348	0	0	2,389	0	2,430	−41
4,578	216	29	6	24	393	0	0	2,355	0	2,428	−73
4,603	211	19	6	22	375	0	0	2,471	0	2,375	96
5,360	222	54	79	31	354	0	0	1,961	0	1,994	−33
5,388	272	8	19	24	355	0	0	2,509	0	1,933	576
5,519	284	3	4	128	360	0	0	2,729	0	1,870	859
5,536	3,029	121	20	169	241	0	0	4,096	0	2,282	1,814
5,882	2,566	544	29	226	253	0	0	5,587	0	2,743	2,844
6,543	2,376	244	99	160	261	0	0	6,606	0	4,622	1,984
6,550	3,619	142	172	235	263	0	0	7,027	0	5,815	1,212
6,856	2,706	923	199	242	260	0	0	8,724	0	5,519	3,205
7,598	2,409	634	397	256	251	0	0	11,653	0	6,444	5,209
8,732	2,213	368	1,133	599	284	0	0	4,026	0	7,411	6,615
11,160	2,215	867	774	586	291	0	0	12,450	0	9,365	3,085
15,410	2,193	799	793	485	256	0	0	13,117	0	11,129	1,988
20,499	2,303	579	1,360	356	339	0	0	12,886	0	11,650	1,236
25,307	2,375	440	1,204	394	402	0	0	14,373	0	12,748	1,625
28,515	2,287	977	862	446	495	0	0	15,915	0	14,457	1,458
28,952	2,272	393	508	314	607	0	0	16,139	0	15,577	562
28,868	1,336	870	392	569	563	0	0	17,899	0	16,400	1,499
28,224	1,325	1,123	642	547	590	0	0	20,479	0	19,277	1,202
27,600	1,312	821	767	750	106	0	0	16,568	0	15,550	1.018
27,741	1,293	668	895	565	714	0	0	17,681	0	16,509	1,172
29,206	1,270	247	526	363	746	0	0	20,056	0	19,667	389
30,433	1,270	389	550	455	777	0	0	19,950	0	20,520	−570
30,781	761	346	423	493	839	0	0	20,160	0	19,397	763
30,509	796	563	490	441	907	0	0	18,876	0	18,618	258
31,158	767	394	402	554	925	0	0	19,005	0	18,903	102
31,790	775	441	322	426	901	0	0	19,059	0	19,089	−30
31,834	761	481	356	246	998	0	0	19,034	0	19,091	−57
32,193	683	358	272	391	1,122	0	0	18,504	0	18,574	−70
32,591	391	504	345	694	841	0	0	18,174	310	18,619	−135
32,869	377	485	217	533	941	0	0	17,081	2,544	18,988	637
33,918	422	465	279	320	1,044	0	0	17,387	2,544	18,988	96
35,338	380	597	247	393	1,007	0	0	17,454	3,262	20,071	645
37,692	361	880	171	291	1,065	0	0	17,049	4,099	20,677	471
39,619	612	820	229	321	1,036	0	0	18,086	4,151	21,663	574

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items – Year-End 1918–89, and Month-End 1989[1] – Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	Total			
	Total	Bought outright[12]	Held under repurchase agreement								
1965	40,768	40,478	290	137	2,248	187	0	43,340	13,733	...	5,575
1966	44,316	43,655	661	173	2,495	193	0	47,177	13,159	...	6,317
1967	49,150	48,980	170	141	2,576	164	0	52,031	11,982	...	6,784
1968	52,937	52,937	0	186	3,443	58	0	56,624	10,367	...	6,795
1969	57,154	7,154[3]	0	183	3,440	64	2,743	64,584	10,367	...	6,852
1970	62,142	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971	70,804	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972	71,230	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973	80,495	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974	85,714	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975	94,124	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976	104,093	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977	111,274	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978	118,591	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979	126,167	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	13,083
1980	130,592	128,038	2,554	1,809	4,467	776	8,739	146,383	11,160	2,518	13,427
1981	140,348	136,863	3,485	1,601	1,762	195	9,230	153,136	11,151	3,318	13,687
1982	148,837	144,544	4,293	717	2,735	1,480	9,890	63,659	11,148	4,618	13,786
1983	160,795	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732
1984	169,627	167,612	2,015	3,577	833	0	12,347	186,384	11,096	4,618	16,418
1985	191,248	186,025	5,223	3,060	988	0	15,302	210,598	11,090	4,718	17,075
1986	221,459	205,454	16,005	1,565	1,261	0	17,475	241,760	11,084	5,018	17,567
1987	231,420	226,459	4,961	3,815	811	0	15,837	251,883	11,078	5,018	18,177
1988	247,489	240,628	6,861	2,170	1,286	0	18,803	269,748	11,060	5,018	18,799
1989	235,417	233,300	2,117	481	1,093	0	39,631	276,622	11,059	8,518	19,620
1989											
Jan....	239,752	239,752	0	863	798	0	19,643	261,056	11,056	5,018	18,855
Feb ...	236,278	236,278	0	1,602	1,296	0	19,253	258,429	11,061	5,018	18,911
Mar...	235,422	235,422	0	2,454	559	0	19,780	258,215	11,061	5,368	18,961
Apr ...	255,001	241,462	13,539	1,952	545	0	21,515	279,013	11,061	5,518	19,017
May...	230,189	230,189	0	2,033	2,064	0	22,383	256,669	11,060	8,518	19,073
June...	238,421	238,421	0	841	−203	0	29,978	269,037	11,063	8,518	19,211
July ...	225,285	225,285	0	594	351	0	32,915	259,145	11,066	8,518	19,309
Aug...	224,018	224,018	0	541	634	0	31,722	256,914	11,066	8,518	19,344
Sept...	227,606	227,606	0	598	501	0	35,433	264,137	11,066	8,518	19,425
Oct....	224,701	224,701	0	270	1,471	0	38,275	264,717	11,062	8,518	19,494
Nov...	229,667	229,667	0	181	668	0	36,544	267,060	11,060	8,518	19,564
Dec ...	235,417	233,300	2,117	481	1,093	0	39,631	276,622	11,059	8,518	19,620

1. For a description of figures and discussion of their significance, see *Banking and Monetary Statistics, 1941–1970* (Board of Governors of the Federal Reserve System, 1976), pp. 507–23. Components may not add to totals because of rounding.
2. Beginning with 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.
3. Principally acceptances and, until Aug. 21, 1959, industrial loans, authority for which expired on that date.
4. For the period before Apr. 16, 1969, includes the total of Federal Reserve capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets, and was reported as "Other Federal Reserve accounts"; thereafter, "Other Federal Reserve assets" and "Other Federal Reserve liabilities and capital" are shown separately.
5. For the period before Jan. 30, 1934, includes gold held in Federal Reserve Banks and in circulation.
6. Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details see "Currency and Coin in Circulation," *Treasury Bulletin*.
7. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.
8. Beginning in November 1979, includes reserves of member banks. Edge corporations, and U.S. agencies and branches of foreign banks. Beginning on Nov. 13, 1980, includes reserves of all depository institutions.
9. Between Dec. 1, 1959, and Nov. 23, 1960, part was allowed as reserves; thereafter all was allowed.
10. Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call dates were Dec. 29). Beginning on Sept. 12, 1968, the amount is based on close-of-business figures for the reserve period two weeks before the report date.

14.—Continued

Factors absorbing reserve funds											
		Deposits, other than reserves, with Federal Reserve Banks						Member bank reserves[8]			
Currency in circulation	Treasury cash holdings[7]	Treasury	Foreign	Other	Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[4]	With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10,13]
42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	−238
44,663	1,176	416	174	588	−147	0	0	19,779	4,310	24,321	−232
47,226	1,344	1,123	135	563	−773	0	0	21,092	4,631	25,905	−182
50,961	695	703	216	747	−1,353	0	0	21,818	4,921	27,439	−700
53,950	596	1,312	134	807	0	0	0	22,085	5,187	28,173	−901
57,903	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	−460
61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98[13]
72,497	317	2,542	251	1,419[14]	0	0	2,669	27,060	6,781	35,268	−1,360
79,743	185	2,113	418	1,275[14]	0	0	2,935	25,843	7,370	37,011	−3,798
86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	−1,103[15]
93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	−1,535
103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	−1,265
114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	−893
125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	−2,835
136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	−1,442
154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
171,935	479	3,661	191	851	0	1,013	5,392	20,413	17,821	39,179	−945
183,796	513	5,316	253	867	0	1,126	5,952	20,693			
197,488	550	9,351	480	1,041	0	1,490	5,940	27,141.			
211,995	447	7,588	287	917	0	1,812	6,088	46,295			
230,205	454	5,313	244	1,027	0	1,687	7,129	40,097			
247,649	395	8,656	347	548	0	1,605	7,683	37,742			
260,453	450	6,217	589	1,298	0	1,626	8,486	36,701			
239,581	412	11,766	279	390	0	1,589	7,746	34,221			
240,733	432	6,298	326	517	0	1,595	8,127	35,390	n.a.	n.a.	n.a.
242,880	457	4,462	351	380	0	1,671	7,681	35,723			
243,411	476	22,952	352	481	0	1,667	8,969	36,301			
247,525	488	5,288	429	524	0	1,616	7,513	31,937			
249,139	474	12,153	275	229	0	1,616	8,178	35,765			
248,637	451	5,312	371	236	0	1,592	8,693	32,747			
249,245	420	6,652	265	273	0	1,611	7,063	30,313			
247,581	440	13,452	326	318	0	1,630	8,776	30,623			
249,025	444	13,124	252	292	0	1,623	8,303	30,728			
253,960	445	5,500	307	311	0	1,638	8,402	35,639			
260,453	450	6,217	589	1,298	0	1,626	8,486	36,701			

11. Beginning on Dec. 1, 1966, includes federal agency obligations held under repurchase agreements and beginning on Sept. 29, 1971, federal agency issues bought outright.

12. Includes, beginning in 1969, securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale-purchase transactions.

13. Beginning with week ending Nov. 15, 1972, includes $450 million of reserve deficiencies on which Federal Reserve Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective Nov. 9, 1972. Allowable deficiencies are as follows (beginning with first statement week of quarter, in millions): 1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; 1974—Q1, $67; Q2, $58. The transition period ended with the second quarter of 1974.

14. For the period before July 1973, includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with Federal Reserve Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System program of credit restraint.

As of Dec. 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at Federal Reserve Banks that are associated with marginal reserves are no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States and (2) Eurodollar liabilities.

15. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy effective Nov. 19, 1975.

15. Changes in Number of Banking Offices in the United States, 1989[1]

Type of office and change	Total	Commercial banks[2]						Mutual savings banks	
		Total	Member			Nonmember			
			Total	National	State	Insured	Non-insured[3]	Insured	Non-insured
Banks, Dec. 31, 1988...	13,791	13,415	5,448	4,354	1,094	7,717	250	376	0
Changes during 1989									
New banks............	235	233	91	72	19	110	32	2	0
Ceased banking operation..........	−243	−243	−132	−116	−16	−93	−18	0	0
Banks converted into branches	−401	−396	−163	−133	−30	−233	0	−5	0
Other[4]	−4	−4	7	1	6	−5	−6	0	0
Net change	−413	−410	−197	−176	−21	−221	8	−3	0
Banks, Dec. 31, 1989 ..	**13,378**	**13,005**	**5,251**	**4,178**	**1,073**	**7,496**	**258**	**373**	**0**
Branches and additional offices, Dec. 31, 1988	49,519	46,713	30,384	24,942	5,442	16,218	111	2,806	0
Changes during 1989									
De novo..............	1,770	1,678	1,096	895	201	578	4	92	0
Banks converted into branches	401	396	203	145	58	193	0	5	0
Discontinued	−650	−581	−419	−325	−94	−158	−4	−69	0
Sale of branch..........	0	18	30	21	9	−12	0	−18	0
Other[4]	1,672	1,634	1,476	1220	256	148	10	38	0
Net change[4]	3,193	3,145	2,386	1,956	430	749	10	48	0
Branches and additional offices, Dec. 31, 1989	**52,712**	**49,858**	**32,770**	**26,898**	**5,872**	**16,967**	**121**	**2,854**	**0**

1. Preliminary. Final data will be available in the *Annual Statistical Digest, 1989*, forthcoming.
2. Includes stock savings banks and nondeposit trust companies.
3. As of Dec. 31, 1988, includes noninsured national trust companies.
4. Includes interclass changes.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1989

First Western Bank Custer, Custer, South Dakota, *to acquire the* **Hill City South Dakota branch of Rushmore State Bank, Rapid City, South Dakota**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12/16/88)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/20/89)
First Western Bank Custer (Applicant) has assets of $32 million and the Hill City Branch (Branch) has assets of $5.6 million. Applicant and Branch operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Central Bank, Hollidaysburg, Pennsylvania, *to acquire the* **Pleasant Valley and Logan Valley branches of United States National Bank, Johnstown, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (1/13/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/17/89)
Central Bank (Applicant) has assets of $167 million and the two branches (Branches) have assets of $15.7 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Crestar Bank, Richmond, Virginia, *to merge with* **Colonial American National Bank, Roanoke County, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (1/13/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/14/89)
Crestar Bank (Applicant) has assets of $9.4 billion and Colonial American National Bank (Bank) has assets of $367 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Bank of Mid Jersey, Bordentown, New Jersey, *to acquire the* **University Plaza branch office of Howard Savings Bank, Livingston, New Jersey**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/17/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/17/89)
The Bank of Mid Jersey (Applicant) has assets of $527.8 million and the University Plaza Branch (Branch) has assets of $5.7 million. Applicant and Branch operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Kent City State Bank, Kent City, Michigan, *to acquire the* **Sparta, Michigan branch office of PrimeBank Federal Savings Bank, Grand Rapids, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/3/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/31/89)
Kent City State Bank (Applicant) has assets of $53.6 million and the Sparta Branch (Branch) has assets of $7.5 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Central Bank of Oklahoma City, Oklahoma City, Oklahoma, *to acquire certain assets and assume liabilities of* **Allied Oklahoma Bank, N.A., Oklahoma City, Oklahoma**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of Allied Oklahoma Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/13/89)

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1989 – Continued

Central Bank of Oklahoma City (Applicant) has assets of $229.3 million and Allied Oklahoma Bank (Bank) has assets of $ 59.1 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Family Bank of Hallandale, Hallandale, Florida, *to merge with* **Seminole National Bank, Hollywood, Florida**

Summary Report by the Attorney General
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of the Bank.

Basis for Approval by the Federal Reserve (4/26/89)
Family Bank (Applicant) has assets of $93.3 million and Seminole National Bank (Bank) has assets of $7.3 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Bank of Fountain Hills, Fountain Hills, Arizona, *to assume deposit liabilities of* **Grand Canyon State Bank, Scottsdale, Arizona**

Summary Report by the Attorney General
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of the Bank.

Basis for Approval by the Federal Reserve (5/22/89)
Bank of Fountain Hills (Applicant) has assets of $6.9 million and Grand Canyon State Bank (Bank) has deposits of $12.3 million. The State has recommended immediate action to prevent the probable failure of the Bank.

Banco De Ponce, Ponce, Puerto Rico, *to acquire the* **Prospect Avenue Branch of Banco Central S.A., New York, New York**

Summary Report by the Attorney General (4/14/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (6/1/89)
Banco De Ponce (Applicant) has assets of $2.9 billion and the Prospect Avenue Branch (Branch) has assets of $3.4 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Union Colony Bank, Greeley, Colorado, *to merge with* **Northern Bank and Trust, Ft. Collins, Colorado**

Summary Report by the Attorney General
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of Northern Bank and Trust.

Basis for Approval by the Federal Reserve (6/15/89)
Union Colony Bank (Applicant) has assets of $115.6 million and Northern Bank and Trust (Bank) has assets of $6.2 million. The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Liberty Bank South, San Francisco, California, *to acquire certain assets and liabilities of the* **Boulder Creek Branch of Pacific Western Bank, San Jose, California**

Summary Report by the Attorney General (3/3/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (6/16/89)
Liberty Bank (Applicant) has assets of $47 million and the Boulder Creek Branch (Branch) has assets of $14 million. Applicant and Bank do not operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Texas Commerce Bank Rio Grande Valley, Brownsville, Texas, *to merge with* **National Bank of Brownsville, Brownsville, Texas**

Summary Report by the Attorney General
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of the National Bank of Brownsville.

16.—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/13/89)
Texas Commerce Bank (Applicant) has assets of $442.2 million and National Bank of Brownsville (Bank) has assets of $32.7 million. The Federal Reserve System has acted immediately to prevent the probable failure of Bank.

Bank of Fountain Hills, Fountain Hills, Arizona, *to merge with* **Fidelity Bank, Scottsdale, Arizona**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of the Fidelity Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/21/89)
Bank of Fountain Hills (Applicant) has assets of $11.8 million and Fidelity Bank (Bank) has assets of $11.5 million. The Federal Reserve System has acted immediately to prevent the probable failure of Bank.

BancFirst, Oklahoma City, Oklahoma, *to assume the liabilities of* **The Liberty State Bank, Tahlequah, Oklahoma**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7/14/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/27/89)
BancFirst (Applicant) has assets of $657 million and The Liberty State Bank (Bank) has assets of $41 million. Applicant and Bank do not operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Community Bank, Princeton, West Virginia, *to merge with* **Cherry River National Bank, Richwood, West Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7/5/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/28/89)
First Community Bank (Applicant) has assets of $360.2 million and Cherry River National Bank (Bank) has assets of $36.8 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Interstate Bank of California, Los Angeles, California, *to merge with* **Bank of Alex Brown, Sacramento, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (5/10/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8/1/89)
First Interstate Bank of California (Applicant) has assets of $19.6 billion and Bank of Alex Brown (Bank) has assets of $324 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Comerica Bank—Detroit, Detroit, Michigan, *to merge with* **Dearborn Bank and Trust Company, Dearborn, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/11/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/21/89)
Comerica Bank Detroit (Applicant) has assets of $9.1 billion and Dearborn Bank and Trust Company (Bank) has assets of $287.2 million. Applicant and Bank do not operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval. Manufacturers Hanover Trust Company, New York, New York, to purchase certain branches of Goldome, Buffalo, New York

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/14/89)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/26/89)
Manufacturers Hanover Trust Company (Applicant) has assets of $57 billion and the 12 branches

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1989 – Continued

(Branches) has assets of $1.2 billion. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Central Savings Bank, Sault Ste. Marie, Michigan, *to acquire certain assets and liabilities of the* **Main Street Branch of First of America Bank, Northern Michigan, Cheboygan, Michigan**

Summary Report by the Attorney General (9/1/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/3/89)
Central Savings Bank (Applicant) has assets of $68 million and The Main Street Branch (Branch) has assets of $2.2 million. Applicant and Bank do not operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Meridian Bank, Reading, Pennsylvania, *to merge with* **Hill Financial Savings Association, Red Hill, Pennsylvania**

Summary Report by the Attorney General (9/12/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/13/89)
Meridian Bank (Applicant) has assets of $8.5 billion and Hill Financial Savings Association (Bank) has assets of $2.0 billion. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Heartland Bank, Croton, Ohio, *to merge with* **Lyndon Guaranty Bank of Ohio, Columbus, Ohio**

Summary Report by the Attorney General (10/4/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/23/89)
Heartland Bank (Applicant) has assets of $36 million and Lyndon Guaranty Bank of Ohio (Bank) has assets of $16 million. Applicant and Bank do not operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

CivicBank of Commerce, Oakland, California, *to merge with* **Meridian National Bank, Concord, California**

Summary Report by the Attorney General (10/18/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/9/89)
CivicBank of Commerce (Applicant) has assets of $232 million and Meridian National Bank (Bank) has assets of $87 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Central Bank, Hollidaysburg, Pennsylvania, *to merge with* **two branches of Landmark Savings Association**

Summary Report by the Attorney General (10/12/89)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (12/6/89)
Central Bank (Applicant) has assets of $203.8 million and the two branches (Branches) have assets of $17.0 million. Applicant and Bank operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Rapides Bank and Trust Company in Alexandria, Alexandria, Louisiana, *to merge with* **First Bank, Pineville, Pineville, Louisiana**

Summary Report by the Attorney General
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of First Bank.

16. – Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/8/89)
Rapides Bank and Trust Company (Applicant) has assets of $415.9 million and First Bank (Bank) has assets of $84.6 million. The State has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Central State Bank, Elkader, Iowa, *to merge with* **First State Savings Bank, McGregor, Iowa**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of First State Savings Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/12/89)
Central State Bank (Applicant) has assets of $44.7 million and First State Savings Bank (Bank) has assets of $7.8 million. The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Mergers Approved Involving Wholly Owned Subsidiaries of the Same Bank Holding Company

The following transactions involve banks that are subsidiaries of the same bank holding company. In each case, the summary report by the Attorney General indicates that the transaction would not have a significantly adverse effect on competition because the proposed merger is essentially a corporate reorganization. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board of Governors, whichever approved the application, determined that the competitive effects of the proposed transaction, the financial and managerial resources and prospects of the banks concerned, as well as the convenience and needs of the community to be served were consistent with approval.

Institution[1]	Assets (millions of dollars)	Date of approval
Texas Bank of Denton, Denton, Texas	16	1/9/89
Merger		
Texas Bank of Weatherford, Weatherford, Texas	153	
BancFirst and Trust Company, Oklahoma City, Oklahoma	657	2/10/89
Merger		
American Bank of Commerce, McAlester, Oklahoma	41	
Citizens State Bank, Hugo Oklahoma	26	
City Bank, Muskogee, Oklahoma	34	
Federal Bank and Trust Company, Shawnee, Oklahoma	239	
First Bank & Trust Company, Sand Springs, Oklahoma	50	
First National Bank of Guthrie, Guthrie, Oklahoma	45	
First National Bank in Madill, Madill, Oklahoma	35	
First National Bank of Prague, Prague, Oklahoma	40	
First National Bank of Seminole, Seminole, Oklahoma	40	
First National Bank, Stillwater, Oklahoma	93	
First Oklahoma Bank and Trust Company, Sulphur, Oklahoma	30	
Oklahoma State Bank, Konawa, Oklahoma	22	
Sovran Bank, Memphis Tennessee	303	2/16/89
Merger		
First National Bank, Collierville, Tennessee	54	
Sovran Bank, Chattanooga, Tennessee	213	3/1/89
Merger		
First Bank of Marion County, South Pittsburg, Tennessee	96	

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1989 – Continued

Institution[1]	Assets (millions of dollars)	Date of approval
Macomb County Bank, Richmond, Michigan	54	3/23/89
Merger		
First State Bank of East Detroit, (Clinton Branch), East Detroit, Michigan	6	
Chemical Bank Bay Area, Bay City, Michigan	28	4/17/89
Merger		
Cass City State Bank, Cass City, Michigan	18	
Huron City Bank, Harbor Beach, Michigan	32	
The Peoples State Bank of Caro, Caro, Michigan	37	
Sovran Bank Central South, Nashville, Texas	3,200	4/26/89
Merger		
Sovran Bank Marshall City, N.A., Lewisburg, Tennessee	76	
First of America Bank–Northern Michigan, Cheboygan, Michigan	131	5/25/89
Merger		
First of America–Petoskey, N.A., Petoskey, Michigan	165	
First Bank of Stockton/Warren, Stockton, Illinois	40	5/31/89
Merger		
First National Bank of Freeport, Freeport, Illinois	152	
Mount Carroll National Bank, Mount Carroll, Illinois	29	
First Bank/Dixon, Dixon, Illinois	56	5/31/89
Merger		
Polo National Bank, Polo, Illinois	34	
Lincolnway State Bank, Sterling, Illinois	22	
First Nebraska Bank–Valley, Valley, Nebraska	78	6/8/89
Merger		
First Nebraska Bank–Arcadia, Arcadia, Nebraska	10	
Lake Buchanan State Bank, Buchanan Dam, Texas	12	6/8/89
Merger		
Lake Country National Bank, Burnet, Texas	6	
Pioneer Bank and Trust Company, Belle Fourche, South Dakota	96	6/16/89
Merger		
First State Bank, Buffalo, South Dakota	19	
Bank of New York, New York, New York	23	6/29/89
Merger		
Irving Trust Company, New York, New York	21	
Bank of Long Island, Babylon, New York	294	
Dutchess Bank & Trust Company, Poughkeepsie, New York	299	
Nanuet National Bank, Nanuet, New York	385	
Scarsdale National Bank & Trust Company, Scarsdale, New York	498	

16.—Continued

Institution[1]	Assets (millions of dollars)	Date of approval
First of America Bank–Northern Michigan, Cheboygan, Michigan ...	131	6/30/89
Merger		
First of America Bank–Grand Travers, N.A., Traverse City, Michigan ...	165	
Norstar Bank, Hepstead, New York ...	2520	7/5/89
Merger		
First National Bank of Downsville, Downsville, New York ...	72	
Crestar Bank, Richmond, Virginia ...	10,038	7/10/89
Merger		
Mountain National Bank of Clifton Forge, Clifton Forge, Virginia ...	58	
Sovran Bank/Central South, Nashville, Tennessee ...	3,221	8/23/89
Merger		
Sovran Bank/Eastern, Oak Ridge, Tennessee ...	199	
Sovran Bank/Hickman County, Centerville, Tennessee ...	39	
Security Bank and Trust Company, Southgate, Michigan ...	1,403	8/30/89
Merger		
Trenton Bank and Trust Company, Trenton, Michigan ...	135	
Indian Head Bank and Trust Company, Portsmouth, New Hampshire.	377	8/31/89
Merger		
Indian Head National Bank, Nashua, New Hampshire ...	976	
Indian Head Bank North, Littleton, New Hampshire ...	208	
Dartmouth National Bank, Hanover, New Hampshire ...	175	
Indian Head National Bank of Keene, Keene, New Hampshire ...	166	
Fleet Bank of New Hampshire, Nashua, New Hampshire ...	3	
Victoria Bank & Trust Company, Victor, Texas ...	613	9/25/89
Merger		
Bank of Commerce Calhoun City, Point Comfort, Texas ...	9	
Jackson County State Bank, Edna County, Texas ...	52	
Chemical Bank and Trust Company, Midland, Michigan ...	447	10/17/89
Merger		
Chemical Bank Bay Area (Saginaw Township Branch), Bay City, Michigan ...	4	
American Bank of St. Louis, St. Louis, Missouri ...	117	10/31/89
Merger		
American Bank of St. Louis County, Chesterfield, Missouri ...	11	
Liberty Bank–Oakland, Troy, Michigan ...	354	11/8/89
Merger		
Liberty State Bank and Trust, Hamtramck, Michigan ...	99	
Villa Grove State Bank, Villa Grove, Illinois ...	24	11/10/89
Merger		
First National Bank of Villa Grove, Villa Grove, Illinois ...	11	

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1989 – Continued

Institution [1]	Assets (millions of dollars)	Date of approval
First of America Bank-Northern Michigan, Cheboygan, Michigan ...	168	11/14/89
Merger		
Antrim County State Bank, Maoncelona, Michigan	32	
Landmark Bank of Highland, Highland, Illinois	96	12/1/89
Merger		
Landmark Bank of Alton, Alton, Illinois	35	
Landmark Bank of Madison County, Glen Carbon, Illinois	26	
Union Bank/Streator, Streator, Illinois	127	12/15/89
Merger		
Union Bank/Triumph, Triumph, Illinois	18	
Sovran Bank/Central South, Nashville, Tennessee	3,621	12/28/89
Merger		
Sovran Bank/Chattanooga, Chattanooga, Tennessee	218	
Sovran Bank/Greenville, Greenville, Tennessee	131	
Sovran Bank/Memphis, Memphis, Tennessee	388	
Sovran Bank/Tri Cities, Johnson City, Tennessee	95	
Sovran Bank/Union City, Union City, Tennessee	105	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

16. – Continued

Mergers Approved Involving a Nonoperating Institution with an Existing Bank

The following transactions have no significant effect on competition; they merely facilitate the acquisition of the voting shares of a bank (or banks) by a holding company. In such cases, the summary report by the Attorney General indicates that the transaction will merely combine an existing bank with a nonoperating institution; in consequence, and without regard to the acquisition of the surviving bank by the holding company, the merger would have no effect on competition. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board of Governors, whichever approved the application, determined that the proposal would, in itself, have no adverse competitive effects and that the financial factors and considerations relating to the convenience and needs of the community were consistent with approval.

Institution [1]	Assets (millions of dollars) [2]	Date of approval
New Byron Bank, Byron Center, Michigan	. . .	1/19/89
Merger		
Byron Center State Bank, Byron Center, Michigan	118	
1st United Interim Bank, Boca Raton, Florida	. . .	3/7/89
Merger		
First United Bank, Boca Raton, Florida	30	
Citizens Bank of Virginia, Arlington, Virginia	. . .	3/21/89
Merger		
Arlington Bank, Arlington, Virginia	64	
Romney Interim Bank Corporation,	. . .	5/23/89
Merger		
Bank of Romney, Romney West Virginia	66	
First Interim Bank of Crestview, Crestview, California	. . .	8/4/89
Merger		
First Bank of Crestview, Crestview, California	42	
CB Interim State Bank, Philadelphia, Pennsylvania	. . .	11/3/89
Merger		
Constitution Bank, Philadelphia, Pennsylvania	117	
Effingham Interim Bank, Inc., Effingham, Illinois	. . .	12/8/89
Merger		
Effingham State Bank, Effingham, Illinois	132	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

2. Where no assets are listed, the bank is newly organized and not in operation.

Federal Reserve Directories and Meetings

Board of Governors of the Federal Reserve System

December 31, 1989

	Term expires
ALAN GREENSPAN of New York, *Chairman*[1]	January 31, 1992
MANUEL H. JOHNSON of Virginia, *Vice Chairman*[1]	January 31, 2000
MARTHA R. SEGER of Michigan	January 31, 1998
WAYNE D. ANGELL of Kansas	January 31, 1994
EDWARD W. KELLEY, JR., of Texas	January 31, 1990
JOHN P. LAWARE of Massachusetts	January 31, 2002

OFFICE OF BOARD MEMBERS
Joseph R. Coyne, *Assistant to the Board*
Donald J. Winn, *Assistant to the Board*
Bob Stahly Moore, *Special Assistant to the Board*

DIVISION OF MONETARY AFFAIRS
Donald L. Kohn, *Director*
David E. Lindsey, *Deputy Director*
Brian F. Madigan, *Assistant Director*
Richard D. Porter, *Assistant Director*
Normand R.V. Bernard, *Special Assistant to the Board*

OFFICE OF STAFF DIRECTOR FOR MANAGEMENT
S. David Frost, *Staff Director*
Edward T. Mulrenin, *Assistant Staff Director*
Portia W. Thompson, *Equal Employment Opportunity Programs Officer*

OFFICE OF STAFF DIRECTOR FOR FEDERAL RESERVE BANK ACTIVITIES
Theodore E. Allison, *Staff Director*

OFFICE OF THE EXECUTIVE DIRECTOR FOR INFORMATION RESOURCES MANAGEMENT
Allen E. Beutel, *Executive Director*
Stephen R. Malphrus, *Deputy Executive Director*

OFFICE OF THE SECRETARY
William W. Wiles, *Secretary*
Jennifer J. Johnson, *Associate Secretary*
Barbara R. Lowrey, *Associate Secretary*

LEGAL DIVISION
J. Virgil Mattingly, Jr., *General Counsel*
Richard M. Ashton, *Associate General Counsel*
Oliver Ireland, *Associate General Counsel*
Ricki R. Tigert, *Associate General Counsel*
Scott G. Alvarez, *Assistant General Counsel*
MaryEllen A. Brown, *Assistant to the General Counsel*

DIVISION OF RESEARCH AND STATISTICS
Michael J. Prell, *Director*
Edward C. Ettin, *Deputy Director*
Thomas D. Simpson, *Associate Director*
Lawrence Slifman, *Associate Director*
David J. Stockton, *Associate Director*
Martha Bethea, *Deputy Associate Director*
Peter A. Tinsley, *Deputy Associate Director*
Myron L. Kwast, *Assistant Director*
Susan J. Lepper, *Assistant Director*
Patrick M. Parkinson, *Assistant Director*
Martha S. Scanlon, *Assistant Director*
Joyce K. Zickler, *Assistant Director*
Levon H. Garabedian, *Assistant Director (Administration)*

1. The designations as Chairman and Vice Chairman expire on August 10, 1991, and August 4, 1990, respectively, unless the services of these members of the Board shall have terminated sooner.

DIVISION OF INTERNATIONAL FINANCE
Edwin M. Truman, *Staff Director*
Larry J. Promisel, *Senior Associate Director*
Charles J. Siegman, *Senior Associate Director*
David H. Howard, *Deputy Associate Director*
Robert F. Gemmill, *Staff Adviser*
Donald B. Adams, *Assistant Director*
Peter Hooper, III, *Assistant Director*
Karen H. Johnson, *Assistant Director*
Ralph W. Smith, Jr., *Assistant Director*

DIVISION OF FEDERAL RESERVE BANK OPERATIONS
Clyde H. Farnsworth, Jr., *Director*
David L. Robinson, *Associate Director*
C. William Schleicher, Jr., *Associate Director*
Bruce J. Summers, *Associate Director*[2]
Charles W. Bennett, *Assistant Director*
Jack Dennis, Jr., *Assistant Director*
Earl G. Hamilton, *Assistant Director*
John H. Parrish, *Assistant Director*
Louise L. Roseman, *Assistant Director*
Florence M. Young, *Assistant Director*

DIVISION OF BANKING SUPERVISION AND REGULATION
William Taylor, *Staff Director*
Don E. Kline, *Associate Director*
Frederick M. Struble, *Associate Director*
William A. Ryback, *Deputy Associate Director*
Stephen C. Schemering, *Deputy Associate Director*
Richard Spillenkothen, *Deputy Associate Director*
Herbert A. Biern, *Assistant Director*
Joe M. Cleaver, *Assistant Director*
Roger T. Cole, *Assistant Director*
James I. Garner, *Assistant Director*
James D. Goetzinger, *Assistant Director*
Michael G. Martinson, *Assistant Director*
Robert S. Plotkin, *Assistant Director*
Sidney M. Sussan, *Assistant Director*
Laura M. Homer, *Securities Credit Officer*

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS
Griffith L. Garwood, *Director*
Glenn E. Loney, *Assistant Director*
Ellen Maland, *Assistant Director*
Dolores S. Smith, *Assistant Director*

DIVISION OF HUMAN RESOURCES MANAGEMENT
David L. Shannon, *Director*
John R. Weis, *Associate Director*
Anthony V. DiGioia, *Assistant Director*
Joseph H. Hayes, Jr., *Assistant Director*
Fred Horowitz, *Assistant Director*

DIVISION OF SUPPORT SERVICES
Robert E. Frazier, *Director*
George M. Lopez, *Assistant Director*
David L. Williams, *Assistant Director*

OFFICE OF THE CONTROLLER
George E. Livingston, *Controller*
Stephen J. Clark, *Assistant Controller (Programs and Budgets)*
Darrell R. Pauley, *Assistant Controller (Finance)*

DIVISION OF HARDWARE AND SOFTWARE SYSTEMS
Bruce M. Beardsley, *Director*
Day W. Radebaugh, Jr., *Assistant Director*
Elizabeth B. Riggs, *Assistant Director*

DIVISION OF APPLICATIONS DEVELOPMENT AND STATISTICAL SERVICES
William R. Jones, *Director*
Richard C. Stevens, *Assistant Director*
Patricia A. Welch, *Assistant Director*
Robert J. Zemel, *Assistant Director*

OFFICE OF THE INSPECTOR GENERAL
Brent L. Bowen, *Inspector General*
Barry R. Snyder, *Assistant Inspector General*

2. On loan from Federal Reserve Bank of Richmond.

Federal Open Market Committee

December 31, 1989

Members

ALAN GREENSPAN, *Chairman*, Board of Governors
E. GERALD CORRIGAN, *Vice Chairman*, President, Federal Reserve Bank of New York
WAYNE D. ANGELL, Board of Governors
ROGER GUFFEY, President, Federal Reserve Bank of Kansas City
SILAS KEEHN, President, Federal Reserve Bank of Chicago
MANUEL H. JOHNSON, Board of Governors
EDWARD W. KELLEY, JR., Board of Governors
JOHN P. LAWARE, Board of Governors
THOMAS C. MELZER, President, Federal Reserve Bank of St. Louis
MARTHA R. SEGER, Board of Governors
RICHARD F. SYRON, President, Federal Reserve Bank of Boston

Alternate Members

EDWARD G. BOEHNE, President, Federal Reserve Bank of Philadelphia
ROBERT H. BOYKIN, President, Federal Reserve Bank of Dallas
W. LEE HOSKINS, President, Federal Reserve Bank of Cleveland
GARY H. STERN, President, Federal Reserve Bank of Minneapolis
JAMES H. OLTMAN, First Vice President, Federal Reserve Bank of New York

Officers

DONALD L. KOHN, *Secretary and Economist*
NORMAND R.V. BERNARD, *Assistant Secretary*
GARY P. GILLUM, *Deputy Assistant Secretary*
J. VIRGIL MATTINGLY, *General Counsel*
ERNEST T. PATRIKIS, *Deputy General Counsel*
MICHAEL J. PRELL, *Economist*
EDWIN M. TRUMAN, *Economist*
ANATOL B. BALBACH, *Associate Economist*
RICHARD G. DAVIS, *Associate Economist*
THOMAS E. DAVIS, *Associate Economist*
DAVID E. LINDSEY, *Associate Economist*
ALICIA H. MUNNELL, *Associate Economist*
LARRY J. PROMISEL, *Associate Economist*
KARL A. SCHELD, *Associate Economist*
CHARLES J. SIEGMAN, *Associate Economist*
THOMAS D. SIMPSON, *Associate Economist*
LAWRENCE SLIFMAN, *Associate Economist*

PETER D. STERNLIGHT, *Manager for Domestic Operations, System Open Market Account*
SAM Y. CROSS, *Manager for Foreign Operations, System Open Market Account*

During 1989, the Federal Open Market Committee held eight regularly scheduled meetings (see Record of Policy Actions of the Federal Open Market Committee in this REPORT.)

Federal Advisory Council

December 31, 1989

Members

District 1 – J. TERRENCE MURRAY, *Chairman, President, and Chief Executive Officer*, Fleet/Norstar Financial Group, Inc., and *Chairman and Chief Executive Officer*, Fleet National Bank, Providence, Rhode Island

District 2 – WILLARD C. BUTCHER, *Chairman and Chief Executive Officer*, The Chase Manhattan Bank, N.A., New York, New York

District 3 – SAMUEL A. MCCULLOUGH, *Chairman and Chief Executive Officer*, Meridian Bancorp, Inc., Reading, Pennsylvania

District 4 – THOMAS H. O'BRIEN, *Chairman, President and Chief Executive Officer*, PNC Financial Corp, Pittsburgh, Pennsylvania

District 5 – FREDERICK DEANE, JR., *Chairman of the Board and Chief Executive Officer*, Signet Banking Corporation, Richmond, Virginia

District 6 – KENNETH L. ROBERTS, *Chairman and Chief Executive Officer*, First American Corporation, Nashville, Tennessee

District 7 – B. KENNETH WEST, *Chairman and Chief Executive Officer*, Harris Bankcorp, Inc. and Harris Trust and Savings Bank, Chicago, Illinois

District 8 – DONALD N. BRANDIN, *Retired Chairman of the Board*, Boatmen's Bancshares, Inc., St. Louis, Missouri

District 9 – LLOYD P. JOHNSON, *Chairman and Chief Executive Officer*, Norwest Corporation, Minneapolis, Minnesota

District 10 – JORDAN L. HAINES, *Chairman*, Fourth Financial Corporation and BANK IV Wichita, Wichita, Kansas

District 11 – JAMES E. BURT III, *President and Chief Executive Officer*, Commercial National Bank in Shreveport, Shreveport, Louisiana

District 12 – PAUL HAZEN, *President and Chief Operating Officer*, Wells Fargo and Co., San Francisco, California

Officers

DONALD N. BRANDIN, *President*

SAMUEL A. MCCULLOUGH, *Vice President*

HERBERT V. PROCHNOW, *Secretary*

WILLIAM J. KORSVIK, *Associate Secretary*

Directors

FREDERICK DEANE, JR.

PAUL HAZEN

J. TERRENCE MURRAY

The Federal Advisory Council met on February 2–3, May 4–5, September 7–8, and November 2–3, 1989. The Board of Governors met with the council on February 3, May 5, September 8, and November 3, 1989. The council, which is composed of one representative of the banking industry from each of the twelve Federal Reserve Districts, is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with, and advise, the Board on all matters within the jurisdiction of the Board.

Consumer Advisory Council

December 31, 1989

Members[1]

GEORGE H. BRAASCH, *Corporate Credit Counsel*, Spiegel, Inc., Oak Brook, Illinois
JUDITH N. BROWN, *President*, Judith N. Brown and Associates, Minneapolis, Minnesota
BETTY TOM CHU, *Chairman*, Trust Savings Bank, Arcadia, California
CLIFF E. COOK, *Vice President*, Puget Sound National Bank, Tacoma, Washington
JERRY D. CRAFT, *Senior Vice President*, First National Bank of Atlanta, Atlanta, Georgia
DONALD C. DAY, *President*, New England Securities Corporation, Boston, Massachusetts
R. B. DEAN, JR., *Administrator*, South Carolina National Bank, Columbia, South Carolina
RICHARD B. DOBY, *Financial Services Consultant*, Doby and Associates, Denver, Colorado
WILLIAM C. DUNKELBERG, *Professor of Economics*, Temple University, Philadelphia, Pennsylvania
RICHARD H. FINK, *Executive Vice President*, George Mason University, Fairfax, Virginia
JAMES FLETCHER, *President and Director*, South Shore Bank of Chicago, Chicago, Illinois
STEPHEN GARDNER, *Assistant Attorney General*, State of Texas, Dallas, Texas
ELENA HANGGI, *Director*, Institute for Social Justice, Little Rock, Arkansas
JAMES W. HEAD, *Executive Director*, National Economic Development and Law Center, Berkeley, California
ROBERT HESS, *President*, Wright Patman Congressional Federal Credit Union, Washington, D.C.
RAMON E. JOHNSON, *Professor of Finance*, University of Utah, Salt Lake City, Utah
BARBARA KAUFMAN, *Co-Director*, KCBS Call for Action, San Francisco, California
A. J. KING, *Chairman*, Valley Bank of Kalispell, Kalispell, Montana
MICHELLE MEIER, *Counsel for Government Affairs*, Consumers Union, Washington, D.C.
RICHARD L. D. MORSE, *Professor of Family Economics*, Kansas State University, Manhattan, Kansas
WILLIAM E. ODOM, *Chairman of the Board*, Ford Motor Credit Company, Dearborn, Michigan
LINDA K. PAGE, *Director*, Department of Commerce, State of Ohio, Columbus, Ohio
SANDRA PHILLIPS, *Executive Director*, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania
VINCENT QUAYLE, *Director*, St. Ambrose Housing Aid Center, Baltimore, Maryland
CLIFFORD N. ROSENTHAL, *Executive Director*, National Federation of Community Development Credit Unions, New York, New York
ALAN M. SILBERSTEIN, *Senior Vice President*, Chemical Bank, New York, New York
RALPH E. SPURGIN, *President*, Limited Credit Services, Inc., Columbus, Ohio
DAVID B. WARD, *Consultant*, Chester, New Jersey
LAWRENCE WINTHROP, *President*, Consumer Credit Counseling Service of Oregon, Inc., Portland, Oregon

1. Naomi G. Albanese, Former Professor of Home Economics, Greensboro, North Carolina, appointed to the council in January 1988 to a three year-term, died on December 6, 1989.

Consumer Advisory Council – Continued

Officers

JUDITH N. BROWN, *Chairman*
WILLIAM E. ODOM, *Vice Chairman*

The Consumer Advisory Council met with members of the Board of Governors on March 30–31, June 22, and October 26, 1989. The council is composed of academics, state government officials, representatives of the financial industry, and representatives of consumer and community interests. It was established pursuant to the 1976 amendments to the Equal Credit Opportunity Act to advise the Board on consumer financial services.

Thrift Institutions Advisory Council

December 31, 1989

Members

CHARLOTTE CHAMBERLAIN, *Executive Vice President for Strategic Planning*, Glendale Federal Savings and Loan Association, Glendale, California

GERALD M. CZARNECKI, *Chairman of the Board and Chief Executive Officer*, HONFED, Honolulu, Hawaii

ROBERT S. DUNCAN, *Chairman, President, and Chief Executive Officer*, Magnolia Federal Bank for Savings, Hattiesburg, Mississippi

ADAM A. JAHNS, *Chairman and President*, Cragin Federal Bank for Savings, Chicago, Illinois

H. C. KLEIN, *President and Chief Executive Officer*, Little Rock Air Force Base Federal Credit Union, Jacksonville, Arkansas

PHILIP E. LAMB, *Chairman and Chief Executive Officer*, Springfield Institution for Savings, Springfield, Massachusetts

JOE C. MORRIS, *Chairman of the Board*, Columbia Savings Association, Overland Park, Kansas

JOSEPH W. MOSMILLER, *Chairman and Chief Executive Officer*, Loyola Federal Savings and Loan Association, Baltimore, Maryland

LOUIS H. PEPPER, *Chairman and Chief Executive Officer*, Washington Mutual Savings Bank, Seattle, Washington

MARION O. SANDLER, *President and Chief Executive Officer*, World Savings and Loan Association, Oakland, California

DONALD B. SHACKELFORD, *Chairman of the Board*, State Savings Bank, Columbus, Ohio

CHARLES B. STUZIN, *Chairman, President, and Chief Executive Officer*, Citizens Federal Savings and Loan Association, Miami, Florida

Officers

GERALD M. CZARNECKI, *President*
DONALD B. SHACKELFORD, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on March 21, May 23, September 12, and December 5, 1989. The council, which is composed of representatives from credit unions, savings and loan associations, and savings banks, consults with and advises the Board on issues pertaining to the thrift industry and on various other matters within the Board's jurisdiction.

Officers of Federal Reserve Banks, Branches, and Offices

December 31, 1989[1]

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON[3]	George N. Hatsopoulos Richard N. Cooper	Richard F. Syron Robert W. Eisenmenger	
NEW YORK[3]	Cyrus R. Vance Ellen V. Futter	E. Gerald Corrigan James H. Oltman	
Buffalo	Mary Ann Lambertsen		John T. Keane
PHILADELPHIA	Peter A. Benoliel Gunnar E. Sarsten	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND[3]	Charles W. Parry John R. Miller	W. Lee Hoskins William H. Hendricks	
Cincinnati	Vacancy		Charles A. Cerino[4]
Pittsburgh	Robert P. Bozzone		Harold J. Swart[4]
RICHMOND[3]	Hanne M. Merriman Leroy T. Canoles, Jr.	Robert P. Black Jimmie R. Monhollon	
Baltimore	Thomas R. Shelton		Robert D. McTeer, Jr.[4]
Charlotte	William E. Masters		Albert D. Tinkelenberg[4]
Culpeper			John G. Stoides[4]
ATLANTA	Bradley Currey, Jr. Larry L. Prince	Robert P. Forrestal Jack Guynn	Donald E. Nelson
Birmingham	Nelda P. Stephenson		Fred R. Herr[4]
Jacksonville	Hugh M. Brown		James D. Hawkins[4]
Miami	Jose L. Saumat		James T. Curry, III
Nashville	Patsy R. Williams		Melvyn K. Purcell
New Orleans	James A. Hefner		Robert J. Musso
CHICAGO[3]	Robert J. Day Marcus Alexis	Silas Keehn Daniel M. Doyle	
Detroit	Richard T. Lindgren		Roby L. Sloan[4]
ST. LOUIS	Robert L. Virgil, Jr. H. Edwin Trusheim	Thomas C. Melzer James R. Bowen	
Little Rock	L. Dickson Flake		John F. Breen
Louisville	Thomas A. Alvey		Howard Wells
Memphis	Seymour B. Johnson		Raymond Laurence
MINNEAPOLIS	Michael W. Wright John A. Rollwagen	Gary H. Stern Thomas E. Gainor	
Helena	J. Frank Gardner		John D. Johnson

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
KANSAS CITY	Fred W. Lyons, Jr.	Roger Guffey	
	Burton A. Dole, Jr.	Henry R. Czerwinski	
Denver	James C. Wilson		Kent M. Scott
Oklahoma City	Patience S. Latting		David J. France
Omaha	Kenneth L. Morrison		Harold L. Shewmaker
DALLAS	Bobby R. Inman	Robert H. Boykin	
	Hugh G. Robinson	William H. Wallace	
El Paso	Diana S. Natalicio		Sammie C. Clay
Houston	Andrew L. Jefferson, Jr.		Robert Smith III[4]
San Antonio	Lawrence E. Jenkins		Thomas H. Robertson
SAN FRANCISCO	Robert F. Erburu	Robert T. Parry	
	Carolyn S. Chambers	Carl E. Powell	
Los Angeles	Yvonne B. Burke		Thomas C. Warren[5]
Portland	Paul E. Bragdon		Angelo S. Carella[4]
Salt Lake City	Don M. Wheeler		E. Ronald Liggett[4]
Seattle	Carol A. Nygren		Gerald R. Kelly[4]

1. A current list of these officers appears each month in the *Federal Reserve Bulletin*.
2. The Chairman of a Federal Reserve Bank, by statute, serves as Federal Reserve Agent.
3. Additional offices of these Banks are located at Lewiston, Maine; Windsor Locks, Connecticut; Cranford, New Jersey; Jericho, New York; Utica at Oriskany, New York; Columbus, Ohio; Columbia, South Carolina; Charleston, West Virginia; Des Moines, Iowa; Indianapolis, Indiana; and Milwaukee, Wisconsin.
4. Senior Vice President.
5. Executive Vice President.

Conference of Chairmen

The Chairmen of the Federal Reserve Banks are organized into the Conference of Chairmen, which meets to consider matters of common interest and to consult with, and advise, the Board of Governors. Such meetings, attended also by the deputy chairmen, were held in Washington on May 31 and June 1, and on November 29 and 30, 1989.

The Executive Committee of the Conference of Chairmen during 1989 comprised Robert F. Erburu, Chairman; Bradley Currey, Jr., Vice Chairman; and Peter A. Benoliel, member.

On November 30, 1989, the Conference elected its Executive Committee for 1990, naming Cyrus R. Vance as Chairman, Peter A. Benoliel as Vice Chairman, and Bobby R. Inman as the third member.

Conference of Presidents

The presidents of the Federal Reserve Banks are organized into the Conference of Presidents, which meets periodically to consider matters of common interest and to consult with, and advise, the Board of Governors.

On October 25, 1988, the Conference elected Robert P. Forrestal, President of the Federal Reserve Bank of Atlanta, as its Chairman for 1989, and Thomas C. Melzer, President of the Federal Reserve Bank of St. Louis, as its Vice Chairman. The Conference appointed Christopher G. Brown, of the Federal Reserve Bank of Atlanta, as its Secretary, and Frances E. Sibley, of the Federal Reserve Bank of St. Louis, as its Assistant Secretary.

On December 6, 1988, the Conference voted to establish a two-year term for the Chairman and Vice Chairman of the Conference, beginning in 1989.

Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet periodically for the consideration of operations and other matters.

On November 4, 1988, the Conference elected Jack Guynn, First Vice President of the Federal Reserve Bank of Atlanta, as its Chairman for 1989, and James R. Bowen, First Vice President of the Federal

Reserve Bank of St. Louis, as its Vice Chairman. The Conference appointed Christopher G. Brown, of the Federal Reserve Bank of Atlanta, as its Secretary, and Frances E. Sibley, of the Federal Reserve Bank of St. Louis, as its Assistant Secretary.

Directors

The following list of directors of Federal Reserve Banks and Branches shows for each director the class of directorship, the principal business affiliation, and the date the term expires. Each Federal Reserve Bank has nine members on its board of directors: three Class A and three Class B directors, who are elected by the stockholding member banks, and three Class C directors, who are appointed by the Board of Governors of the Federal Reserve System. Directors are chosen without discrimination as to race, creed, color, sex, or national origin.

Class A directors represent the stockholding member banks in each Federal Reserve District. Class B and Class C directors represent the public and are chosen with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers; they may not be officers, directors, or employees of any bank or bank holding company. In addition, Class C directors may not be stockholders of any bank or bank holding company.

For the election of Class A and Class B directors, the Board of Governors classifies the member banks of each Federal Reserve District into three groups. Each group, which comprises banks with similar capitalization, elects one Class A director and one Class B director. The Board of Governors designates one Class C director as chairman of the board of directors and Federal Reserve Agent of each District Bank and appoints another Class C director as deputy chairman.

Federal Reserve Branches have either five or seven directors, a majority of whom are appointed by the parent Federal Reserve Bank; the others are appointed by the Board of Governors. One of the directors appointed by the Board is designated annually as chairman of the board of that Branch in a manner prescribed by the parent Federal Reserve Bank.

For the name of the chairman and deputy chairman of the board of directors of each Reserve Bank and of the chairman of each Branch, see the preceding table, "Officers of Federal Reserve Banks, Branches, and Offices."

		Term expires Dec. 31
DISTRICT 1 – BOSTON		
Class A		
Joel B. Alvord	Chairman and Chief Executive Officer, Shawmut National Corporation, Hartford, Connecticut	1989
Richard D. Wardell	President and Chief Executive Officer, National Iron Bank of Salisbury, Salisbury, Connecticut	1990
William H. Chadwick	Vice Chairman of the Board and Chief Operating Officer, Banknorth Group, Inc., Burlington, Vermont	1991
Class B		
Richard M. Oster	President and Chief Executive Officer, Cookson America, Inc., Providence, Rhode Island	1989
Stephen R. Levy	Chairman and Chief Executive Officer, Bolt Beranek and Newman, Inc., Cambridge, Massachusetts	1990
Edward H. Ladd	President and Chief Executive Officer, Standish, Ayer and Wood, Inc., Boston, Massachusetts	1991
Class C		
Richard N. Cooper	Maurits C. Boas Professor of International Economics, Harvard University, Cambridge, Massachusetts	1989
Richard L. Taylor	President, Taylor Properties, Inc., Boston, Massachusetts	1990
George N. Hatsopoulos	Chairman of the Board and President, Thermo Electron Corporation, Waltham, Massachusetts	1991
DISTRICT 2 – NEW YORK		
Class A		
Alberto M. Paracchini	Chairman of the Board and Chief Executive Officer, Banco de Ponce, Ponce, Puerto Rico	1989
J. Kirby Fowler	President and Chief Executive Officer, The Flemington National Bank and Trust Company, Flemington, New Jersey	1990
John F. McGillicuddy	Chairman of the Board and Chief Executive Officer, Manufacturers Hanover Trust Company, New York, New York	1991
Class B		
John A. Georges	Chairman of the Board and Chief Executive Officer, International Paper, Purchase, New York	1989
John F. Welch, Jr.	Chairman of the Board and Chief Executive Officer, GE, Fairfield, Connecticut	1990

DISTRICT 2, *Class B*–Continued

		Term expires Dec. 31
Richard L. Gelb	Chairman of the Board and Chief Executive Officer, Bristol-Myers Squibb Company, New York, New York	1991

Class C

Cyrus R. Vance	Presiding Partner, Simpson Thacher & Bartlett, New York, New York	1989
Ellen V. Futter	President, Barnard College, New York, New York	1990
Maurice R. Greenberg	President and Chief Executive Officer, American International Group, Inc., New York, New York	1991

BUFFALO BRANCH

Appointed by the Federal Reserve Bank

Harry J. Sullivan	President, Salamanca Trust Company, Salamanca, New York	1989
Norman W. Sinclair	Chairman of the Board, Lockport Savings Bank, Lockport, New York	1990
Richard H. Popp	Operating Partner, Southview Farm, Castile, New York	1991
Robert G. Wilmers	Chairman of the Board and Chief Executive Officer, Manufacturers and Traders Trust Company, Buffalo, New York	1991

Appointed by the Board of Governors

Matthew Augustine	President and Chief Executive Officer, Eltrex Industries, Inc., Rochester, New York	1989
Paul E. McSweeney	Executive Vice President, United Food and Commercial Workers, District Union Local One, AFL-CIO, Amherst, New York	1990
Mary Ann Lambertsen	Vice President–Human Resources and Information Systems, Fisher-Price Division, The Quaker Oats Company, East Aurora, New York	1991

DISTRICT 3–PHILADELPHIA

Class A

George A. Butler	Chairman and Chief Executive Officer, First Pennsylvania Bank, N.A., Philadelphia, Pennsylvania	1989
Constantinos I. Costalas	Chairman, President, and Chief Executive Officer, Glendale National Bank of New Jersey, Voorhees, New Jersey	1990
Gary E. Burl	President, Delaware National Bank, Georgetown, Delaware	1991

		Term expires Dec. 31
DISTRICT 3—Continued		
Class B		
Carl E. Singley	Attorney, Philadelphia, Pennsylvania	1989
Charles F. Seymour	Chairman, Jackson-Cross Company, Philadelphia, Pennsylvania	1990
Nicholas Riso	Executive Vice President, AHOLD, U.S.A., Harrisburg, Pennsylvania	1991
Class C		
Peter A. Benoliel	Chairman of the Board, Quaker Chemical Corporation, Conshohocken, Pennsylvania	1989
Jane G. Pepper	President, The Pennsylvania Horticultural Society, Philadelphia, Pennsylvania	1990
Gunnar E. Sarsten	Chairman, President, and Chief Executive Officer, United Engineers & Constructors, Inc., Philadelphia, Pennsylvania	1991
DISTRICT 4—CLEVELAND		
Class A		
Frank Wobst	Chairman and Chief Executive Officer, Huntington Bancshares Incorporated, Columbus, Ohio	1989
William H. May	Chairman and President, First National Bank of Nelsonville, Nelsonville, Ohio	1990
William T. McConnell	President, The Park National Bank, Newark, Ohio	1991
Class B		
Laban P. Jackson, Jr.	Chairman of the Board, Clearcreek Properties, Lexington, Kentucky	1989
Verna K. Gibson	President, The Limited Stores, Inc., Columbus, Ohio	1990
Douglas E. Olesen	President and Chief Executive Officer, Battelle Memorial Institute, Columbus, Ohio	1991
Class C		
Charles W. Parry	Director and Retired Chairman and Chief Executive Officer, Aluminum Company of America, Pittsburgh, Pennsylvania	1989
Robert D. Storey	Partner, Burke, Haber & Berick, Cleveland, Ohio	1990
John R. Miller	Former President and Chief Operating Officer, The Standard Oil Company (Ohio), Cleveland, Ohio	1991
CINCINNATI BRANCH		
Appointed by the Federal Reserve Bank		
Robert M. Duncan	President, First National Bank of Louisa, Louisa, Kentucky	1989

		Term expires Dec. 31
DISTRICT 4, CINCINNATI BRANCH, *Appointed by the Federal Reserve Bank*—Continued		
Jack W. Buchanan	President, Sphar and Company, Inc., Winchester, Kentucky	1990
Jerry L. Kirby	Chairman of the Board, President, and Chief Executive Officer, Citizens Federal Savings & Loan Assn., Dayton, Ohio	1990
Allen L. Davis	President and Chief Executive Officer, The Provident Bank, Cincinnati, Ohio	1991
Appointed by the Board of Governors		
Owen B. Butler	Chairman of the Board (Retired), The Procter & Gamble Company, Cincinnati, Ohio	1989
Marvin Rosenberg	Partner, Towne Properties, Ltd., Cincinnati, Ohio	1990
Kate Ireland	National Chairman, Frontier Nursing Service, Wendover, Kentucky	1991
PITTSBURGH BRANCH		
Appointed by the Federal Reserve Bank		
Thomas G. Dove	Chairman of the Executive Committee and Chief Executive Officer, Wheeling Dollar Bank, Wheeling, West Virginia	1989
George A. Davidson, Jr.	Chairman and Chief Executive Officer, Consolidated Natural Gas Company, Pittsburgh, Pennsylvania	1990
Stephen C. Hansen	President and Chief Executive Officer, Dollar Bank, F.S.B., Pittsburgh, Pennsylvania	1990
E. James Trimarchi	President and Chief Executive Officer, First Commonwealth Financial Corporation, Indiana, Pennsylvania	1991
Appointed by the Board of Governors		
Robert P. Bozzone	President and Chief Operating Officer, Allegheny Ludlum Corporation, Pittsburgh, Pennsylvania	1989
Milton A. Washington	President and Chief Executive Officer, Allegheny Housing Rehabilitation Corporation, Pittsburgh, Pennsylvania	1990
Jack B. Piatt	Chairman of the Board and President, Millcraft Industries, Inc., Washington, Pennsylvania	1991
DISTRICT 5—RICHMOND		
Class A		
Chester A. Duke	President and Chief Executive Officer, Marion National Bank, Marion, South Carolina	1989

		Term expires Dec. 31
DISTRICT 5, *Class A*—Continued		
John F. McNair III	President and Chief Executive Officer, Wachovia Bank & Trust Company, N.A. and The Wachovia Corporation, Winston-Salem, North Carolina	1990
C. R. Hill, Jr.	Chairman of the Board and President, Merchants & Miners National Bank, Oak Hill, West Virginia	1991
Class B		
Thomas B. Cookerly	President, Cookerly Communications, Bethesda, Maryland	1989
Jack C. Smith	Chairman of the Board and Chief Executive Officer, K-VA-T Food Stores, Inc., Grundy, Virginia	1990
Edward H. Covell	President, The Covell Company, Easton, Maryland	1991
Class C		
Leroy T. Canoles, Jr.	President, Kaufman & Canoles, Norfolk, Virginia	1989
Hanne Merriman	Retail Business Consultant, Washington, D.C.	1990
Anne Marie Whittemore	Partner, McGuire, Woods, Battle & Boothe, Richmond, Virginia	1991
BALTIMORE BRANCH		
Appointed by the Federal Reserve Bank		
Charles W. Hoff III	President and Chief Executive Officer, Farmers and Mechanics National Bank, Frederick, Maryland	1989
Raymond V. Haysbert, Sr.	President and Chief Executive Officer, Parks Sausage Company, Baltimore, Maryland	1990
H. Grant Hathaway	Chairman of the Board, Equitable Bank, N.A., Baltimore, Maryland	1991
Joseph W. Mosmiller	Chairman of the Board, Loyola Federal Savings and Loan Association, Baltimore, Maryland	1991
Appointed by the Board of Governors		
John R. Hardesty, Jr.	President, Preston Energy, Inc., Kingwood, West Virginia	1989
Gloria L. Johnson	Deputy Director of Administration, The Baltimore Museum of Art, Baltimore, Maryland	1990
Thomas R. Shelton	President, Case Foods, Inc., Salisbury, Maryland	1991

		Term expires Dec. 31
DISTRICT 5 – Continued		
CHARLOTTE BRANCH		
Appointed by the Federal Reserve Bank		
William McKay	President, First Federal Savings Bank, Hendersonville, North Carolina	1989
James M. Culberson, Jr.	Chairman and President, The First National Bank of Randolph County, Asheboro, North Carolina	1990
Crandall C. Bowles	President, The Springs Company, Lancaster, South Carolina	1991
James G. Lindley	Chairman and Chief Executive Officer, South Carolina National Corporation; Chairman, President, and Chief Executive Officer, The South Carolina National Bank, Columbia, South Carolina	1991
Appointed by the Board of Governors		
Anne M. Allen	President, Allen-Austin, Inc., Greensboro, North Carolina	1989
William E. Masters	President, Perception, Inc., Easley, South Carolina	1990
Harold D. Kingsmore	President and Chief Operating Officer, Graniteville Company, Graniteville, South Carolina	1991
DISTRICT 6 – ATLANTA		
Class A		
Mary W. Walker	Vice Chairman, The National Bank of Walton County, Monroe, Georgia	1989
E. B. Robinson, Jr.	Chairman and Chief Executive Officer, Deposit Guaranty National Bank and Deposit Guaranty Corporation, Jackson, Mississippi	1990
Virgil H. Moore, Jr.	Chairman and Chief Executive Officer, First Farmers and Merchants National Bank, Columbia, Tennessee	1991
Class B		
Paul W. Green	President and Chief Executive Officer, American Cast Iron Pipe Company, Birmingham, Alabama	1989
Gary J. Chouest	President and Chief Executive Officer, Edison Chouest Offshore, Inc., Galliano, Louisiana	1990
Saundra H. Gray	Co-Owner, Gemini Springs Farm, DeBary, Florida	1991
Class C		
Bradley Currey, Jr.	President, Rock-Tenn Company, Norcross, Georgia	1989

		Term expires Dec. 31
DISTRICT 6, *Class C*—Continued		
Edwin A. Huston	Senior Executive Vice President–Finance, Ryder System, Inc., Miami, Florida	1990
Larry L. Prince	President and Chief Executive Officer, Genuine Parts Company, Atlanta, Georgia	1991

BIRMINGHAM BRANCH

Appointed by the Federal Reserve Bank

John H. Newman, Jr.	President and Chief Executive Officer, First National Bank of Scottsboro, Scottsboro, Alabama	1989
Harry B. Brock, Jr.	Chairman and Chief Executive Officer, Central Bank of the South, Birmingham, Alabama	1990
Shelton E. Allred	Chairman, President, and Chief Executive Officer, Frit Industries, Inc., Ozark, Alabama	1991
William F. Childress	President, First American Federal Savings and Loan Association, Huntsville, Alabama	1991

Appointed by the Board of Governors

Nelda P. Stephenson	President, Nelda Stephenson Chevrolet, Inc., Florence, Alabama	1989
A. G. Trammell	President, Alabama Labor Council, AFL-CIO, Birmingham, Alabama	1990
Roy D. Terry	President and Chief Executive Officer, Terry Manufacturing Company, Inc., Roanoke, Alabama	1991

JACKSONVILLE BRANCH

Appointed by the Federal Reserve Bank

A. Bronson Thayer	Chairman and Chief Executive Officer, First Florida Banks, Inc., Tampa, Florida	1989
Hugh H. Jones, Jr.	Chairman and Chief Executive Officer, Barnett Bank of Jacksonville, N.A., Jacksonville, Florida	1990
Perry M. Dawson	President and Chief Executive Officer, Suncoast Schools Federal Credit Union, Tampa, Florida	1991
Samuel H. Vickers	President and Chief Executive Officer, Design Containers, Inc., Jacksonville, Florida	1991

Appointed by the Board of Governors

Lana Jane Lewis-Brent	Vice Chairman, President, and Chief Executive Officer, Sunshine Jr. Stores, Inc., Panama City, Florida	1989
Joan Dial Ruffier	Chairman, Florida Board of Regents, Orlando, Florida	1990
Hugh M. Brown	President and Chief Executive Officer, BAMSI, Inc., Titusville, Florida	1991

Term expires Dec. 31

DISTRICT 6—Continued

MIAMI BRANCH

Appointed by the Federal Reserve Bank

James H. Robinson	President, Sun Bank/South Florida, N.A., Fort Lauderdale, Florida	1989
Robert M. Taylor	Chairman and Chief Executive Officer, The Mariner Group, Inc., Fort Myers, Florida	1990
Frederick A. Teed	President and Chief Executive Officer, Community Savings, F.A., North Palm Beach, Florida	1990
Roberto G. Blanco	Vice Chairman and Chief Financial Officer, Republic National Bank of Miami, Miami, Florida	1991

Appointed by the Board of Governors

Jose L. Saumat	Chairman, Kaufman and Roberts, Inc., Miami, Florida	1989
Robert D. Apelgren	President, Apelgren Corporation, Pahokee, Florida	1990
Dorothy C. Weaver	Vice President, Intercap Investments, Inc., Miami, Florida	1991

NASHVILLE BRANCH

Appointed by the Federal Reserve Bank

James A. Rainey	Chairman, Sovran Financial Corporation/Central South, Nashville, Tennessee	1989
Vincent K. Hickam	President and Chief Executive Officer, Executive Park National Bank, Kingsport, Tennessee	1990
William Baxter Lee III	Chairman and President, Southeast Services Corporation, Knoxville, Tennessee	1991
Edwin W. Moats, Jr.	Chairman and Chief Executive Officer, Metropolitan Federal Savings and Loan Association, Nashville, Tennessee	1991

Appointed by the Board of Governors

Patsy R. Williams	Partner, Rhyne Lumber Company, Newport, Tennessee	1989
Victoria B. Jackson	President and Chief Executive Officer, Diesel Sales and Service, Inc. and Prodiesel, Inc., Nashville, Tennessee	1990
Shirley A. Zeitlin	President, Shirley Zeitlin & Co. Realtors, Nashville, Tennessee	1991

		Term expires Dec. 31
DISTRICT 6 – Continued		
NEW ORLEANS BRANCH		
Appointed by the Federal Reserve Bank		
Robert S. Gaddis	President and Chief Executive Officer, Trustmark National Bank, Laurel, Mississippi	1989
Ronald M. Boudreaux	President and Chief Executive Officer, First National Bank of St. Landry Parish, Opelousas, Louisiana	1990
Joel B. Bullard, Jr.	President, Joe Bullard Automotive Companies, Mobile, Alabama	1991
Stanley S. Scott	President, Crescent Distributing Company, Harahan, Louisiana	1991
Appointed by the Board of Governors		
James A. Hefner	President, Jackson State University, Jackson, Mississippi	1989
Caroline G. Theus	President, Inglewood Land and Development Company, Alexandria, Louisiana	1990
Andre M. Rubenstein	Chairman and Chief Executive Officer, Rubenstein Brothers, Inc., New Orleans, Louisiana	1991
DISTRICT 7 – CHICAGO		
Class A		
B. F. Backlund	Chairman and Chief Executive Officer, Bartonville Bank, Bartonville, Illinois	1989
Barry F. Sullivan	Chairman of the Board, First Chicago Corporation, Chicago, Illinois	1990
John W. Gabbert	President and Chief Executive Officer, First of America Bank-LaPorte, N.A., LaPorte, Indiana	1991
Class B		
Paul J. Schierl	Chairman of the Board and Chief Executive Officer, Fort Howard Corporation, Green Bay, Wisconsin	1989
Edward D. Powers	President, Fire Brick Engineers, Milwaukee, Wisconsin	1990
Max J. Naylor	President, Naylor Farms, Inc., Jefferson, Iowa	1991
Class C		
Robert J. Day	Chairman and Chief Executive Officer, USG Corporation, Chicago, Illinois	1989
Marcus Alexis	Dean, College of Business Administration, University of Illinois at Chicago, Chicago, Illinois	1990

		Term expires Dec. 31
DISTRICT 7, *Class C*—Continued		
Charles S. McNeer	Chairman of the Board and Chief Executive Officer, Wisconsin Energy Corporation, Milwaukee, Wisconsin	1991

DETROIT BRANCH

Appointed by the Federal Reserve Bank

Ronald D. Story	Chairman and President, The Ionia County National Bank of Ionia, Ionia, Michigan	1989
James A. Aliber	Chairman of the Board and Chief Executive Officer, First Federal of Michigan, Detroit, Michigan	1990
Frederik G. H. Meijer	Chairman of the Board, Meijer, Incorporated, Grand Rapids, Michigan	1990
Robert J. Mylod	Chairman, President and Chief Executive Officer, Michigan National Corporation, Farmington Hills, Michigan	1991

Appointed by the Board of Governors

Richard T. Lindgren	Birmingham, Michigan	1989
Beverly Beltaire	President, P R Associates, Inc., Detroit, Michigan	1990
Phyllis E. Peters	Director, Professional Standards Review, Deloitte & Touche, Detroit, Michigan	1991

DISTRICT 8—ST. LOUIS

Class A

David W. Kemper II	Chairman and Chief Executive Officer, Commerce Bank of St. Louis, N.A., Clayton, Missouri; and President and Chief Executive Officer, Commerce Bancshares, Inc., Kansas City, Missouri	1989
H. L. Hembree III	Chairman of the Executive Committee, Merchants National Bank, Fort Smith, Arkansas	1990
Henry G. River, Jr.	President and Chief Executive Officer, First National Bank in Pinckneyville, Pinckneyville, Illinois	1991

Class B

Frank M. Mitchener, Jr.	President, Mitchener Farms, Inc., Sumner, Mississippi	1989
Roger W. Schipke	Senior Vice President, GE Appliances, GE, Louisville, Kentucky	1990
Thomas F. McLarty III	Chairman and Chief Executive Officer, Arkla, Inc., Little Rock, Arkansas	1991

DISTRICT 8—Continued

Class C

		Term expires Dec. 31
H. Edwin Trusheim	Chairman and Chief Executive Officer, General American Life Insurance Company, St. Louis, Missouri	1989
Janet McAfee Weakley	President, Janet McAfee, Inc., Clayton, Missouri	1990
Robert L. Virgil, Jr.	Dean, John M. Olin School of Business, Washington University in St. Louis, St. Louis, Missouri	1991

LITTLE ROCK BRANCH

Appointed by the Federal Reserve Bank

Patricia M. Townsend	President, Townsend Company, Stuttgart, Arkansas	1989
David Armbruster	President, First America Federal Savings Bank, Fort Smith, Arkansas	1990
W. Wayne Hartsfield	President and Chief Executive Officer, First National Bank, Searcy, Arkansas	1990
Barnett Grace	President and Chief Executive Officer, First Commercial Bank, N.A., Little Rock, Arkansas	1991

Appointed by the Board of Governors

L. Dickson Flake	President, Barnes, Quinn, Flake & Anderson, Inc., Little Rock, Arkansas	1989
William E. Love	President, Sound-Craft Systems, Inc., Morrilton, Arkansas	1990
James R. Rodgers	Airport Manager, Little Rock Regional Airport, Little Rock, Arkansas	1991

LOUISVILLE BRANCH

Appointed by the Federal Reserve Bank

Morton Boyd	President, First Kentucky National Corporation, Louisville, Kentucky	1989
Irving W. Bailey II	Chairman, President, and Chief Executive Officer, Capital Holding Corporation, Louisville, Kentucky	1990
Wayne G. Overall, Jr.	President, First Federal Savings Bank, Elizabethtown, Kentucky	1990
Douglas M. Lester	Chairman, President, and Chief Executive Officer, Trans Financial Bancorp, Inc., Bowling Green, Kentucky	1991

Appointed by the Board of Governors

Thomas A. Alvey	Delegate, Owensboro Council of Labor, Owensboro, Kentucky	1989

		Term expires Dec. 31
DISTRICT 8, LOUISVILLE BRANCH, *Appointed by the Board of Governors* – Continued		
Raymond M. Burse	Partner, Wyatt, Tarrant and Combs, Louisville, Kentucky	1990
Lois H. Gray	Chairman of the Board, James N. Gray Construction Company, Inc., Glasgow, Kentucky	1991
MEMPHIS BRANCH		
Appointed by the Federal Reserve Bank		
Michael J. Hennessey	President, Munro & Company, Inc., Wynne, Arkansas	1989
Thomas M. Garrott	President and Chief Operating Officer, National Bank of Commerce and National Commerce Bancorporation, Memphis, Tennessee	1990
Larry A. Watson	Chairman of the Board and President, Liberty Federal Savings Bank, Paris, Tennessee	1990
Ray U. Tanner	Chairman and Chief Executive Officer, Jackson National Bank and Volunteer Bancshares, Inc., Jackson, Tennessee	1991
Appointed by the Board of Governors		
Sandra B. Sanderson	President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi	1989
Seymour B. Johnson	Owner, Kay Planting Company, Indianola, Mississippi	1990
Katherine Hinds Smythe	President, Memorial Park, Inc., Memphis, Tennessee	1991
DISTRICT 9 – MINNEAPOLIS		
Class A		
Charles W. Ekstrum	President and Chief Executive Officer, First National Bank, Philip, South Dakota	1989
Joel S. Harris	President, Yellowstone Bank, Billings, Montana	1990
James H. Hearon III	Chairman of the Board and Chief Executive Officer, National City Bank, Minneapolis, Minnesota	1991
Class B		
Bruce C. Adams	Partner, Triple Adams Farms, Minot, North Dakota	1989
Earl R. St. John, Jr.	President, St. John Forest Products, Inc., Spalding, Michigan	1990
Duane E. Dingmann	President, Trubilt Auto Body, Inc., Eau Claire, Wisconsin	1991

Term expires Dec. 31

DISTRICT 9—Continued

Class C

		Term expires Dec. 31
Michael W. Wright	Chairman, President, and Chief Executive Officer, Super Valu Stores, Inc., Minneapolis, Minnesota	1989
Delbert W. Johnson	President and Chief Executive Officer, Pioneer Metal Finishing, Minneapolis, Minnesota	1990
John A. Rollwagen	Chairman and Chief Executive Officer, Cray Research Inc., Minneapolis, Minnesota	1991

HELENA BRANCH

Appointed by the Federal Reserve Bank

		Term expires Dec. 31
F. Charles Mercord	President and Managing Officer, First Federal Savings Bank of Montana, Kalispell, Montana	1989
Noble E. Vosburg	President and Chief Executive Officer, Pacific Hide and Fur Corporation, Great Falls, Montana	1990
Robert H. Waller	President and Chief Executive Officer, First Interstate Bank of Billings, N.A., Billings, Montana	1990

Appointed by the Board of Governors

		Term expires Dec. 31
Vacancy		1989
J. Frank Gardner	President, Montana Resources, Inc., Butte, Montana	1990

DISTRICT 10—KANSAS CITY

Class A

		Term expires Dec. 31
Harold L. Gerhart, Jr.	President and Chief Executive Officer, First National Bank, Newman Grove, Nebraska	1989
Roger L. Reisher	Co-Chairman, FirstBank Holding Company of Colorado, Lakewood, Colorado	1990
Robert L. Hollis	Chairman of the Board and Chief Executive Officer, First National Bank and Trust Co., Okmulgee, Oklahoma	1991

Class B

		Term expires Dec. 31
Richard D. Harrison	Honorary Chairman, Fleming Companies, Inc., Oklahoma City, Oklahoma	1989
S. Dean Evans, Sr.	Partner, Evans Grain Company, Salina, Kansas	1990
Frank J. Yaklich, Jr.	President, CF & I Steel Corporation, Pueblo, Colorado	1991

Class C

		Term expires Dec. 31
Fred W. Lyons, Jr.	President, Marion Merrell Dow Inc., Kansas City, Missouri	1989

		Term expires Dec. 31
DISTRICT 10, *Class B*—Continued		
Thomas E. Rodriguez	President and General Manager, Thomas E. Rodriguez & Associates, P.C., Aurora, Colorado	1990
Burton A. Dole, Jr.	Chairman and President, Puritan-Bennett Corporation, Overland Park, Kansas	1991

DENVER BRANCH

Appointed by the Federal Reserve Bank

Henry A. True III	Partner, True Companies, Casper, Wyoming	1989
Junius F. Baxter	Chairman of the Board and Chief Executive Officer, Bank Western, a Federal Savings Bank, Denver, Colorado	1990
Norman R. Corzine	President and Chief Executive Officer, First National Bank in Albuquerque, Albuquerque, New Mexico	1991
W. Richard Scarlett III	Chairman and Chief Executive Officer, Jackson State Bank, Jackson Hole, Wyoming	1991

Appointed by the Board of Governors

James C. Wilson	Management Consultant, Longmont, Colorado	1989
Gilbert Sanchez	President, New Mexico Highlands University, Las Vegas, New Mexico	1990
Barbara B. Grogan	President, Western Industrial Contractors, Inc., Denver, Colorado	1991

OKLAHOMA CITY BRANCH

Appointed by the Federal Reserve Bank

William H. Crawford	Chairman and Chief Executive Officer, First National Bank and Trust Company, Frederick, Oklahoma	1989
W. Dean Hidy	Chairman of the Board, Triad Bank, N.A., Tulsa, Oklahoma	1990
John Wm. Laisle	President, MidFirst Savings and Loan Association, Oklahoma City, Oklahoma	1990

Appointed by the Board of Governors

Patience S. Latting	Oklahoma City, Oklahoma	1989
John F. Snodgrass	President and Trustee, The Samuel Roberts Noble Foundation, Inc., Ardmore, Oklahoma	1990

OMAHA BRANCH

Appointed by the Federal Reserve Bank

John T. Selzer	President, Scottsbluff National Bank and Trust Company, Scottsbluff, Nebraska	1989

		Term expires Dec. 31
DISTRICT 10, OMAHA BRANCH, *Appointed by the Federal Reserve Bank*—Continued		
Charles H. Thorne	Chairman of the Board, First Federal Savings and Loan Association of Lincoln, Lincoln, Nebraska	1989
John R. Cochran	President and Chief Executive Officer, Norwest Bank Nebraska, N.A., Omaha, Nebraska	1990
Appointed by the Board of Governors		
Kenneth L. Morrison	President, Morrison Enterprises, Hastings, Nebraska	1989
Herman Cain	President and Chief Executive Officer, Godfather's Pizza, Inc., Omaha, Nebraska	1990

DISTRICT 11—DALLAS

Class A		
Robert G. Greer	Chairman of the Board, Tanglewood Bank, N.A., Houston, Texas	1989
T. C. Frost	Chairman of the Board, The Frost National Bank, San Antonio, Texas	1990
Charles T. Doyle	Chairman of the Board and Chief Executive Officer, Gulf National Bank, Texas City, Texas	1991
Class B		
Gary E. Wood	President, Texas Research League, Austin, Texas	1989
Robert L. Pfluger	Rancher, San Angelo, Texas	1990
Charles Dickie Williamson	Chairman of the Board and Chief Executive Officer, Williamson-Dickie Manufacturing Company, Fort Worth, Texas	1991
Class C		
Leo E. Linbeck, Jr.	Chairman of the Board and Chief Executive Officer, Linbeck Construction Corporation, Houston, Texas	1989
Bobby R. Inman	Chairman of the Board and Chief Executive Officer, Westmark Systems Inc., Austin, Texas	1990
Hugh G. Robinson	Chairman of the Board and Chief Executive Officer, The Tetra Group, Inc., Dallas, Texas	1991

EL PASO BRANCH

Appointed by the Federal Reserve Bank		
David L. Stone	President, The Portales National Bank, Portales, New Mexico	1989
Henry B. Ellis	President and Chief Credit Officer, MBank El Paso, N.A., El Paso, Texas	1990

		Term expires Dec. 31
DISTRICT 11, EL PASO BRANCH, *Appointed by the Federal Reserve Bank*—Continued		
Ethel Ortega Olson	Owner, NAMBE of Ruidoso, Ruidoso, New Mexico	1990
Humberto F. Sambrano	President, SamCorp General Contractors, El Paso, Texas	1991
Appointed by the Board of Governors		
W. Thomas Beard III	President, Leoncita Cattle Company, Alpine, Texas	1989
Diana S. Natalicio	President, The University of Texas at El Paso, El Paso, Texas	1990
Donald G. Stevens	Owner, Stevens Oil Company, Roswell, New Mexico	1991
HOUSTON BRANCH		
Appointed by the Federal Reserve Bank		
Jenard M. Gross	President, Gross Builders, Inc., Houston, Texas	1989
Clive Runnells	President and Director, Runnells Cattle Company, Bay City, Texas	1990
David E. Sheffield	President (Retired), First Victoria National Bank, Victoria, Texas	1990
Jeff Austin, Jr.	President, First National Bank of Jacksonville, Jacksonville, Texas	1991
Appointed by the Board of Governors		
Walter M. Mischer, Jr.	President and Chief Operating Officer, The Mischer Corporation, Houston, Texas	1989
Andrew L. Jefferson, Jr.	Attorney, Jefferson and Mims, Houston, Texas	1990
Gilbert D. Gaedcke, Jr.	Chairman of the Board and Chief Executive Officer, Gaedcke Equipment Company, Houston, Texas	1991
SAN ANTONIO BRANCH		
Appointed by the Federal Reserve Bank		
C. Ivan Wilson	Chairman of the Board, Chief Executive Officer, and Regional Director, First City, Texas–Corpus Christi, Corpus Christi, Texas	1989
Javier Garza	Executive Vice President, The Laredo National Bank, Laredo, Texas	1990
Sam R. Sparks	President, Sam R. Sparks, Inc., Progreso, Texas	1990
Jane Flato Smith	Investor and Rancher, San Antonio, Texas	1991
Appointed by the Board of Governors		
Lawrence E. Jenkins	Vice President (Retired), Lockheed Missiles & Space Co., Inc., Austin, Texas	1989
Scott H. Glass	President and Chief Operating Officer, Scarbroughs, Austin, Texas	1990

		Term expires Dec. 31
DISTRICT 11, San Antonio Branch, *Appointed by the Board of Governors* – Continued		
Roger R. Hemminghaus	Chairman and Chief Executive Officer, Diamond Shamrock R&M, Inc., San Antonio, Texas	1991

DISTRICT 12 – San Francisco

Class A

Rayburn S. Dezember	Chairman of the Board and Chief Executive Officer, Central Pacific Corporation; and Chairman of the Board, American National Bank, Bakersfield, California	1989
R. Blair Hawkes	President and Chief Executive Officer, Ireland Bank, Malad City, Idaho	1990
William E. B. Siart	Chairman of the Board, President, and Chief Executive Officer, First Interstate Bank of California, Los Angeles, California	1991

Class B

John C. Hampton	President and Chief Executive Officer, Willamina Lumber Company, Portland, Oregon	1989
John N. Nordstrom	Co-Chairman of the Board, Nordstrom, Inc., Seattle, Washington	1990
William L. Tooley	Chairman, Tooley & Company, Investment Builders, Los Angeles, California	1991

Class C

Robert F. Erburu	Chairman of the Board and Chief Executive Officer, The Times Mirror Company, Los Angeles, California	1989
Cordell W. Hull	Executive Vice President and Director, Bechtel Group, Inc., San Francisco, California	1990
Carolyn S. Chambers	President and Chief Executive Officer, Chambers Communications Corp., Eugene, Oregon	1991

Los Angeles Branch

Appointed by the Federal Reserve Bank

Fred D. Jensen	Chairman of the Board, President, and Chief Executive Officer, National Bank of Long Beach, Long Beach, California	1989
Ross M. Blakely	Chairman of the Executive Committee of the Board, Coast Savings and Loan, Los Angeles, California	1990
Ignacio E. Lozano, Jr.	Editor-in-Chief, La Opinion, Los Angeles, California	1991
Howard C. McCrady	Vice Chairman, Valley National Corporation, Phoenix, Arizona	1991

		Term expires Dec. 31
DISTRICT 12, LOS ANGELES BRANCH – Continued		
Appointed by the Board of Governors		
Yvonne Brathwaite Burke	Partner, Jones, Day, Reavis & Pogue, Los Angeles, California	1989
Richard C. Seaver	Chairman, Hydril Company, Los Angeles, California	1990
Harry W. Todd	Chairman and Chief Executive Officer, Rohr Industries, Inc., Chula Vista, California	1991
PORTLAND BRANCH		
Appointed by the Federal Reserve Bank		
Wayne E. Phillips, Jr.	Vice President, Phillips Ranch, Inc., Baker, Oregon	1989
Stephen G. Kimball	President and Chief Executive Officer, Baker Boyer Bancorp, Walla Walla, Washington	1990
G. Dale Weight	Chairman of the Board, President, and Chief Executive Officer, The Benjamin Franklin Savings and Loan Association, Portland, Oregon	1990
Stuart H. Compton	Chairman and Chief Executive Officer, Pioneer Trust Bank, N.A. Salem, Oregon	1991
Appointed by the Board of Governors		
Paul E. Bragdon	Assistant to the Governor for Education, Office of the Governor, Salem, Oregon	1989
Sandra A. Suran	Former Small Business Advocate, State of Oregon, Lake Oswego, Oregon	1990
William A. Hilliard	Editor, The Oregonian, Portland, Oregon	1991
SALT LAKE CITY BRANCH		
Appointed by the Federal Reserve Bank		
Ronald S. Hanson	President, Zions First National Bank, Salt Lake City, Utah	1989
Curtis H. Eaton	President and Vice Chairman of the Board, Twin Falls Bank & Trust Company, Twin Falls, Idaho	1990
Virginia P. Kelson	Associate, Ralston & Associates, Salt Lake City, Utah	1990
Gerald R. Christensen	President and Chairman, First Federal Savings Bank, Salt Lake City, Utah	1991
Appointed by the Board of Governors		
Robert N. Pratt	President and Chief Operating Officer, Bonneville Pacific Corporation, Salt Lake City, Utah	1989
Don M. Wheeler	President, Wheeler Machinery Company, Salt Lake City, Utah	1990

		Term expires Dec. 31
DISTRICT 12, SALT LAKE CITY BRANCH, *Appointed by the Board of Governors* – Continued		
D. N. Rose	President and Chief Executive Officer, Mountain Fuel Supply Company, Salt Lake City, Utah	1991
SEATTLE BRANCH		
Appointed by the Federal Reserve Bank		
H. H. Larison	President, Columbia Paint & Coatings, Spokane, Washington	1989
B. R. Beeksma	Chairman of the Board, InterWest Savings Bank, Oak Harbor, Washington	1990
William S. Randall	Chairman, President and Chief Executive Officer, First Interstate Bank of Washington, N.A., Seattle, Washington	1990
Robert P. Gray	President, National Bank of Alaska, Anchorage, Alaska	1991
Appointed by the Board of Governors		
Carol A. Nygren	Partner, Laventhol & Horwath, Certified Public Accountants, Seattle, Washington	1989
Irma Goertzen	Goertzen & Associates, Health Care Consultants, Seattle, Washington	1990
Bruce R. Kennedy	Chairman and Chief Executive Officer, Alaska Air Group, Inc., Seattle, Washington	1991

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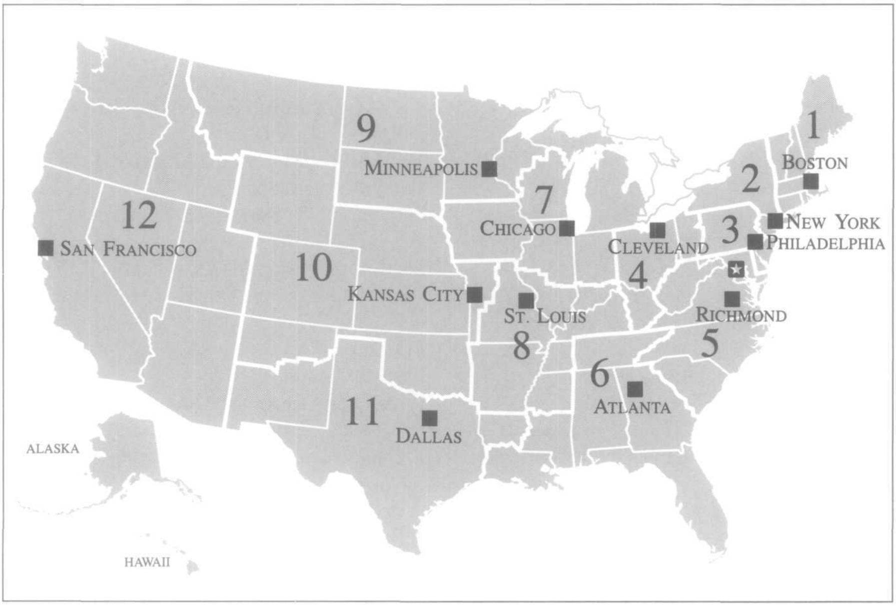
FRB 1-12,500-0590

Maps of the Federal Reserve System



LEGEND

Both pages

■ Federal Reserve Bank city

◘ Board of Governors of the Federal Reserve System

Facing page

• Federal Reserve Branch city

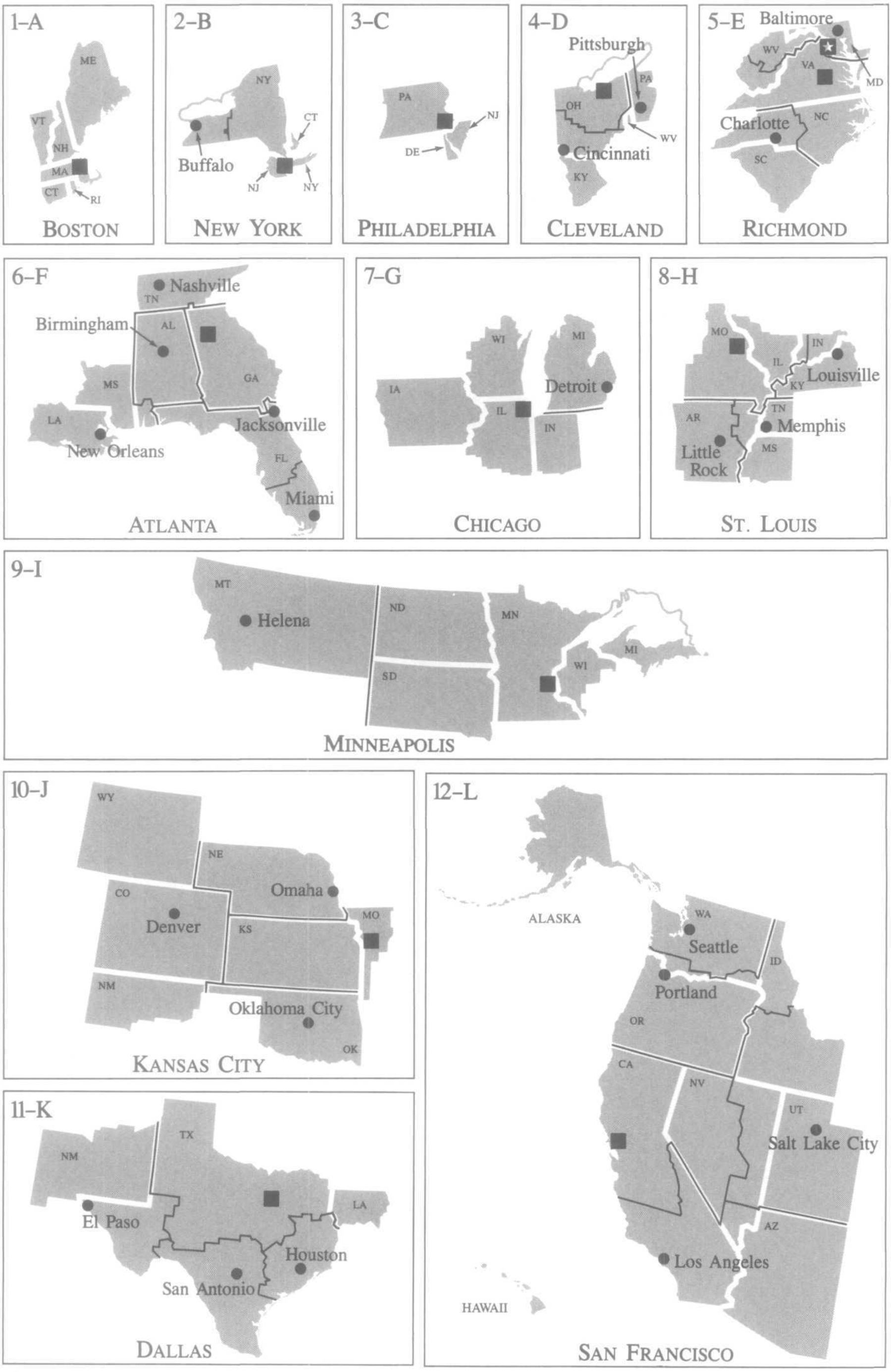
— Branch boundary

NOTE

The Federal Reserve officially identifies Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska, and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: the New York Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The Board of Governors revised the boundaries of the System most recently in August 1986.


1–A
ME
VT
NH
MA
CT
RI
BOSTON
2–B
NY
CT
Buffalo
NJ
NY
NEW YORK
3–C
PA
NJ
DE
PHILADELPHIA
4–D
Pittsburgh
PA
OH
WV
Cincinnati
KY
CLEVELAND
5–E
Baltimore
WV
VA
MD
Charlotte
NC
SC
RICHMOND
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Birmingham
AL
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Jacksonville
New Orleans
FL
Miami
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Louisville
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AR
TN
Memphis
Little Rock
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ST. LOUIS
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Helena
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Oklahoma City
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KANSAS CITY
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El Paso
Houston
San Antonio
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OR
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NV
UT
Salt Lake City
AZ
Los Angeles
HAWAII
SAN FRANCISCO