
82nd Annual Report 1995



Board of Governors of the Federal Reserve System

**This publication is available from the Board of Governors of the Federal Reserve System,
Publications Services, Mail Stop 127, Washington, DC 20551.**

Letter of Transmittal

**BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., May 6, 1996**

**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 Eighty-Second Annual Report of the Board of Governors
of the Federal Reserve System.

This report covers operations of the Board during calendar year 1995.

Sincerely,

A handwritten signature in black ink, appearing to read "Alan Greenspan", with a stylized flourish at the end.

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Part 1

Monetary Policy and the U.S. Economy in 1995

Introduction

The economy performed reasonably well in 1995. Sustained economic expansion kept the unemployment rate at a relatively low level, and inflation, as measured by the four-quarter change in the consumer price index, was less than 3 percent for the third consecutive year, the first such occurrence in thirty years. The combination of low inflation and low unemployment provided further substantiation of a fundamental point that the Board has made on past occasions—namely, that there is no trade-off in the long run between the monetary policy goals of maximum employment and stable prices set in the Federal Reserve Act. Indeed, it is by fostering price stability that a central bank can make its greatest contribution to the efficient operation and overall ability of the nation's economy to create jobs and advance living standards over time.

As economic prospects changed over the course of 1995, the Federal Reserve found that promoting full employment and price stability required adjustments in its policy settings. In February, the economy still seemed to be pressing against its potential, and prices were tending to accelerate. To reduce the risk that inflation might mount, with the attendant threat to continued economic expansion, the Federal Open Market Committee raised the federal funds rate an additional $\frac{1}{2}$ percentage point, to

6 percent. Inflation did, in fact, pick up in the first part of 1995, but data released during the spring indicated that price pressures were receding, and the Committee reduced the federal funds rate $\frac{1}{4}$ percentage point at its July meeting. Through the remainder of the year, inflation was even more favorable than had been anticipated in July, and inflation expectations decreased. In addition, an apparent slowing of economic activity late in the year further reduced the potential for inflationary pressures going forward. To forestall an undue increase in real interest rates as inflation slowed, and to guard against the possibility of unnecessary slack developing in the economy, the Committee eased reserve conditions in December, reducing the federal funds rate $\frac{1}{4}$ percentage point.

The monetary policy easings after mid-1995 contributed to declines in short-term market interest rates, which by year-end were about 1 percentage point to 2 percentage points down from the highs reached early in 1995. Intermediate- and long-term rates also moved sharply lower last year, as the risks of rising inflation receded and as prospects for substantial progress in reducing the federal budget deficit seemed to improve. By the end of 1995, these rates were 2 to $2\frac{1}{2}$ percentage points below their levels at the beginning of 1995. Helped by lower interest rates and favorable earnings, major equity price indexes rose 30 percent to 40 percent in 1995. These financial developments reduced the cost to businesses of financing investment and to households of buying homes and consumer durables; households were also

NOTE. The discussion here and in the next two chapters is adapted from *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978* (Board of Governors, February 1996). Data cited here and in the next three chapters are those available as of mid-March 1996.

aided by substantial additions to financial wealth from rising bond and equity prices.

The foreign exchange value of the U.S. dollar, measured in terms of the currencies of the other G-10 countries, fell about 5 percent, on net, during 1995. The dollar appreciated substantially from the summer onward but not enough to offset a sharp decline that took place in the first four months of 1995. Interest rates fell in most other foreign industrial countries, which also were experiencing slower economic growth, but the decline in rates abroad was less than that in the United States. Early in 1995, the dollar also was pulled down by the reactions to the crisis in Mexico, but the negative influence on the dollar from this source appeared to lessen as Mexican financial markets stabilized over the balance of the year. Inflation rates in major industrial countries held fairly steady in 1995 at levels somewhat lower than those prevailing in this country; thus, depreciation of the dollar in real terms against other G-10 currencies was less than the depreciation in nominal terms. Against the currencies of a broader group of U.S. trading partners, the dollar's real depreciation was even smaller.

Borrowing and spending in the United States was facilitated not only by lower interest rates but also by favorable supply conditions in credit markets. Spreads between interest rates on securities issued by private firms and those issued by the Treasury generally remained narrow, and banks continued to ease terms and qualifying standards on loans to businesses and households through most of the year. The total debt of domestic nonfinancial sectors grew $5\frac{1}{2}$ percent last year, a little above the midpoint of the Committee's 3 percent to 7 percent monitoring range. Rapid growth of business spending on inventories and fixed

capital early in the year boosted the credit demands of firms, despite strong corporate profits. Borrowing was also lifted by the financing of heavy net retirements of equity shares in connection with mergers and share repurchase programs. Growth of household debt remained brisk as consumer credit continued to grow quite rapidly. Federal debt grew relatively slowly for a second year; the federal deficit declined further, and toward year-end, normal seasonal borrowing was constrained by the federal debt ceiling. Outstanding state and local government debt ran off a bit more rapidly than in 1994.

Commercial banks and thrift institutions again financed a large portion of the borrowing last year; their share of total outstanding debt of nonfederal sectors edged up in 1994 and 1995 after having declined for more than fifteen years. The growth in depository credit was funded primarily with deposits, boosting the expansion of the broad monetary aggregates.

M3 grew 6 percent, at the top of its 2 percent to 6 percent annual range established by the Committee at mid-year. Depositories relied heavily on large-denomination time deposits for funding, but retail deposits also showed gains as declining market interest rates made these deposits more attractive to retail customers.

M2 advanced $4\frac{1}{4}$ percent, putting it in the upper portion of its 1 percent to 5 percent annual range. The expansion of M2 was the largest in six years, and its velocity was little changed after having increased substantially during the previous three years. Nonetheless, growth of the aggregate was erratic through the year, and the stability of its relationship to nominal spending remained in doubt.

M1 declined last year for the first time since the beginning of the official

series, in 1959. An increasing number of banks introduced retail sweep accounts, which shift money from interest-bearing checkable accounts to savings accounts to reduce banks' reserve requirements. Without these shifts, M1 would have risen in 1995, although slowly. ■

The Economy in 1995

According to estimates that were available as of mid-March 1996, real gross domestic product increased slightly less than $1\frac{1}{2}$ percent over the four quarters of 1995 after a gain of $3\frac{1}{2}$ percent in 1994. The 1995 rise in aggregate output was accompanied by an increase in payroll employment of $1\frac{3}{4}$ million, and the unemployment rate, after having fallen sharply in 1994, held fairly steady over the course of 1995, keeping to a range of about $5\frac{1}{2}$ percent to $5\frac{3}{4}$ percent. Consumer prices, as measured by the CPI for all items, rose $2\frac{3}{4}$ percent over the four quarters of 1995, an increase that was virtually the same as those of the two previous years.

Growth of output during the past year was slowed in part by the actions of businesses to reduce the pace of inventory accumulation after a burst of stockpiling in 1994. Final sales—a measure of current output that does not end up in inventories—rose at an average rate of about 2 percent over the four quarters of 1995 after an increase of 3 percent during 1994. The slowing of final sales was largely a reflection of a downshifting in

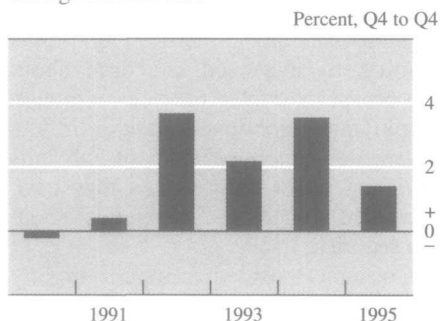
growth of the real outlays of households and businesses, from elevated rates of increase in 1994 to rates that are more sustainable. Real government outlays for consumption and investment fell about $1\frac{1}{4}$ percent during the year. Increases in exports and imports of goods and services were smaller in real terms than the increases of 1994, and their combined effect on GDP growth was slightly positive.

The Household Sector

Real personal consumption expenditures rose about 2 percent during 1995 after having risen 3 percent over the four quarters of 1994. The reduced rate of rise in consumption spending this past year came against the backdrop of moderate gains in employment and income. The financial wealth of households surged, but the impetus to spending from this source evidently was countered by other influences, such as increases in debt burdens among some households and a rise, according to survey data, in consumers' concerns about job security.

Real consumer expenditures for durable goods increased 2 percent during 1995, a slower rate of rise than in other recent years. Consumer expenditures for motor vehicles declined about 3 percent after having moved up nearly 20 percent over the three previous years. A variety of price concessions to motor vehicle buyers probably gave some lift to sales in 1995; however, pent-up demand, which had helped to boost sales earlier in the expansion, probably was no longer an important factor.

Change in Real GDP



NOTE: The data are derived from chained (1992) dollars and come from the Department of Commerce.

Real outlays for durable goods other than motor vehicles continued to rise at a brisk pace in 1995 but not so rapidly as in other recent years. Spending for furniture and household equipment hit a temporary lull in the first part of 1995 but picked up again over the next three quarters, lifted in part by a rebound in the construction of new houses. Spending for home computers and other electronic gear, which has been surging in recent years, continued to move up rapidly in 1995.

Consumer expenditures for nondurables increased less than 1 percent, in real terms, during 1995 after a larger-than-average gain in 1994. The growth of real expenditures on apparel slowed sharply after three years of sizable advances, and outlays for food registered only a small gain in real terms.

Real expenditures for services—which account for more than half of total consumer outlays—increased 2½ percent during 1995, a moderately faster pace than in either 1993 or 1994. After declining in 1994, outlays for energy services increased sharply in 1995. Spending gains for other categories of services proceeded at an average rate of slightly less than 2½ percent over the four quarters of 1995, just a touch faster than the rate of rise in the two previous years.

Real disposable personal income grew nearly 3 percent during 1995, a slightly larger gain than in the previous year. Nominal personal income increased slightly faster in 1995 than it did in 1994, and growth of nominal disposable income, which excludes income taxes, held close to its 1994 pace. Inflation continued to take only a moderate bite from increases in nominal receipts.

After little change during 1994, the real value of household wealth surged in 1995. The value of assets was boosted substantially by huge increases in the

prices of stocks and bonds. Liabilities continued to rise fairly rapidly but at a rate well below the rate of increase in household assets; the rapid growth of consumer credit was again the most notable feature on the liability side. Behind these aggregate measures of household assets and liabilities was some wide variation in the circumstances of individual households. Appreciation of share prices and the rally in the bond market provided a substantial boost to the wealth of households holding large amounts of those assets, but households holding few such assets benefited little from the rally in securities prices. Some households also began to experience greater financial pressure in 1995. Overall, however, the incidence of financial stress appears to have been limited, as sustained increases in personal income helped to facilitate timely repayment of obligations.

Consumers maintained relatively upbeat perceptions of current and future economic conditions during 1995. The measure of consumer confidence that is prepared by the Conference Board held fairly steady at a high level. The index of consumer sentiment compiled by the University of Michigan Survey Research Center edged down a little, on net, from the end of 1994 to the end of 1995, but its level also remained relatively high. By contrast, some survey questions dealing specifically with perceptions of labor market conditions pointed to increased concerns about job prospects during the year; although employment continued to rise in the aggregate, announcements of job cuts by some major corporations may have rekindled consumers' anxieties about job security.

Consumers tended to save a slightly higher proportion of their income in 1995 than they had in 1994. Large increases in financial wealth usually

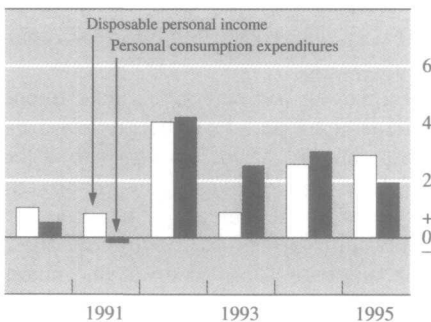
cause households to spend a greater share of their current income, thereby reducing the share of income that is saved. However, rising debt burdens and increased nervousness about job prospects would work in the opposite direction, and these influences may have offset the effect of increases in wealth. Some households also may have started focusing more intently on saving for retirement, especially in light of increased political debate about curbing the growth of entitlements provided under government programs. Nonetheless, the personal saving rate for all of 1995, while moving up a little, remained in a range that was relatively low by historical standards.

Residential investment fell in the first half of 1995 but turned up in the second half. Both the downswing in the first half and the subsequent rebound after midyear appear to have been shaped, at least in a rough way, by swings in mortgage interest rates. Although housing activity had been slow to respond to increases in mortgage interest rates through much of 1994, sizable declines in sales of new and existing homes started to show up toward the end of that year, and by early 1995, permits and starts also were dropping. However, the

decline in activity proved to be relatively short and mild. By March, mortgage interest rates already were down appreciably from the peaks of late 1994, and midway through the second quarter, most indicators of housing activity were starting to rebound. Sales of new homes surged to especially high levels during the summer, and permits and starts of single-family units rose appreciably. In the autumn, sales retreated from their midyear peaks. Starts also slipped back somewhat during the autumn, but permits continued to firm, climbing to a yearly high in December.

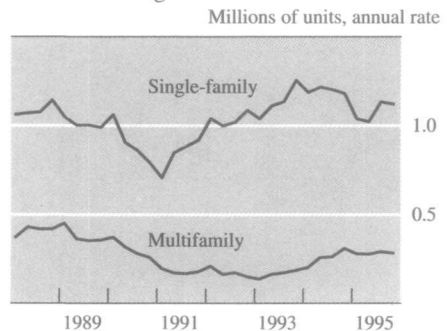
The intra-year swings in the various housing indicators left the annual totals for these indicators at fairly elevated levels. Sales of existing homes in 1995 were well above the annual average for the 1980s, even after adjusting for increases in the stock of houses. Starts and sales of new single-family dwellings in 1995 were about one-tenth higher than their averages for the 1980s. So far in the 1990s, demographic influences have been less supportive of housing activity than in the 1980s; the rate of household formation has lagged, in part because many young adults have delayed setting up their own domiciles. However, offsetting impetus to demand has come from the improved affordabil-

Change in Real Income and Consumption
Percent, Q4 to Q4



NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

Private Housing Starts



NOTE. The data are seasonally adjusted and come from the Department of Commerce.

ity of housing, brought about in particular by declines in mortgage interest rates.

The construction of multifamily units, after taking a notable step toward recovery in 1994, exhibited little momentum in 1995. For the year as a whole, starts of multifamily units amounted to about 280,000, compared with a tally of about 260,000 in 1994 and a low of about 160,000 in 1993. Financing for the construction of new multifamily projects appeared to be readily available in 1995. However, the national vacancy rate for multifamily rental units, while down from the peaks of a few years ago, remained relatively high, and increases in rents apparently were not sufficient to stimulate a significant gain in the construction of new units.

The Business Sector

Most indicators of business activity remained favorable in 1995, but strength was less widespread than it had been in 1994, and growth overall was less robust. The output of all nonfarm businesses rose slightly less than 2 percent over the four quarters of 1995 after a gain of 4 percent in 1994—the latter

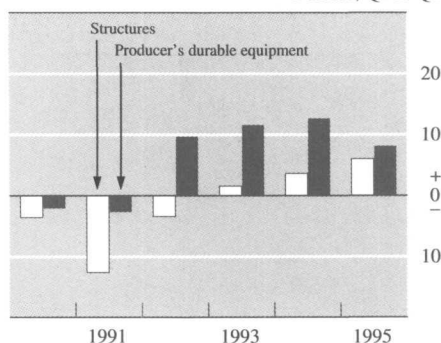
pace of growth could not have been sustained given already high operating levels. Inventory problems cropped up in some lines of manufacturing and trade in 1995 and prompted production adjustments. Scattered structural problems were apparent as well, especially in parts of retail trade in which intense competition for market share caused financial losses and eventual bankruptcy for some enterprises. More generally, however, businesses continued to profit from strategies that have served them well throughout the 1990s—most notably, tight control over costs and the rapid adoption of new technologies achieved through heavy investment in high-tech equipment.

In total, real business fixed investment increased 7½ percent during 1995 after a gain of 10 percent in 1994. Growth in business spending for equipment continued to outpace the growth of investment in structures even though the latter scored its largest gain of the past several years. On a quarterly basis, investment remained very strong through the first quarter of 1995. After slowing sharply in the spring, it then picked up again in the third and fourth quarters but did not reach the pace seen early in the year.

Businesses continued to invest heavily in computers in 1995. In real terms, these expenditures rose nearly 40 percent over the year, an increase that was even larger than those of other recent years.

Excluding computers, real investment outlays increased less rapidly, on balance, than in 1994, and growth after the first quarter was quite small. In the equipment category, outlays for information-processing equipment other than computers moved up at an annual rate of about 13 percent in the first half of 1995, fell back a little in the third quarter, and turned back up again in the

Change in Real Business Fixed Investment
Percent, Q4 to Q4



NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

year's final quarter. Spending for industrial equipment also rose sharply in the first half of the year; it then fell moderately in the second half. Real outlays for transportation equipment followed a choppy pattern that resulted in little net gain over the year as a whole. Real investment in nonresidential structures moved up in each quarter, with gains cumulating to an annual rise of 6 percent; 1995 brought increased construction of most types of nonresidential buildings.

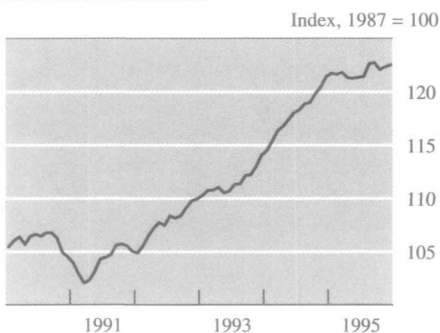
In the industrial sector, elevated levels of investment in equipment and structures led to a gain of about 4 percent in industrial capacity. However, in a turnabout from the outcome of the previous year, output of the industrial sector rose considerably less rapidly than capacity: A gain of 1½ percent in total industrial production over the four quarters of 1995 was a sharp slowdown from a 1994 rise of more than 6½ percent. Production of consumer goods followed an up-and-down pattern during 1995 and rose less than ½ percent over the year as a whole, the smallest annual increase of the current expansion. The output of business equipment advanced in each quarter, but a cumulative gain of 4½ percent for this category was smaller than the increases of other recent years. Production of materials faltered tempo-

rarily in the second quarter, but production gains resumed thereafter, leading to a rise of about 2½ percent over the four quarters of the year.

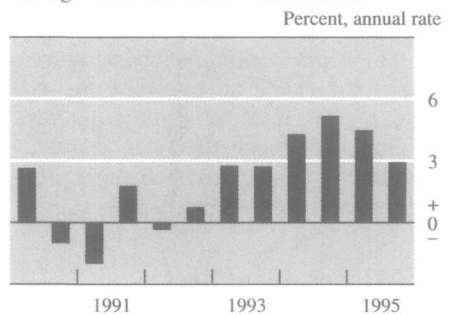
With capacity expanding rapidly and production growth slowing, the rate of capacity utilization in industry turned down sharply in 1995, backing away from the high operating rates of late 1994. As of December 1995, the utilization rate in manufacturing was about ½ percentage point above its long-term average.

After rising rapidly during 1994, business inventories continued to build at a substantial pace in the early part of 1995. By the end of the first quarter, real inventories of nonfarm businesses were about 5½ percent above the level of a year earlier. Meanwhile, strength that had been evident in final sales during 1994 gave way to more subdued growth in the first quarter of 1995, and the ratio of inventories to sales rose. In the second and third quarters, the growth of inventories slowed appreciably, and another sharp downward step in the rate of inventory accumulation took place in the fourth quarter. At year-end, significant imbalances probably were present in only a few industries. The potential for wider inventory problems appears to

Industrial Production



Change in Real Business Inventories



NOTE. Total nonfarm sector. The data are seasonally adjusted, derived from chained (1992) dollars, and come from the Department of Commerce.

have been contained through a combination of production restraint late in 1995, caution in ordering merchandise from abroad, and discounting by some retailers during the holiday shopping season.

Business profits rose further over the first three quarters of 1995. Economic profits of all U.S. corporations increased at an annual rate of nearly 11 percent, a pace similar to that seen over the four quarters of 1994. The profits of corporations from their operations in the rest of the world moved up sharply, on net, and earnings from domestic operations also continued to advance. The strongest gains in domestic profits came at financial corporations and reflected, in part, an increased volume of lending by financial institutions, reduced premiums on deposit insurance at commercial banks, and rising profits of securities dealers.

The economic profits earned by nonfinancial corporations from their domestic operations rose at an annual rate of about $3\frac{1}{2}$ percent over the first three quarters of 1995 after three years in which the annual increases were 15 percent or more. A moderation of output growth and a flattening of the rise in profits per unit of output both worked to reduce the rate of growth in nominal earnings at nonfinancial corporations in 1995. Nonetheless, with unit costs also moving up at a moderate pace, the share of the value of nonfinancial corporate output that ended up as profits changed little, on net, in the first three quarters, holding in a range that was relatively high in comparison to the average profit share over the past couple of decades.

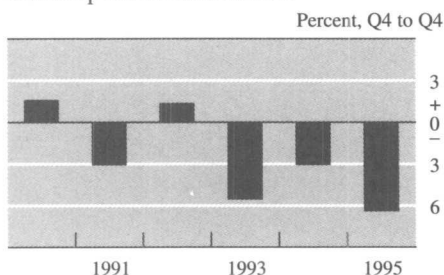
The Government Sector

At the federal level, combined real outlays for investment and consumption fell nearly $6\frac{1}{2}$ percent over the four quarters

of 1995, dropping by the fourth quarter to a level about 15 percent below the level in 1990. Both investment and consumption were cut back. Outlays for defense continued to contract, and non-defense expenditures turned down, more than reversing their moderate increase over the four quarters of 1994.

Federal outlays in the unified budget, which covers transfers and grants as well as consumption and investment expenditures other than the consumption of fixed capital, rose $3\frac{3}{4}$ percent in nominal terms in fiscal 1995, matching almost exactly the percentage rise of the previous fiscal year. Nominal outlays for defense declined $3\frac{3}{4}$ percent in both fiscal 1995 and fiscal 1994. Outlays for social security increased about 5 percent in both years. Spending for Medicare and Medicaid continued to rise at rates appreciably faster than the growth of nominal GDP. Net interest payments jumped in fiscal 1995 after three years of relatively little change, but working in the other direction, net outlays for deposit insurance were more negative than in 1994 (that is, revenues from premiums and other sources exceeded the payout for losses by a larger amount). Proceeds from auctions of spectrum rights also helped to hold down expenditures; like the premiums

Change in Real Federal Expenditures on Consumption and Investment



NOTE: The data are derived from chained (1992) dollars and come from the Department of Commerce.

for deposit insurance, these proceeds enter the budget as a negative outlay. In the first three months of fiscal 1996—that is, the three-month period ended in December 1995—federal outlays were about 1 percent lower in nominal terms than in the comparable period of fiscal 1995. Nominal outlays for defense continued to trend down, and the spending restraint embodied in continuing budget resolutions translated into sharp cuts in some nondefense outlays.

Federal receipts rose $7\frac{1}{2}$ percent in fiscal 1995 after having increased 9 percent in fiscal 1994. In both years, categories of receipts that are most closely related to the state of the economy showed sizable increases. With receipts moving up more rapidly than spending in fiscal 1995, the federal budget deficit fell for a third consecutive year, to \$164 billion. Progress in reducing the deficit in recent years has come from cyclical expansion of the economy, tax increases, nonrecurring factors such as the sale of spectrum rights, and adherence to the budgetary restraints embodied in the Budget Enforcement Act of 1990 and the Omnibus Budgetary Reconciliation Act of 1993.

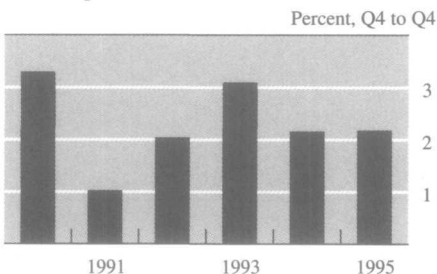
The economic expansion also has helped to relieve budgetary pressures that many state and local governments

were experiencing earlier in the 1990s. Excluding social insurance funds, surpluses in the combined current accounts of state and local governments were equal to about $\frac{1}{2}$ percent of nominal GDP in the first three quarters of 1995; this figure was more than double the average for 1991 and 1992, when budgetary pressures were most severe.

Even so, state and local budgets remain at the center of strongly competing pressures, with the demand for many of the services that these governments typically provide continuing to rise at a time when the public also is pressing for tax relief. Although states and localities have responded to these pressures in different ways, the aggregate picture is one in which expenditures and revenues have continued to rise faster than nominal GDP—but by smaller margins than in the early part of the 1990s. In total, the current expenditures of state and local governments, made up mainly of transfers and consumption expenditures, were equal to about $12\frac{1}{2}$ percent of nominal GDP in 1995, up slightly from the percentages of the two previous years and about $1\frac{3}{4}$ percentage points higher than the comparable figure for 1989. Total receipts of state and local governments were equal to about 13 $\frac{3}{4}$ percent of nominal GDP in the first three quarters of 1995, a little above the comparable percentages of the two previous years and about $1\frac{1}{4}$ percentage points higher than the percentage in 1989.

State and local outlays for consumption and investment—the expenditures that are included in GDP—have been rising less rapidly than the current expenditures of these jurisdictions because GDP excludes transfer payments, which have been growing faster than other outlays. In real terms, combined state and local outlays for consumption and investment increased about $2\frac{1}{4}$ percent

Change in Real State and Local Expenditures on Consumption and Investment



NOTE: The data are derived from chained (1992) dollars and come from the Department of Commerce.

over the four quarters of 1995. Real investment expenditures, which consist mainly of outlays for construction, moved up almost 6 percent. By contrast, consumption expenditures, which are about four times the size of investment outlays, rose less than 1½ percent in real terms.

Labor Markets

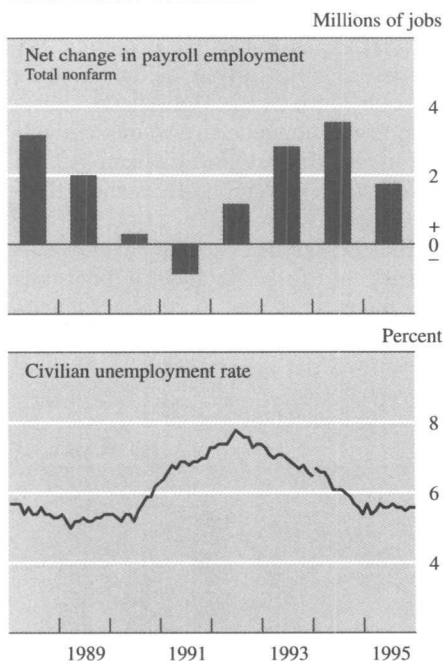
The number of jobs on nonfarm payrolls increased 1¾ million, or 1.6 percent, over the twelve months ended in December 1995. After a sharp rise during 1994, gains in employment began to slow in the first quarter of 1995, and the second-quarter gain was relatively small. Thereafter, increases picked up somewhat. Nearly 450,000 jobs were added in the final three months of the year, a rate of gain that was about equal to that for the year as a whole.

As in 1994, increases in payroll employment in 1995 came mainly in the private sector of the economy, but gains there were more mixed than those of 1994. In manufacturing, employment fell about 165,000 over the twelve months ended in December, reversing almost half of the previous year's gain. Losses were concentrated in industries that produce nondurables. A decline this past year in the number of jobs at apparel manufacturers was one of the largest ever in that industry. Sizable reductions in employment also were reported by manufacturers of textiles, tobacco, leather products, and petroleum and coal. In many of these industries, cyclical deceleration of the economy in 1995 compounded the effects of adjustments stemming from longer-run structural changes. In contrast to the widespread contraction in employment among producers of nondurables, employment at the manufacturers of durable goods increased slightly during

1995. Hiring continued to expand briskly at firms that produce business equipment. Metal fabricators also sustained growth in employment but at a slower pace than in 1994. The number of jobs in transportation equipment declined, on net.

In most other sectors of the economy, employment rose moderately last year. The number of jobs in construction increased 130,000 over the twelve months ended in December, a rise of more than 3 percent. In the private service-producing sector, which now accounts for about three-fourths of all jobs in the private sector, employment increased 1.7 million in 1995 after having advanced 2.6 million in 1994. Establishments that are involved in wholesale trade continued to boost payrolls at a

Labor Market Conditions



NOTE. The data are from the Department of Labor. The department introduced a new survey of households in January 1994; unemployment data from that point on are not directly comparable with those of earlier periods.

relatively brisk pace in 1995. Retailers also added to employment but at a considerably slower rate than in 1994; within retail trade, employment at apparel outlets fell substantially last year, and payrolls at stores selling general merchandise dropped moderately after a large increase in 1994. Providers of health services added slightly more jobs than in other recent years. At firms that supply services to other businesses, employment growth was sizable again in 1995 but less rapid than in either of the two previous years; in this category, providers of computer services expanded their job counts at an accelerated pace in 1995, but suppliers of personnel—a category that includes temporary help agencies—added jobs at a much slower rate than in other recent years.

Results from the monthly survey of households showed the civilian unemployment rate holding in a narrow range throughout 1995, and the December rate—5.6 percent of the labor force—was near the midpoint of the range.

The proportion of working-age persons choosing to participate in the labor force edged down slightly, on net, over the course of 1995. It has changed little, on balance, since the start of the 1990s. By contrast, the two previous decades had brought substantial net increases in labor force participation, although longer-term trends during that period were interrupted at times by spells of cyclical sluggishness in the economy. Two or three years ago, cyclical influences also seemed to be a plausible explanation for the lack of growth in the participation rate in the current business expansion. But with the sluggishness persisting as job opportunities have continued to expand, the evidence is pointing increasingly toward a slower rate of rise in the trend of labor force participation. Slower growth in participation will

tend to limit the growth of potential output, unless an offsetting rise is forthcoming in the trend of productivity growth. So far in the current expansion, measured increases in productivity seem to have followed a fairly typical cyclical pattern, with larger increases early in the expansion and smaller gains, on average, in subsequent years. Overall, however, this pattern has not yielded evidence of a significant pickup in the longer-term trend of productivity growth.

The average unemployment rate for all of 1995 was about $\frac{1}{2}$ percentage point below the average for 1994, and it was only a little above the levels to which the unemployment rate fell in the latter stages of the long business expansion of the 1980s. The low unemployment rates reached then proved to be unsustainable, as they eventually were accompanied by a significant step-up in the rate of inflation, brought on in part by faster rates of rise in hourly compensation and unit labor costs.

Similar inflation pressures have not emerged in the current expansion. The employment cost index for hourly compensation of workers in private nonfarm industries rose only 2.8 percent over the twelve months ended in December, the smallest annual increase on record in a series that goes back to 1980. Hourly wages increased 2.8 percent during the past year, the same relatively low rate of increase as in 1994. The cost of fringe benefits, prorated to an hourly basis, rose only 2.7 percent last year, the smallest annual rise on record. With many firms still undergoing restructurings and reorganizations, many of which have involved permanent job losses, workers probably have been more reluctant to press for wage increases than they normally would have been during a period of tight labor markets. Also, firms have been making unprecedented

efforts to gain better control over the rate of rise in the cost of benefits provided to employees, especially those related to health care. Although some of these efforts may have only a one-time effect on the level of benefit costs, groundwork also seems to have been laid for slower growth of benefits over time than would otherwise have prevailed.

Prices

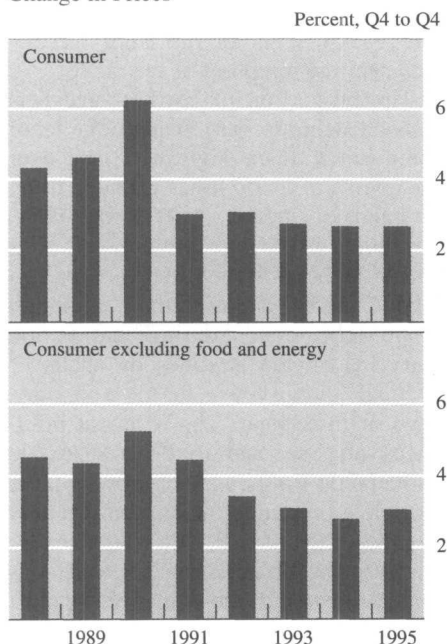
Early in 1995, inflation pressures that had started building in 1994 seemed to be gaining intensity. Indexes of spot commodity prices continued to surge in the early part of last year, and in the producer price index, materials prices recorded some exceptionally large increases. Consumer prices also began to exhibit some upward pressure, with the index for items other than food and energy moving up fairly rapidly over the first four months of the year.

The surge in inflation proved to be relatively short-lived, however. The spot prices of industrial commodities turned down in the spring of the year and fell further, on net, after midyear. Price increases for intermediate materials slowed in the second and third quarters of 1995, and by the final quarter of the year these prices also were declining. Monthly increases in the CPI excluding food and energy slowed in May; increases in this indicator of core inflation generally were small over the remainder of the year. The slowing of the economy after the start of the year appears to have cut short the buildup of inflationary pressures before they could have much effect on the underlying processes of wage and price determination. In the end, the rise in the core CPI from the final quarter of 1994 to the final quarter of 1995 amounted to 3 percent, an increase that differed little from those

of the two previous years. The increase in the total CPI in 1995 came in at 2¾ percent, the third consecutive year in which it has been less than 3 percent.

In the aggregate, rates of price increase held fairly steady for both goods and services this past year. The CPI for commodities other than food and energy rose 1¾ percent over the four quarters of 1995 after increases of 1½ percent in both 1993 and 1994. The last three-year period in which prices of these goods rose by such small amounts came in the middle part of the 1960s. Apparel prices continued to decline last year but not so rapidly as in the previous year. Price increases for vehicles moderated. The 1995 rise in the CPI for services other than energy was 3¾ percent; although this increase exceeded the 1994 rise by a slight amount, the results for both years were among the smallest

Change in Prices



NOTE. Consumer price index for all urban consumers. Based on data from the Department of Labor.

increases for this category in the last three decades.

Trends in food prices and energy prices remained favorable to consumers in 1995. The rise in food prices from the final quarter of 1994 to the final quarter of 1995 was slightly more than 2½ percent, almost exactly the same as the increases of the two previous years. The last yearly increase in food prices in excess of 3 percent came in 1990. In 1995, weather problems led to a decline in crop production and to a surge in the prices of some crops, but this surge did not bring about widespread increases in food prices at the retail level. Livestock production continued to advance, helping to restrain price increases for meats and dairy products. Also, moderate rates of increase in the costs of nonfarm inputs that contribute heavily to value added continued to be an important anchor in the setting of food prices at the consumer level.

In the energy area, prices at the consumer level fell 1¾ percent, on net, over the four quarters of 1995, more than reversing a moderate 1994 increase. Gasoline prices dropped nearly 5 percent, on net, over the four quarters of the year, and consumer prices of natural gas also declined appreciably. However, some upward pressures developed late in 1995, partly in response to unexpectedly cold temperatures that boosted fuel requirements for winter heating.

All told, the price developments of 1995 appear to have left a favorable imprint on expectations of future rates of inflation, if results from various surveys of consumers and forecasters are an accurate reflection of the views held by the broader public. Monthly responses to the surveys tend to bounce around somewhat, but over 1995 as a whole, average readings of anticipated price increases one year into the future were slightly lower than those of 1994,

and survey responses about inflation prospects over the longer term came down more substantially. Although the responses regarding expected inflation still tended, on balance, to run to the high side of actual rates of price increase, the easing of inflation expectations this past year provided another encouraging sign that inflation processes that helped to undermine other recent business expansions were in check as 1995 drew to a close. ■

Monetary Policy and Financial Markets in 1995

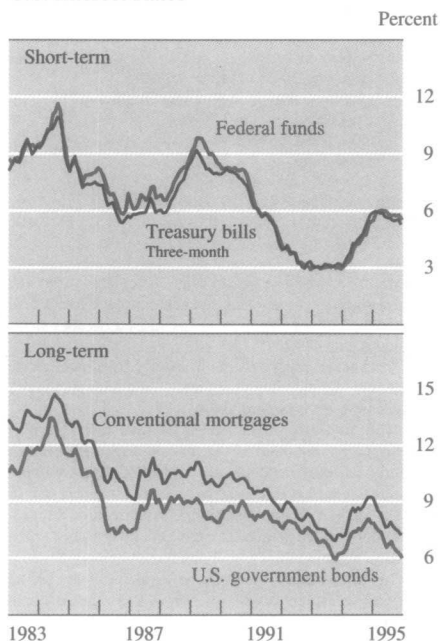
In 1995 the Federal Reserve had to adjust its policy stance several times to promote credit market conditions supportive of sustained growth with low inflation. At the beginning of 1995, some risk remained that inflation might rise. To provide additional insurance against that development, the Federal Open Market Committee (FOMC) tightened reserve conditions in February, raising the intended federal funds rate $\frac{1}{2}$ percentage point, to 6 percent, thereby extending the episode of policy firming that had begun one year earlier. As time passed, it became clear that these policy tightenings had been successful in containing inflationary pressures, and the System initiated $\frac{1}{4}$ point reductions in the federal funds rate in July and December.

Most market interest rates had peaked before the policy tightening of February. During the spring, interest rates declined appreciably, as market participants increasingly came to believe that no additional policy restraint would be forthcoming, and, indeed, that easing might be in the cards. Mounting evidence that the growth of spending had downshifted and that price pressures were muted, along with greater hopes that substantial progress would be made toward reducing the federal budget deficit, contributed to the change in attitudes and to the drop in interest rates, especially longer-term rates. On balance, interest rates dropped 1 to $2\frac{1}{2}$ percentage points during 1995, with the largest declines registered on intermediate- and long-term securities.

The course of interest rates during the year influenced overall credit flows and their composition. The expansion of the

total debt of domestic nonfinancial sectors was relatively strong during the first half of the year but moderated later in 1995. For the year, debt grew $5\frac{1}{2}$ percent, somewhat above the midpoint of its monitoring range. Initially, household and nonfinancial business credit demands were concentrated in floating rate or short-term debt instruments. As the yield curve flattened, credit demands

U.S. Interest Rates



NOTE. 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 coupon-equivalent 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 major financial institutions and is from the Federal Home Loan Mortgage Corporation.

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

Annual Rate of Change in Reserves, Money Stock, and Debt Aggregates

Percent

Item	1992	1993	1994	1995				
				Year	Q1	Q2	Q3	Q4
Depository institution reserves ¹								
Total	20.1	12.2	-1.3	-4.9	-3.7	-8.0	-1.2	-7.2
Nonborrowed plus extended credit	20.3	12.2	-1.5	-4.9	-2.4	-8.6	-2.2	-6.7
Required	20.3	12.5	-1.1	-5.2	-4.0	-7.0	-2.3	-8.0
Monetary base ²	10.4	10.5	8.4	4.1	6.0	5.7	1.7	2.7
Concepts of money ³								
M1	14.3	10.5	2.4	-1.8	-1	-5	-1.5	-5.1
Currency	9.2	10.3	10.3	5.4	7.7	7.7	2.1	3.8
Demand deposits	17.8	13.3	.4	1.4	-1	.4	5.7	-4
Other checkable deposits	15.6	8.5	-1.9	-11.2	-7.0	-9.0	-11.7	-18.8
M2	1.8	1.4	.6	4.2	1.4	4.3	7.0	4.0
Non-M1 components	-2.6	-2.4	-.3	7.2	2.2	6.6	11.0	8.1
Savings (including MMDAs)	14.5	2.9	-4.3	-3.4	-15.2	-9.2	3.5	7.8
Small denomination time deposits	-18.4	-10.3	2.5	14.9	22.6	21.6	8.4	4.2
Retail money market mutual funds	-3.9	-.5	7.5	22.6	11.7	19.0	36.5	16.9
M3 .....	.6	1.0	1.6	6.1	4.9	6.7	8.0	4.3
Non-M2 components	-4.9	-.5	6.2	14.4	19.9	16.9	12.2	5.7
Large-denomination time deposits	-15.5	-6.5	7.2	15.7	13.7	14.2	13.3	18.0
Institution-only money market mutual funds	18.5	-4.3	-6.8	22.9	17.5	30.4	27.7	9.3
Repurchase agreements	5.5	23.3	13.3	4.7	32.3	7.6	-5.0	-15.1
Eurodollars	-15.0	-1.8	23.6	10.3	25.9	18.4	9.2	-12.9
Domestic nonfinancial sector debt	4.7	5.2	5.2	5.5	5.4	7.0	4.6	4.5
Federal	10.7	8.4	5.7	4.4	5.1	5.4	4.6	2.3
Nonfederal	2.8	4.1	5.0	5.9	5.5	7.6	4.7	5.3

NOTE. Changes for quarters are calculated from the average amounts outstanding in each quarter. Changes for years are measured from Q4 to Q4. Based on seasonally adjusted data.

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

2. The monetary base consists of total reserves; plus the currency component of the money stock; plus, for all quarterly reporters, and for all weekly reporters without required reserve balances, the excess of current vault cash over the amount applied to satisfy current reserve requirements. For further details, see the Federal Reserve's H.3 Statistical Release.

3. M1 consists of currency in circulation excluding vault cash; 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 savings deposits (including money market deposit accounts); small-denomination time deposits (including retail repurchase agreements), from which have been subtracted all individual retirement accounts (IRAs) and Keogh accounts at commercial banks and thrift institutions; and balances in taxable and tax-exempt retail money market mutual funds (money funds with minimum initial investments of less than \$50,000), excluding IRAs and Keogh accounts.

M3 is M2 plus large-denomination time deposits at all depository institutions other than those due to money stock issuers; balances in institution-only money market mutual funds (money funds with minimum initial investments of \$50,000 or more); wholesale RP liabilities (overnight and term) issued by all depository institutions, net of money fund holdings; and Eurodollars (overnight and term) held by U.S. residents at all banking offices in Canada and the United Kingdom and at foreign branches of U.S. banks worldwide, net of money fund holdings. For further details, see the Federal Reserve's H.6 Statistical Release.

shifted to fixed rate, long-term debt instruments.

Because depository institutions are important sources of short-term and floating rate credit to households and businesses, depository assets grew rapidly early on and then backed off. The need to fund the increase in assets, along with declines in market interest rates relative to yields on retail deposits, led to the fastest growth in M2 and M3 since the late 1980s; M2 ended the year in the top of its annual range, and M3 was at the upper end of its range. In contrast, M1 declined for the first time since 1959, the beginning of the official series, as many banks introduced retail sweep accounts that shift deposits from interest-bearing checking accounts to savings-type accounts to reduce reserve requirements.

The Course of Policy and Interest Rates

The Federal Reserve entered 1995 having tightened policy appreciably during the previous year. Short-term interest rates had risen more than 2½ percentage points from the end of 1993, and long-term rates were up 2 percentage points. Policy tightening had been necessitated by the threat of rising inflation posed by unusually low real short-term interest rates earlier in the 1990s. Rates had been kept low to counter the effects of impediments to credit flows and economic growth. But as these impediments were reduced, the economy expanded at an unsustainable pace and margins of underutilized labor and capital began to erode. Ultimately, a continuation of excessive demands on productive resources and the resulting higher inflation would have produced strains, threatening economic expansion.

In early February the policy actions taken in 1994 did not appear to be suffi-

cient to head off inflationary pressures. The growth of economic activity had not shown convincing signs of slowing to a more sustainable pace, and available information, including a marked rise in materials prices during the last half of 1994, seemed indicative of emerging resource constraints and building inflationary pressures. In these circumstances, the FOMC agreed on a ½ percentage point increase in the federal funds rate, and the Board of Governors approved an equal increase in the discount rate.

During the remainder of the winter and through the spring, incoming data signaled that economic growth was finally moderating. At first, it was unclear if the slowdown was temporary or if it was a lasting shift toward a sustainable rate of economic expansion. Adding to the uncertainty was a pickup of consumer price inflation and a pronounced weakening in the foreign exchange value of the dollar. At the March meeting, the FOMC determined that it would be prudent to await further information before taking any additional policy actions, but it alerted the Manager of the System Open Market Account that, if intermeeting action were to be required, the step would more likely be to firm than to ease.

By the May meeting, the accumulating evidence indicated that the threat of rising inflation might be lessening. Economic growth was being slowed by the efforts of businesses to correct inventory imbalances that had developed earlier in the year. However, the underlying trajectory of final sales was still uncertain. The FOMC determined that the existing stance of policy was appropriate and expressed no presumption as to the direction of potential policy action over the intermeeting period.

Intermediate- and long-term interest rates had fallen throughout the winter

and spring, as evidence accumulated that the expansion of economic activity was slowing and that inflationary pressures were ebbing. Furthermore, budget discussions in the Congress seemed to foreshadow significant fiscal restraint over the balance of the decade, putting additional downward pressure on these rates. Short-term rates had declined less, but in late spring, financial market participants had begun to anticipate an easing of monetary policy. By midyear, the three-month Treasury bill rate was down slightly from its level at the beginning of the year, and rates on securities with maturities greater than one year had dropped as much as 2 percentage points.

Employment data released shortly after the May FOMC meeting were surprisingly weak, and by the July meeting it appeared that the growth of aggregate output had sagged markedly during the second quarter as businesses sought to keep inventories from rising to undesirable levels. This deceleration of output growth was accompanied by a softening of industrial prices and a marked reduction in the pace at which materials prices were rising. With the economy growing more slowly than had been anticipated and potential inflationary pressures receding, the FOMC voted to ease reserve pressures slightly with a $\frac{1}{4}$ percentage point decline in the intended federal funds rate.

Although financial market participants had anticipated a decline in the federal funds rate at some point, bond and equity markets rallied strongly immediately after the change in policy was announced. However, a pickup in economic growth during the summer made further reductions in the funds rate appear less likely, and interest rates backed up for a time.

The Committee did keep rates unchanged at the August and September

meetings. Although inflation had improved, the slowdown had been anticipated to a considerable extent. Moreover, uncertainties about federal budget policies and their effects on the economy remained substantial.

At the November meeting, the economic signals were mixed. Anecdotal information tended to suggest a softening in spending after the third quarter, but the extent of any slowing of spending and inflation was unclear. Although short-term rates remained above long-term averages on an inflation-adjusted basis, substantial rallies in bond and stock markets were thought likely to buoy spending. Against this backdrop, the FOMC voted to maintain the existing stance of monetary policy.

The generally positive news about inflation and hopes for a budget agreement had helped propel the bond market higher throughout the fall. By the December meeting, intermediate- and long-term interest rates were $1\frac{3}{4}$ to $2\frac{1}{2}$ percentage points below their levels at the beginning of the year. The bond market rally, along with strong earnings reports, pushed equity prices higher during the year, and by mid-December, equity price indexes were up about 35 percent from levels at the beginning of the year. Since the last easing in July, inflation had been somewhat more favorable than anticipated, and the expansion of economic activity had moderated substantially after posting a strong third quarter. With both inflation and inflation expectations more subdued than expected, and with the slowing in economic growth suggesting that price pressures would continue to be contained, the FOMC decided to reduce the intended federal funds rate an additional $\frac{1}{4}$ percentage point, bringing it to $5\frac{1}{2}$ percent.

Credit and Money Flows

In 1995 the debt of the domestic non-financial sectors grew only a bit faster than it had in the previous year, although debt growth in the first half of 1995 was stronger than in the second. Credit supplies remained plentiful: Banks continued to be willing lenders, and in securities markets most interest rate spreads remained quite narrow. Debt burdens for households increased, but except for a few types of consumer credit obligations, delinquency rates remained at low levels. Rising equity prices bolstered the overall financial condition of households.

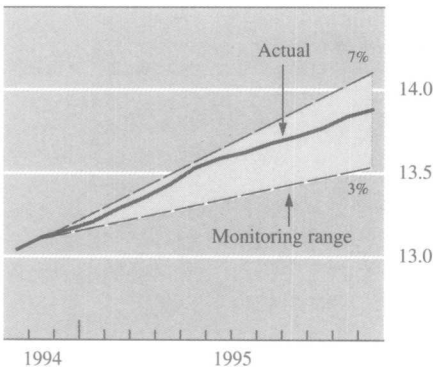
Federal debt rose about 4½ percent in 1995, slightly less than in 1994. The government's demands for credit were restrained by shrinkage of about 20 percent in the deficit for the calendar year. Debt growth also was slowed toward year-end by a Treasury drawdown of its cash balance to keep borrowing within the \$4.9 trillion debt ceiling.

State and local government debt fell 4½ percent—more than in 1994. A few years earlier, municipalities had taken advantage of low long-term rates to pre-refund a substantial volume of issues,

many of which were eligible to be called in 1995. As those securities were called, and with gross issuance light, the stock of municipal securities contracted for a second consecutive year. Despite the overall reduction in debt outstanding, the ratios of tax-exempt yields to taxable yields jumped in the first half of the year and, for long-term debt, held at an elevated level during the remainder of the year. This increase was associated with concerns about the demand for tax-free municipal debt in light of proposals for changes in federal taxation that would sharply reduce the tax advantages of holding municipal bonds.

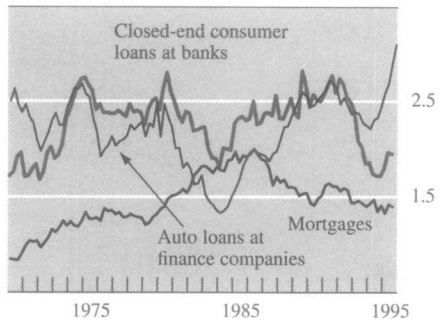
Household borrowing remained robust in 1995, and the ratio of household debt to disposable personal income rose further. Even so, the financial condition of this sector remained good on balance, although some signs of deterioration emerged. The rally in the domestic equity markets supported household balance sheets by boosting net worth sharply. In addition, delinquency rates on home mortgages and closed-end consumer loans at banks, while rising, remained at low levels. Other indicators, however, provided evidence that some households were likely beginning to

Total Domestic Nonfinancial Debt
Trillions of dollars



NOTE. The range was adopted by the FOMC for the period from 1994:Q4 to 1995:Q4.

Delinquency Rates on Household Loans
Percent



NOTE. The data for closed-end consumer loans are from the American Bankers Association; for auto loans, from the Federal Reserve; and for mortgages, from the Mortgage Bankers Association.

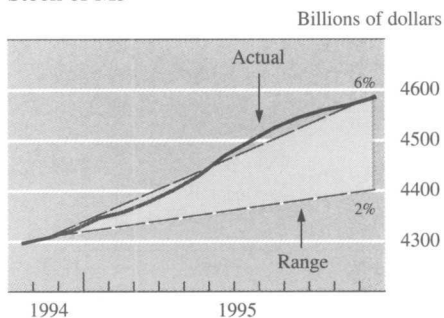
experience increased financial pressures. For instance, delinquency rates on credit card debt held by banks and on auto loans booked at captive finance companies rose sharply. Furthermore, the average household debt service burden—calculated as the share of disposable income needed to meet required payments on mortgage and consumer debt—continued to rise last year. By year-end, this measure of debt burden had reversed about one-half of the decline it posted earlier in the decade.

The average debt service burden of nonfinancial corporations—the ratio of net interest payments to cash flow—also rose last year, but it remained well beneath the most recent peak, reached in 1990. The increase in debt burden was in part associated with the relatively strong growth of the debt of nonfinancial businesses. This sector's debt growth was especially robust early in the year, when business fixed investment picked up further and inventory accumulation was rapid. Debt issuance was also boosted by the rising wave of mergers, although a good number involved stock swaps. Financing needs fell back later on as investment growth slowed and profits increased. Funding patterns also shifted as bond yields fell, and firms relied more heavily on longer-

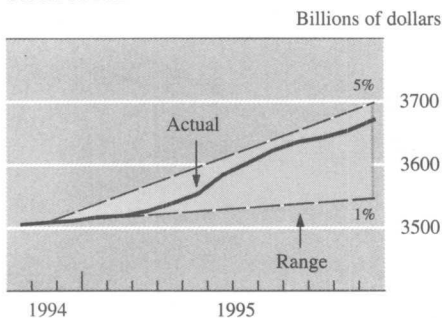
-term debt. Despite the increase in credit demands, interest rate spreads of private investment-grade securities over comparable Treasuries widened only slightly and remained narrow by historical standards, suggesting that lenders continued to view balance sheets of nonfinancial corporations as remaining healthy on the whole. Spreads on below-investment-grade debt rose more sharply but stayed well beneath levels reached early in the decade.

Commercial banks met a significant portion of the increase in business credit demands last year, which, in turn, contributed to the rapid expansion of bank balance sheets. Banks funded a portion of the loan increase by reducing their securities holdings, although higher market prices of securities and off-balance-sheet contracts left reported securities holdings slightly higher for the year. In fact, bank security holdings relative to the size of their balance sheets remained elevated and, together with banks' strong capital positions, indicated that late in the year banks were well positioned to continue accommodating the credit demands of households and businesses. Although qualitative information suggested that banks were no longer reducing the standards they applied to businesses seeking loans,

Stock of M3



Stock of M2



some easing of credit terms continued, with interest rate spreads on business loans narrowing further. Growth of real estate loans held by banks slowed over the year as the share of fixed rate mortgages in total originations rose with the decline in long-term rates. Banks tend to securitize fixed rate mortgages more than adjustable rate loans. Consumer loans on the books of banks began the year growing at very high rates; this growth decelerated throughout 1995 as the volume of securitization increased. In response to rising delinquency rates, some banks tightened terms and standards for consumer loans toward the end of 1995.

Total assets of thrift institutions are estimated to have risen slightly last year. Growth at healthy thrifts more than offset a substantial transfer of thrift assets to commercial banks through mergers. The revival of growth in thrift assets, along with the strong showing of bank credit, helped to nudge up depository credit as a share of domestic nonfinancial debt for the second straight year after fifteen years of declines. Banks and thrifts still account for more than one-third of all credit to nonfinancial sectors.

Banks and thrifts funded a large share of their asset growth with deposits, and M3 grew 6 percent. The non-M2 portion of M3 was especially strong, in part because depository institutions substituted large time deposits for nondeposit sources of funds. The sharp reduction in

deposit insurance premiums, which made large time deposits a more attractive source of funds, probably contributed to this shift. Late in the year, branches and agencies of Japanese banks, facing some resistance in U.S. funding markets, ran off time deposits while continuing to increase their funding from overseas offices.

M2 rose as lower market interest rates and a flatter yield curve increased the relative attractiveness of retail deposits.¹ As is typical, deposit interest rates, and to a lesser extent returns on money market mutual funds, adjusted slowly to declines in market rates last year. However, falling interest rates for comparable maturity market instruments were not the whole story for the growth of M2. As the yield curve flattened, the relative gains from holding longer-term assets with less certain price behavior fell and probably strengthened household demand for components of M2. The velocity of M2 was little changed last year after having increased substantially during the previous three years.

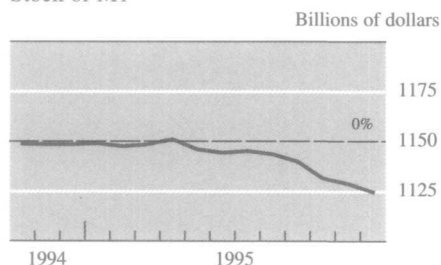
M1 fell almost 2 percent in 1995, the first annual decline in the Board's official series, which dates back to 1959.

1. In February 1996 M2 was redefined to exclude overnight RPs and overnight Eurodollars (they remain in M3); the historical M2 data presented here exclude those instruments.

The instruments were first included in M2 in 1980 because they were being substituted for demand deposits as businesses were in the process of managing their cash holdings more closely. Since then, other uses of overnight RPs and Eurodollars have become more dominant. Moreover, while RPs and Eurodollars are only 3 percent of M2, they contribute substantially to the short-run volatility of that aggregate. Removing these components from M2 should make the weekly levels of the aggregate less volatile and reduce the reporting burden on banks that have had to distinguish between overnight and term RPs and Eurodollars.

On a monthly and quarterly basis, the relationships of the two measures of M2 to income and interest rates are almost indistinguishable.

Stock of M1



Sweeps of deposits from reservable checking accounts, a component of M1, to nonreservable money market deposit accounts were a major influence. Without these sweeps, M1 would have risen 1 percent. By the end of last year, sweeps had spread to thirty-two bank holding companies, and the initial amounts swept by these programs totaled \$54 billion. The corresponding decline of more than \$5 billion in required reserves largely showed through to reserve balances maintained at Federal Reserve Banks. As banks continue to introduce retail sweep programs in the future, the aggregate level of required reserve balances will tend to fall further. Although it has not happened yet, one possible consequence of the declining required reserve balances is greater instability in the aggregate demand for reserves and in overnight interest rates. As a case in point, a cut in reserve requirements at the end of 1990 produced unusually low levels of required reserve balances in 1991; in turn, as banks' volatile clearing needs began to dominate the demand for reserves, the federal funds rate began exhibiting much greater variability, thereby making daily reserve demand more difficult to estimate.

The runoff in reserve balances held the growth of the monetary base to 4 percent in 1995. In addition, currency growth slowed, primarily because of reduced shipments abroad. Foreign demand moderated with the stabilization of financial conditions in some countries where dollars circulate widely. Indeed, reduced demands from abroad contributed to a rare decline in the currency component of M1 this past summer, the first decrease since the early 1960s. The demand for existing Federal Reserve notes also slackened in anticipation of the introduction of a newly designed \$100 bill that will be more difficult to counterfeit. ■

International Developments

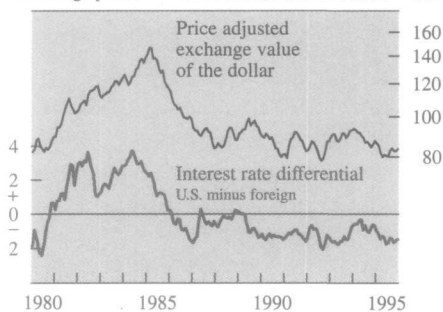
Economic activity in most major foreign industrial countries decelerated sharply in 1995 from the robust growth recorded in 1994. By contrast, Japan evidenced some provisional signs of recovery as 1995 progressed, after registering almost no growth during the previous three years.

With slack in the slowing European and Canadian economies and with Japan's recovery still tentative, inflation remained low in 1995. On average, consumer prices rose about 1 $\frac{3}{4}$ percent over the year in the six major foreign industrial countries, roughly the same rate as in 1994.¹

1. The six countries are Canada, France, Germany, Italy, Japan, and the United Kingdom.

Exchange Value of the Dollar
and Interest Rate Differential

Percentage points Ratio scale, December 1973 = 100



NOTE. The exchange value of the U.S. dollar is its weighted average exchange value in terms of the currencies of the other G-10 countries using 1972-76 total trade weights. Price adjustments are made using relative consumer prices.

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

The data are monthly.

Among developing countries, economic growth remained robust in most of those in Asia, in line with the experience of the last several years. In Latin America, gains in output were more subdued in 1995 than in recent years. Mexico's economy contracted sharply in response to policies adopted after the collapse of the peso late in 1994; the developments in Mexico dampened confidence throughout Latin America. Output accelerated in much of Eastern Europe; in most parts of the former Soviet Union, the prolonged shrinkage in activity abated somewhat. Economic growth in African countries was mixed, but the region as a whole maintained the moderate rate achieved in 1994. Growth continued to be slow in the Middle East.

The U.S. trade deficit in goods and services amounted to \$111 billion in 1995, close to the 1994 level of \$106 billion. U.S. income growth in 1995 was similar to the average for the country's major trading partners, but as is typically the case, comparable increases in income stimulated U.S. imports more than U.S. exports. The dollar's depreciation during 1994 and early 1995 worked in the opposite direction, tending to boost exports and hold down imports. Overall, the result of these offsetting tendencies was that the value of exports grew somewhat faster than the value of imports. However, with imports significantly exceeding exports at the start of the year, these growth rates translated into a slightly larger deficit.

The current account deficit was \$153 billion in 1995, about the same as in 1994. In contrast to 1994, a large portion of the concomitant net capital inflows in 1995 represented accumula-

tions of foreign official assets in the United States. Substantial amounts of private capital moved in both directions, but the resulting net inflow was smaller than in 1994.

The foreign exchange value of the dollar declined about 5 percent on balance in 1995 in terms of a trade-weighted average of the other G-10 currencies.² The dollar's value fell sharply over the first four months of the year, declining almost 10 percent. Some indications that U.S. growth might be slowing contributed to expectations that further increases in U.S. interest rates were less likely as the year progressed; in addition, increasingly acrimonious trade disputes between the United States and Japan clouded prospects for an early and harmonious resolution of those problems. The crisis in Mexico also weighed on the dollar's value, partly because of its negative effects on U.S. trade with Mexico. The improvement in the dollar's value later in the year developed when weaknesses in the economies of other major industrial countries began to emerge and interest rates there declined relative to those in the United States.

Foreign Economies

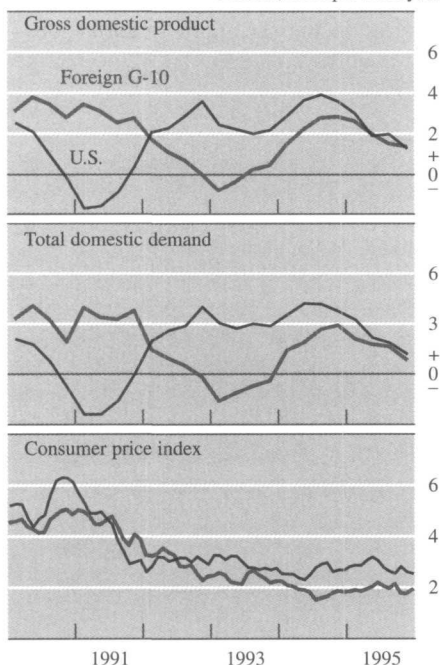
Other than in Japan, economic activity in the major foreign industrial countries slowed in 1995. In Canada, where economic activity had been particularly vigorous through 1994, the slowing in growth in part reflected weaker U.S. growth; but it also resulted from domestic macroeconomic policies designed to prevent the reemergence of inflationary pressures. In Germany and France, growth dropped markedly in the second

half of the year as currency appreciation earlier in 1995 slowed exports and declining business and consumer confidence curtailed spending. By contrast, the economic situation in Japan appeared to improve late in the year. A firming in the growth of domestic demand stimulated by easier monetary and fiscal policies over the course of the year was only partly offset by a welcome ongoing adjustment in the external surplus in response to the appreciation of the yen.

Unemployment rates continued to decline during 1995 in the United King-

Changes in GDP, Demand, and Prices

Percent, from previous year



NOTE. Data for the foreign G-10 countries are from national sources. The data are weighted by the countries' 1987-89 GDP as valued after adjusting for differences in the purchasing power of their currencies; GDP and domestic demand are in constant prices.

Data for the United States are from the Departments of Commerce and Labor. GDP and domestic demand are derived from chained (1992) dollars.

For GDP and domestic demand, the data are quarterly; for consumer prices, the data are monthly.

2. The Group of Ten consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

dom and Canada, where recoveries have been under way for several years. In continental Europe, labor market conditions were mixed, with the rate of unemployment increasing in some countries. Rising unemployment refocused attention on a vexing problem of the last ten years in Europe—structural unemployment or unemployment related to causes other than the business cycle. The slight acceleration of activity in Japan did not prevent the unemployment rate there from rising to a post-war high of 3.4 percent. Under persistent weakness in the economic situation, further erosion in Japan's lifetime employment system was apparent.

The slowdown in 1995 sustained or increased gaps between actual output and estimated potential in most major foreign industrial countries. The robust pace of foreign economic growth in 1994 had reduced but not eliminated these differentials. Diminishing pressure on output gaps helped contain inflation; on average, consumer prices in the foreign G-10 economies rose slightly less than 2 percent over the year, as in 1994. In Japan, where the appreciation of the yen damped any upward pressure on prices, consumer prices declined about ½ percent.

General government budget deficits narrowed further in Canada and in Europe, except Germany, despite the slowing pace of economic growth in 1995. A number of countries pursued policies aimed at reducing their deficits. Much of the impetus to fiscal consolidation in Europe was provided by the deficit criterion specified in the Maastricht Treaty. Countries wishing to participate fully in the proposed European Monetary Union—now scheduled for early 1999—must reduce their general government deficits to 3 percent of gross domestic product by 1997. In Japan, expansionary policy measures

took forms that boosted the deficit significantly.

Long-term interest rates declined in all foreign G-10 industrial countries in 1995, after increasing sharply in 1994. On average, rates on government instruments with a maturity of ten years dropped nearly 150 basis points. This development was due in large part to weakening economic growth, which also motivated foreign monetary authorities to ease short-term interest rates about 90 basis points on average. In Japan, short-term rates were cut more—almost 200 basis points—in order to support the flagging recovery. By contrast, authorities in the United Kingdom and Italy tightened monetary policy to counter inflation pressures.

Current account positions improved in a number of foreign industrial countries in 1995. Canada's deficit narrowed substantially because exports remained strong despite slower U.S. activity. With the yen stronger on average during the year and economic activity improving, Japan's large external surplus declined to about \$110 billion, well below the level of \$130 billion registered in both 1993 and 1994. The surpluses in Italy and Sweden rose further under the influence of earlier currency depreciations, which boosted the competitiveness of traded goods for these countries.

Economic growth in the major developing countries in 1995 was also more moderate on average than the strong pace recorded in 1994. Mexico's economy contracted substantially, with important effects on its trade with the United States. In response to the December 1994 collapse of the peso, Mexican authorities adopted policies to counter inflation and significantly reduce the large current account deficit. Under these restraints, output fell 7 percent, declining even more sharply early in the year but recovering a bit in the fall. The

merchandise trade balance improved from a substantial deficit in 1994 to moderate surplus in 1995, and the current account moved nearly into balance. The financial turbulence in Mexico helped impose downward pressure on exchange rates in Argentina and Brazil, inducing authorities there to tighten macroeconomic policies. These developments led to a recession in Argentina, which had had several years of rapid growth, and caused a pronounced deceleration of economic activity in Brazil.

Economies in Asia on average continued their rapid 1994 pace of growth. Although the expansion was driven largely by strong internal demand, especially for investment, most countries also benefited from very fast export growth. The marked acceleration in exports was attributable at least in part to depreciation of the currencies of these countries in terms of the yen and European currencies early in the year. Activity again expanded more than 10 percent in China in 1995, but tight credit conditions dampened investment demand and slowed growth.

U.S. International Transactions

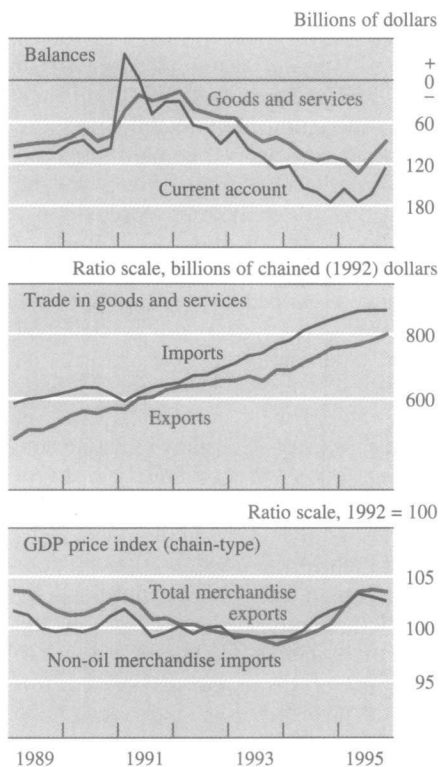
Real exports of U.S. goods and services grew $6\frac{1}{2}$ percent over the four quarters of 1995. Agricultural exports remained high, and the volume of computer exports continued to rise sharply. Exports of machinery and industrial supplies also were robust. While exports to Mexico were declining in response to the economic crisis there, shipments to developing countries in Asia were growing rapidly, and exports to Western Europe, Canada, and Japan were also increasing.

Imports of goods and services increased $4\frac{1}{4}$ percent in real terms during 1995, a slower rate of advance than in 1994. Imports of computers and semi-

conductors rose sharply, but imports of other machinery, consumer goods, and industrial supplies slowed. Import prices increased about $2\frac{1}{2}$ percent. Together with low inflation in most U.S. trading partners, a leveling off of world non-oil commodity prices after a rapid rise in 1994 helped restrain the rise in import prices that might otherwise have been associated with the dollar's weakness.

Foreign official holdings of financial assets in the United States rose a record \$110 billion in 1995, the result of both intervention by some industrial countries and substantial reserve accumulation by several developing countries in Asia and Latin America.

U.S. International Trade



NOTE. The data are from the Department of Commerce; they are quarterly and seasonally adjusted. Data for trade are at annual rates.

Foreign private assets in the United States also rose rapidly in 1995, in keeping with a continuing trend toward internationalization of securities markets. Net purchases of nearly \$100 billion of U.S. Treasury securities by private foreigners far exceeded such purchases in previous years. As in 1994, much of this activity was channeled through Caribbean financial centers and was probably associated with the transactions of hedge funds. Net purchases of U.S. government agency and corporate bonds also reached record

levels. However, despite the rapid rise in U.S. stock prices in 1995, foreign net purchases of U.S. corporate stocks were not nearly as strong as at times in the past.

U.S. net purchases of foreign securities in 1995 rebounded strongly after a very weak first quarter. For the year as a whole, net purchases of stocks in Japan accounted for almost 40 percent of total U.S. purchases of foreign stocks. U.S. investors showed little interest in adding to their holdings of stocks or bonds from emerging markets in Latin America, at

U.S. International Transactions

Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
	1994	1995 ^p	1994	1995			
			Q4	Q1	Q2	Q3	Q4 ^p
Goods and services, net	-106	-111	-27	-29	-33	-27	-22
Exports	701	784	185	189	194	198	202
Merchandise	502	575	134	138	143	145	149
Services	199	209	51	51	52	53	53
Imports	807	895	212	218	228	225	224
Merchandise	669	749	177	183	191	188	187
Services	139	146	35	36	36	37	37
Investment income, net	-9	-11	-5	-2	-3	-5	-2
Direct investment, net	45	59	11	14	15	13	17
Portfolio investment, net	-54	-71	-16	-16	-17	-18	-19
Unilateral transfers, private and government, net	-36	-30	-11	-8	-7	-8	-8
Current account balance	-151	-153	-43	-38	-43	-40	-31
Private capital flows, net	121	46	29	3	-11	51	3
Bank-related capital, net (outflows, -)	115	-39	18	-30	-28	-7	25
U.S. net purchases (-) of foreign securities	-50	-94	-15	-7	-22	-34	-31
Foreign net purchases (+) of U.S. securities	92	194	36	46	51	68	29
Treasury securities	34	99	26	30	30	37	2
Corporate and other non-Treasury bonds	56	82	13	20	19	26	17
Corporate stocks	3	13	-3	-4	2	5	10
U.S. direct investment abroad	-49	-97	-12	-23	-17	-16	-41
Foreign direct investment in United States	49	75	20	17	13	24	21
Other corporate capital flows, net	-37	n.a.	-18	-1	-8	17	n.a.
Foreign official assets in United States (increase, +)	39	110	*	22	38	39	11
U.S. official reserve assets, net (increase, -)	5	-10	2	-5	-3	-2	*
U.S. government foreign credits and other claims, net	*	*	-1	*	*	*	*
Total discrepancy	-14	7	14	19	19	-49	17
Seasonal adjustment discrepancy	0	0	1	6	*	-7	1
Statistical discrepancy	-14	7	13	13	19	-42	17

NOTE. Components may not sum to totals because of rounding.

* In absolute value, greater than zero and less than \$500 million.

n.a. Not available.

^p Preliminary.

SOURCE. Department of Commerce, Bureau of Economic Analysis.

least in part because of heightened caution brought on by financial conditions in Mexico.

Mergers and acquisitions added substantially to the inflow of funds from foreign direct investors and also to direct investment outflows. Inflows reached \$75 billion, surpassing the record pace of 1989. U.S. direct investment abroad of \$97 billion was even larger than foreign direct investment in the United States and also surpassed the previous peak. This outflow was stimulated in part by sales of government-owned entities to the private sector in some foreign countries.

Foreign Exchange Developments

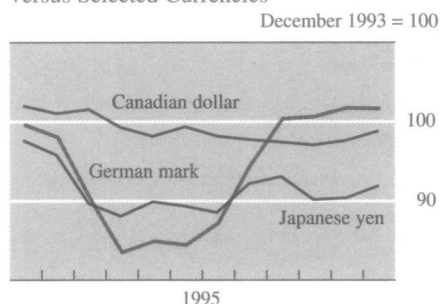
One factor behind the dollar's weakness may have been the ongoing large U.S. current account deficit. Two other developments that appeared to contribute to downward pressure on the dollar early in the year were the possibility of a spillover from the Mexican financial crisis and uncertainty about U.S. government action to reduce the federal budget deficit. The dollar's partial recovery later in the year may have been aided by the apparent containment of the Mexican financial situation and some signs of movement toward a balanced U.S. budget over the medium term. The dollar's depreciation is also consistent with the decline in long-term interest rates in the United States relative to those abroad during 1995; over the full year, the U.S. rate declined about $\frac{1}{2}$ percentage point more than the average of foreign G-10 rates.

The dollar appreciated slightly versus the pound and yen but declined in value when measured against other foreign G-10 currencies. The dollar fell about 8 percent in terms of the mark and the other major currencies that are linked by the European exchange rate mechanism,

the Dutch guilder and the Belgian and French francs. The French currency moved with the mark on balance, but at times it came under severe downward pressure relative to the mark, particularly during two periods of intense political activity in France—the presidential election in the spring and the labor unrest that developed near the end of the year. The Canadian dollar, which showed little net change versus the U.S. dollar for the year as a whole, also came under considerable pressure at the time of the referendum on Quebec independence in October.

The exchange rate between the dollar and the yen fluctuated over a very wide range in 1995. Early in the year the dollar fell sharply, to an historically low level of 83 yen in May. This development was doubtless the product of a number of factors, but the ongoing huge trade imbalance between the United States and Japan probably played an important role. Market participants might have been concerned that any breakdown in trade negotiations between the two countries could lead to an appreciation of the yen as a way to reduce this imbalance. After a trade agreement between the United States and Japan was reached at the end of June, the dollar began to move up

Exchange Value of the Dollar
versus Selected Currencies



NOTE. Foreign currency units per dollar. The data are monthly.

strongly and eventually reversed all its earlier losses. The appreciation was encouraged by U.S. statements favoring a strong dollar and occasional U.S. intervention sales of yen, sometimes in conjunction with Japanese authorities. Further moves to ease Japanese monetary policy also helped the dollar's rebound.

Adjusted for relative changes in consumer prices, the dollar also depreciated in terms of nearly all the currencies of the major U.S. trading partners in Latin America and East Asia. However, in by far the largest movement of 1995, the dollar appreciated sharply relative to the Mexican peso—over 90 percent in nominal terms and about 30 percent after adjusting for the high Mexican inflation rate. This shift balanced the losses elsewhere and left the dollar about 1 percent stronger in terms of the average price-adjusted value of major developing countries' currencies.

During January and February 1995, the Bank of Mexico drew a total of \$1½ billion on its swap line with the Federal Reserve, of which \$650 million was outstanding at the end of the year (and was repaid in full the next month). ■

Foreign Exchange Operations

U.S. authorities intervened to support the dollar on several occasions in 1995, sometimes in conjunction with other central banks. The largest operations took place in the spring when the dollar was under heavy downward pressure relative to the yen. For the year as a whole, U.S. authorities sold a total of \$3,303 million of yen and \$3,250 million of marks. Intervention in dollars by fifteen foreign central banks amounted to net purchases of \$66 billion.

At year-end, the System held \$21,099 million of foreign currencies valued at current exchange rates. No Treasury balances were warehoused with the System during 1995. The System realized \$964 million in profits on sales of foreign currency during 1995 and recorded a translation gain of \$41 million on foreign currency balances.

Monetary Policy Reports to the Congress

Given below are reports submitted to the Congress on February 21 and July 19, 1995, pursuant to the Full Employment and Balanced Growth Act of 1978.

Report on February 21, 1995

Monetary Policy and the Economic Outlook for 1995

The U.S. economy turned in a strong performance in 1994. Real gross domestic product increased 4 percent over the four quarters of the year. The employment gains associated with this rise in production outpaced growth of the labor force by a sizable margin, and the unemployment rate thus declined substantially. Price increases picked up in some sectors of the economy in 1994 as labor and product markets tightened, but broader measures of price change showed inflation holding fairly steady: The consumer price index increased about 2¾ percent over the year, the same as the rise during 1993. Signs that growth is moderating have emerged in the past month or so, but the bulk of the evidence suggests that the economy continues to advance at an appreciable pace.

Federal Reserve policy during 1994 and early 1995 was aimed at fostering a financial environment conducive to sustained economic growth. As the economy moved back toward high rates of resource utilization, pursuit of this aim necessitated acting to prevent a buildup of inflationary pressures. Federal Reserve policy had remained very accommodative in 1993 in order to offset factors that had been inhibiting eco-

nomie growth. By early 1994, however, the expansion clearly had gathered momentum, and maintenance of the prevailing stance of policy would eventually have led to rising inflation that, in turn, would have jeopardized economic and financial stability. Taking account of anticipated lags in the effects of policy changes, the Federal Reserve began to firm money market conditions last February. The Federal Reserve continued to tighten policy over the course of the year and into 1995, as economic growth remained unexpectedly strong, eroding remaining margins of unused resources and intensifying price increases at early stages of production. Developments in financial markets—for example, easier credit availability through banks and a decline in the foreign exchange value of the dollar—may have muted the effects of the tightening of monetary policy.

Short-term interest rates have increased about 3 percentage points since the start of 1994, with the federal funds rate rising from 3 percent to 6 percent. Other market interest rates have risen between 1½ percentage points and 3 percentage points, on net, with the largest increases coming at intermediate maturities. Through much of the year, intermediate- and long-term rates were lifted by more rapid actual and expected economic growth, fears of a pickup in inflation, and market expectations of additional policy moves. However, a further substantial tightening in November and some tentative signs of moderation in economic activity around year-end and in early 1995 appeared to reduce market concerns about increased inflation pressures and additional Fed-

eral Reserve policy actions. As a result, long-term rates declined, on net, from mid-November through mid-February.

The foreign exchange value of the dollar in terms of other Group of Ten (G-10) currencies declined almost 6½ percent last year, even as the economy picked up and interest rates rose. The positive effects on the dollar that would normally have been expected from higher U.S. interest rates were offset in large part by upward movements in long-term interest rates abroad. Indeed, foreign long-term rates increased as much on average as U.S. rates during 1994, owing to much more rapid than expected growth abroad, especially in Europe. Concerns about U.S. inflation may have contributed to the weakness in the dollar in the middle part of last year; late in the year, the dollar rallied for a time, as tighter monetary policy apparently reduced investors' inflation fears. The dollar weakened again, however, in early 1995, perhaps reflecting the emerging indicators of moderating growth in the United States. In addition, financial markets were roiled early this year by severe financial difficulties in Mexico. A sharp depreciation of the peso had adverse effects not only in Mexico but also in a number of other countries, and these developments also may have contributed to the weakness of the dollar.

Despite the rise in U.S. interest rates in 1994, private-sector borrowing, abetted in part by more aggressive lending by intermediaries, picked up in support of increased spending. The debts of both households and businesses grew at their fastest rates in five years. The step-up in growth of private debt was accompanied by changes in its composition. Businesses shifted toward short-term funding sources as bond yields rose, increasing their bank borrowing and commercial paper issuance, while cut-

ting back on new bond issues. Similarly, households turned increasingly to adjustable-rate mortgages as rates on fixed-rate mortgages increased substantially. Banks encouraged the shift of households and businesses to bank borrowing by easing lending standards and not allowing all of the rise in market rates to show through to loan rates. By contrast, federal borrowing was slowed in 1994 by policies adopted in previous years to narrow the federal deficit, as well as by the effects of the strong economy on tax receipts and spending. Taken together, the debt of all nonfinancial sectors expanded 5¼ percent, about the same as the increase of a year earlier and a figure that was in the middle portion of the 1994 monitoring range of 4 percent to 8 percent.

Growth in the broad monetary aggregates remained subdued in 1994. M3 expanded about 1½ percent, well within its 0 percent to 4 percent target range and slightly more than its increase in 1993. M3 was buoyed by growth of more than 7 percent in large time deposits, as banks turned to wholesale markets to fund credit expansion. For the year, M2 rose only 1 percent, an increase that was at the lower bound of its 1 percent to 5 percent target range. In contrast to 1992 and 1993, the slow growth in M2, and the resulting further substantial increase in its velocity (the ratio of nominal GDP to the money stock), was not a consequence of unusually large shifts from M2 deposits to bond and stock mutual funds. Rather, it seemed to reflect behavior similar to that in earlier periods of rising short-term market interest rates. During such periods, changes in the rates available on retail deposits usually lag changes in market rates, providing an incentive to redirect savings from these deposits to market instruments. These shifts tend to have an especially marked

effect on M1 because yields on its components either cannot adjust or adjust quite slowly to shifts in market rates. M1 growth last year was $2\frac{1}{4}$ percent; it had been $10\frac{1}{2}$ percent in 1993. Only continued strong growth in currency, much of which likely reflected increased use abroad, supported M1.

Money and Debt Ranges for 1995

At its most recent meeting, the Federal Open Market Committee (FOMC) reaffirmed the 1995 growth ranges for money and debt that were chosen on a provisional basis last July. The money ranges—1 percent to 5 percent for M2 and 0 percent to 4 percent for M3—are consistent with the Committee members' expectations of a slowing of nominal income growth as the expansion moves to a more sustainable pace but also rest on the anticipation of further increases in the velocities of these aggregates. The velocity of M2 is likely to be boosted by lagged effects of the increases in short-term interest rates during 1994 and early 1995 and possibly by increased flows from M2 deposits into long-term mutual funds, as investor concerns about capital market volatility recede. The M2 range also provides an indication of the longer-run growth that could be expected under

conditions of reasonable price stability if that aggregate's velocity resumes its historical pattern of no long-term trend. M3 velocity has been on a steep upward path in recent years, but the rate of increase might be expected to slow in the near term. Part of the increase in M3 velocity in the early 1990s resulted from weak growth of bank credit, in part reflecting substantial loan losses and consequent capital impairment, and the contraction of the thrift sector as failed institutions were liquidated. However, the recent strength in bank credit and the end of the contraction in thrift sector credit suggest that M3 growth could pick up, perhaps appreciably, and its velocity could begin to level out. The resumption of a more normal relationship between M3 and nominal income might call for a technical adjustment of the target range for M3 at mid-year or in 1996.

The monitoring range for growth in the debt aggregate in 1995 is 3 percent to 7 percent. This range is 1 percentage point lower than the monitoring range in 1994, reflecting the more moderate path anticipated for expansion in nominal spending and borrowing. Private-sector debt growth will likely remain fairly strong in the coming year, boosted by substantial capital investment as well as merger and acquisition activity. Credit availability is unlikely to constrain private-sector borrowing, as banks continue to be eager to lend and as quality spreads in financial markets remain relatively narrow. The outlook for the federal deficit suggests that Treasury borrowing will be comparable to that in 1994.

The monetary and debt aggregates will continue to be among the variables monitored by the Committee to inform its policy deliberations. Given the uncertainties about the behavior of the velocities of the aggregates, however, the

Ranges for Growth of Monetary and Debt Aggregates

Percent

Aggregate	1993	1994	1995
M2	1-5	1-5	1-5
M3	0-4	0-4	0-4
Debt	4-8	4-8	3-7

NOTE. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated. Ranges for monetary aggregates are targets; range for debt is a monitoring range. Debt is of the domestic nonfinancial sector.

Committee will also need to continue assessing a wide variety of other financial and economic indicators.

Economic Projections for 1995

The members of the Board of Governors and the Reserve Bank presidents, all of whom participate in the deliberations of the Federal Open Market Committee, expect the economy to settle into a pattern of more moderate expansion in 1995, after a burst of growth that has brought rates of resource utilization to the highest levels since the latter part of the 1980s. Most of the Board members and Reserve Bank presidents expect the rise in real GDP over the four quarters of 1995 to be in a range of 2 percent to 3 percent.

Effects of the past year's increases in interest rates probably will show through more strongly in the coming year, reflecting the typical lags between Federal Reserve policy actions and changes in the pace of economic growth. Residential building, especially of single-family units, is the part of the economy in which those effects are likely to emerge earliest and stand out most clearly, but reactions to the higher

rates probably will be showing up in other interest-sensitive sectors as well.

Other influences also will be working to moderate the rate of growth. For example, large increases in real outlays for consumer durables over the past three years, partly financed in recent quarters by unsustainably rapid growth in the volume of consumer credit, probably have exhausted most of the pent-up demand that had accumulated when the economy was sluggish early in the 1990s. Similarly, business investment in new equipment has been rising extremely rapidly for some time and has moved to quite a high level; businesses likely will be shifting to more moderate rates of spending growth before too long. Inventory investment seems likely to moderate as well, as sustained additions to stocks at the pace of recent quarters would almost surely generate an unwanted backup of inventories at some point.

In other areas, however, increased strength may be forthcoming. Nonresidential construction, which often tends to lag other sectors of the economy over the course of the business cycle, now appears to be picking up steam. In addition, net exports may be a less

Economic Projections for 1995

Percent

Measure	Federal Reserve governors and Reserve Bank presidents		Administration
	Range	Central tendency	
<i>Change, fourth quarter to fourth quarter¹</i>			
Nominal GDP	4¾–6½	5–6	5.4
Real GDP	2–3¼	2–3	2.4
Consumer price index ²	2¾–3¾	3–3½	3.2
<i>Average level, fourth quarter</i>			
Unemployment rate ³	5¼–6	About 5½	5.5–5.8

1. Change from average for fourth quarter of preceding year to average for fourth quarter of 1995.

2. All urban consumers.

3. Civilian labor force. Figures for the Administration are annual averages.

negative factor in coming quarters than they were in 1994. Many foreign industrial economies entered the new year with considerable forward momentum; that should keep real exports of goods and services on a solid uptrend, even allowing for lower exports to Mexico as a consequence of the peso's devaluation and the likelihood of little or no growth in that country in 1995. Imports, meanwhile, should begin to slow as growth of demand in this country eases.

The Board members and Reserve Bank presidents expect that output growth of the magnitude they anticipate will be accompanied by moderate increases in employment and little change in the unemployment rate. Forecasts of the unemployment rate for the fourth quarter of 1995 are tightly clustered around 5½ percent.

An especially encouraging development in 1994 was that inflation remained relatively quiescent even as the economy moved to high rates of resource utilization. However, the costs of materials and components have been rising rapidly, squeezing profit margins in some sectors, and anecdotal reports of pressures on wages and finished goods prices have proliferated in recent months; increases in average hourly earnings and consumer prices picked up in January. Assessing the prospects, members of the Board of Governors and the Reserve Bank presidents think that the most likely outcome for this year is that inflation will run somewhat higher than in 1994. Such an outcome would be consistent with patterns of price change during earlier periods when the economy was operating at levels of resource utilization like those seen recently. The central tendency of the Federal Reserve officials' CPI forecasts, measured in terms of the change from the final quarter of 1994 to the final

quarter of 1995, spans a range of 3 percent to 3½ percent.

The economic prospects anticipated by the governors and Reserve Bank presidents for 1995 appear to be closely in line with those of the Administration. The Administration's forecasts of real GDP growth and inflation are in the middle of the Federal Reserve's central tendency ranges, and the Federal Reserve forecasts of the unemployment rate are centered near the low end of the annual range that was published in the *Economic Report of the President*.

Over the coming year, the Federal Reserve will seek to foster continued economic expansion while avoiding the provision of so much liquidity that the expected near-term step-up in inflation develops sustained momentum. Much progress has been made over the past couple of business cycles in reducing the role that inflation plays in the economic decisions of households and businesses. Moving ahead, the challenge will be to preserve and extend this progress, given that the Federal Reserve can best contribute to long-run prosperity by establishing an environment of effective price stability.

Economic prospects for the long run will be further enhanced if the Congress and the Administration succeed in making further progress in reducing the federal budget deficit. An improved outlook for the federal deficit over the remainder of this decade and beyond could have significant, favorable effects in financial markets, including a shift in long-term interest rates to a trajectory lower than that which would otherwise prevail. Such a shift in long-term rates would be an essential part of a process in which a larger share of the nation's limited supply of savings would be channeled to productivity-improving investment, thereby boosting growth in output and living standards.

The Performance of the Economy

The economy recorded a third year of strong expansion in 1994. Real GDP grew 4 percent over the four quarters of the year, industrial output rose nearly 6 percent, and the number of jobs on nonfarm payrolls increased about 3½ million, the largest gain in ten years. Labor and product markets tightened appreciably. Price pressures intensified in the markets for materials, but broader measures of price change showed inflation holding steady.

As in 1992 and 1993, the economic advance during 1994 was driven mainly by sharp increases in the real expenditures of households and businesses. Consumer purchases of motor vehicles rose further in 1994, and purchases of other consumer durables increased even faster than they had in the two previous years. Residential investment posted a small gain, on net, over the four quarters of the year, despite sharp increases in mortgage interest rates. Business investment in office and computing equipment slowed from the spectacular pace of 1993 but continued to rise rapidly nonetheless, and business investment in other types of equipment accelerated. Real outlays for nonresidential construction, which had been a weak sector of the economy in previous years, picked up in 1994; outlays for office construction ended a long slide that had stretched well back into the 1980s. Business investment in inventories, which had been quite restrained in previous years of the expansion, increased appreciably in 1994. Much of the inventory buildup apparently was intentional and reflected the desires of firms to stock up in anticipation of continued strength in sales or to build stronger buffers against potential delays in supply.

In contrast to the strength in private expenditures, government purchases of

goods and services edged down on net over the four quarters of 1994. Federal purchases of goods and services, which had declined sharply in 1993, fell further in 1994 as a consequence of actions taken in recent years to reduce the size of the federal deficit. Meanwhile, the real purchases of state and local governments rose only modestly. Although the expanding economy has provided states and localities with a stronger revenue base, many of these jurisdictions are striving to hold spending in check; a number of states have chosen to cut taxes.

As in the two previous years, a significant portion of the rise in domestic spending in 1994 went for imports of goods and services, which increased about 15 percent in real terms during the year. Meanwhile, growth of real exports of goods and services picked up noticeably, with gains cumulating to about 10 percent over the year. Foreign economies strengthened in 1994, and the price competitiveness of this country's products in world markets was aided by a subdued rate of rise in production costs and a somewhat lower exchange value of the U.S. dollar.

Labor and product markets tightened in 1994. After ticking up in January of last year in conjunction with the introduction of a new labor market survey, the civilian unemployment rate fell sharply over the remainder of the year, to 5.4 percent in December. The level of the unemployment rate in January of this year—5.7 percent—was a full percentage point below that of a year earlier. In manufacturing, gains in production exceeded the growth of capacity by a sizable margin during 1994, and the rate of capacity utilization climbed nearly 3 percentage points. Its level in recent months has been essentially in line with the highest level achieved during the economic expansion of the 1980s.

Inflation pressures picked up in some markets in 1994. Prices of raw industrial commodities rose even more rapidly than in 1993, and price increases for intermediate materials accelerated sharply, especially after midyear. However, the inflation impulse in these markets did not carry through with any visible force to the consumer level, probably because unit labor costs, which make up by far the largest part of value added in production and marketing, continued to rise at a modest rate. The employment cost index of hourly compensation in private nonfarm industries actually slowed noticeably from the pace of 1993, and productivity gains in 1994 held close to the pace of the previous year. As for retail prices, 1994 was the fourth year in a row in which the rise in the total CPI has been around 3 percent. The CPI excluding food and energy rose just 2.8 percent over the four quarters of 1994, after an increase of 3.1 percent in 1993; the rate of rise in this index, which is widely used as an indicator of underlying inflation trends, fell almost half from 1990 to 1994.

The Household Sector

Real personal consumption expenditures advanced nearly 3½ percent over the four quarters of 1994, about in line with the average pace of the two previous years. Support for the rise in spending came from rapid income growth, and, according to surveys, sharp increases in consumer confidence. Outlays for durable goods continued to rise especially rapidly, seemingly little affected by rising interest rates. Nor did spending appear to be much affected, in the aggregate, by poor performance of the stock and bond markets, which cut into the real value of household assets. Credit generally was readily available during 1994, and growth of consumer install-

ment debt picked up substantially, to a pace comparable with some of the larger increases that were observed during the expansions of the 1970s and 1980s.

Real consumer expenditures for durable goods increased about 8 percent in 1994, bringing the cumulative rise in these outlays over the past three years to nearly 30 percent. The stock of durable goods that households wish to hold apparently continued to rise quite rapidly in 1994, and at least some households probably were still making up for purchases that had been put off earlier in the 1990s when the economy was sluggish and concerns about job prospects were widespread. Real expenditures for motor vehicles moved up an additional 3 percent over the four quarters of 1994, after gains of about 9 percent in each of the two preceding years; increases in sales of vehicles in 1994 might have been a bit stronger still but for capacity constraints and various supply disruptions that sometimes limited the availability of certain models. Real outlays for durable goods other than motor vehicles rose about 11½ percent over the four quarters of 1994, a pickup from the already rapid rates of expansion of the two previous years. Purchases of personal computers and other electronic equipment continued to surge in 1994, and spending on furniture and household appliances moved up further.

Consumer expenditures for nondurables and services exhibited mixed patterns of change in 1994. Real outlays for nondurables increased 3 percent over the year, a pickup from the subdued rate of growth recorded in the previous year and, for this category, a larger-than-average advance by historical standards. By contrast, real expenditures for services increased roughly 2¼ percent, a slightly smaller gain than that of 1993; growth of outlays for services was held down, to some degree, by a decline in

real outlays for energy, as warm weather late in 1994 reduced the amount of fuel needed for heating.

Real disposable personal income rose $4\frac{1}{4}$ percent during 1994. Except for a couple of occasions in previous years when income growth was boosted temporarily by special factors, the rise in real disposable income in 1994 was the largest increase since the 1983–84 period. Growth of wages and salaries accelerated in 1994 in conjunction with the step-up of employment growth. Income from capital also rose: Dividends moved up along with corporate profits, and interest income turned back up after three years of decline. By contrast, transfer payments, the growth of which tends to slow as the economy strengthens, registered the smallest annual increase since 1987. The net income of nonfarm proprietors appears to have about kept pace with the average rate of growth in other types of income. Farm income rose moderately on an annual average basis, as an increase in the volume of output more than offset the effects of sharp declines in farm output prices that developed over the course of the year.

Consumers' perceptions of economic and financial conditions brightened considerably during 1994. By year-end, the composite measures of consumer confidence that are prepared by the Conference Board and the University of Michigan Survey Research Center had both moved to new highs for the current business expansion. Consumers became more optimistic over the year in regard to both current and future economic conditions. Perceptions of employment prospects also improved, with a growing proportion of respondents saying that jobs were plentiful and a reduced proportion saying that jobs were hard to find. Surveys taken early this year indicate that confidence remains high.

In contrast to most other indicators for the household sector of the economy, household balance sheets—which had strengthened appreciably in previous years—showed no further improvement in 1994. According to preliminary data, the aggregate net worth of households appears to have recorded a relatively small increase in nominal terms over the year, and, in real terms, net worth probably declined slightly. Household assets rose only moderately in nominal terms, and the growth of nominal liabilities picked up somewhat, as a result of the sharp increase in use of consumer credit. Early this year, stock and bond prices have risen, on net, giving some renewed lift to household wealth.

With personal income growing faster than net worth during 1994, the ratio of wealth to income fell over the course of the year. In the past, declines in this ratio sometimes have prompted households to boost the proportion of current income that is saved, in an attempt to restore wealth to more desirable levels, and this same tendency may have been at work, to some extent, in 1994. After dipping in the first quarter of the year to the lowest level of the current expansion, the personal saving rate rose a full percentage point over the remainder of the year, to a fourth-quarter level of 4.6 percent. Even then, however, the saving rate remained quite low by historical standards. Rising levels of income and employment and increased confidence in the outlook apparently convinced consumers to push ahead with increases in outlays, most notably those on consumer durables. In addition, although improvement in household balance sheets apparently flagged, signs of outright stress in household financial conditions were not much in evidence: Delinquency rates on mortgages and other house-

hold loans generally remained quite low relative to their historical ranges.

Residential investment held up remarkably well in 1994 in the face of sharp increases in mortgage interest rates. Preliminary data indicate that, in real terms, these investment outlays were up about 2 percent, on net, over the four quarters of the year, after gains of 17 percent and 8 percent, respectively, in 1992 and 1993. Although starts and sales of single-family houses fell back from the exceptionally high peaks that were reached briefly in late 1993, they remained at elevated levels. In total, 1.20 million single-family units were started in 1994, topping, very slightly, the highest annual total of the 1980s. Sales of existing homes were about the same as the previous annual peak, set in 1978, and although sales of new homes remained well short of previous highs, their annual total was closely in line with the brisk pace of 1993. Only in the past month or so have indications of a weakening in housing activity started to show up more consistently in the incoming data.

Declines in the starts and sales of single-family houses in early 1994 basically reversed the huge gains of late 1993. Whatever tendency there may have been for these indicators to exhibit at least a temporary setback after a period of unusual strength was probably reinforced by the initial reactions of builders and homebuyers to increases in mortgage interest rates that had begun in the final quarter of 1993. Exceptionally severe winter weather in the Northeast and Midwest early in 1994, coming on the heels of favorable conditions in late 1993, probably also helped to account for the sharpness of the downturn. In any event, starts of single-family homes ticked back up a bit in the second quarter of the year, sales of existing homes flattened out, and the

rate of decline in sales of new homes slowed.

In the second half of the year, the signals were mixed: Sales of existing homes trended down at a moderate pace during this period; however, single-family starts and sales of new single-family homes changed little, on net, from the second quarter to the fourth quarter. Sizable gains in employment and income and rising optimism about the future of the economy apparently helped to blunt the effects of increases in interest rates during the second half of the year. In addition, the availability of a widening variety of alternative mortgage instruments and, perhaps, some easing of loan qualification standards may have permitted some buyers who otherwise would not have been able to obtain financing to go ahead with their purchases.

Late in 1994 and in early 1995, a softer tone seems to have taken hold in key indicators of single-family housing activity. Sales of new homes tailed off toward the end of last year, and the ratio of the number of unsold homes to the number of sales, which had turned up early in 1994, continued to rise. The ratio in December was slightly to the high side of the long-run average for this series. Starts of new single-family houses, which had increased in November and December, fell sharply in January, to a level noticeably below the lower bound of the range of monthly readings reported during 1994.

Various measures of house prices showed small-to-moderate increases in 1994. The median transaction prices of new and existing homes that were sold in the first half of the year were roughly 3½ percent above the level of a year earlier, and a similar rise was reported during that period in price indexes that adjust for changes in the quality and regional mix of homes that are sold.

After mid-year, the four-quarter changes in transaction prices slowed, but the rate of rise in the quality-adjusted indexes picked up somewhat. All told, prices have been firmer in the past couple of years than they were earlier in the 1990s.

After falling to exceptionally low levels in late 1992 and early 1993, construction of multifamily housing units increased throughout 1994. Although the level of activity in this part of the housing sector was not especially high, gains during the year were large in percentage terms: Starts of these units moved up about 65 percent from the fourth quarter of 1993 to the fourth quarter of 1994, at which point they were more than double the lows of a couple years ago. The national average vacancy rate for multifamily rental units remained relatively high in 1994, but markets in some areas of the country had tightened enough to make construction of new multifamily units economically attractive. Reauthorization in August 1993 of a tax credit on low-income housing units also provided some incentive for new construction. The financing of multifamily projects was facilitated through more ready availability of credit and increased equity investment.

The Business Sector

Robust expansion was evident in 1994 in most of the economic indicators for the business sector of the economy. Real output of nonfarm businesses increased about 4¼ percent over the four quarters of the year, nearly matching the large gain of 1993. For a second year, business investment in fixed capital advanced exceptionally rapidly. Inventory investment also picked up appreciably, spurred by large, sustained increases in sales. Business finances remained

on a sound footing: Investment expenditures continued to be financed predominantly with internal funds, and signs of financial stress were largely absent.

Industry entered 1994 with considerable momentum, and expansion was maintained at a rapid pace throughout the year. Industrial production rose nearly 6 percent over the four quarters of 1994, a rate of expansion exceeded in only one of the past ten years. The production of business equipment advanced especially rapidly, buoyed by rising investment in the domestic economy and further large increases in exports of capital goods. Production of intermediate products—which consist mainly of supplies used in business and construction—also moved up substantially during 1994, as did the output of materials, especially those used as inputs in the production of durable goods. The industrial sector also appears to have had a strong start in 1995, as industrial production rose 0.4 percent in January.

The rate of capacity utilization in industry increased about 2½ percentage points over the twelve months of 1994. In manufacturing, the operating rate rose about 3 percentage points during the year. By year-end, utilization rates in some industries had moved to exceptionally high levels. Most notably, the average operating rate among manufacturers engaged in primary processing (basically, the producers of materials) had climbed to the highest level since the end of 1973, surpassing, by small margins, the peaks of the late 1970s and late 1980s.

After rising 23½ percent over the four quarters of 1993, corporate profits increased another 4 percent over the first three quarters of 1994. The profits earned by nonfinancial corporations from their domestic operations increased

about 7½ percent over the first three quarters of 1994, after a gain of 21½ percent in 1993. Although the 1994 gain in these profits was partly the result of increased volume, profits per unit of output also rose. In the second and third quarters, before-tax profits of nonfinancial corporations amounted to nearly 11 percent of the gross domestic output of those businesses—the highest that this measure of the profit share has been since the late 1970s. A shift in the capital structure of corporations toward reduced reliance on debt, as well as cyclical recovery of the economy, has helped to push the profit share to this high level. In contrast to the experience of nonfinancial corporations, the profits of private financial institutions from their domestic operations fell about 7 percent on net over the first three quarters of the year, as net interest margins narrowed. The decline reversed some of the large rise in profits that these institutions had reported in 1993.

Business fixed investment increased 13 percent in real terms over the four quarters of 1994, after a gain of 16 percent during 1993. Outlays for office and computing equipment, which had registered an astonishing gain in 1993, slowed in 1994, but the rise in these outlays still amounted to nearly 20 percent in real terms. Meanwhile, the growth of real expenditures for most other types of business equipment picked up.

Business investment in motor vehicles rose about 18½ percent over the four quarters of 1994. With the gains of 1994 coming on the heels of big increases in each of the two previous years, annual business outlays for vehicles reached a level about one-third higher than the peak year of the 1980s. Outlays for communications equipment also scored an especially big gain in 1994, more than 25 percent in real

terms. Business purchases of industrial equipment advanced about 13 percent during 1994, one of the larger gains of the past two decades. By contrast, commercial aircraft once again was a notable area of weakness; the investment cycle in that sector has been sharply out of phase with those of most other industries, owing to persistent excess capacity and poor profitability in the airline business.

Business investment in nonresidential structures rose about 4 percent during 1994, after an increase of 1½ percent in 1993 and declines in each of the three years preceding 1993. Investment in industrial structures rose for the first time since 1990, more than likely a response to high—and rising—rates of capacity utilization. Investment in office buildings also turned up in 1994, after a long string of declines that, in total, had brought spending on these structures down about 60 percent from the peak of the mid-1980s; declining vacancy rates and a firming of property values provided additional evidence of improvement in this sector of the economy in 1994. The investment data for other types of structures showed a mix of pluses and minuses: Expenditures on commercial structures other than offices moved up further, after large gains in 1992 and 1993; however, outlays for drilling declined for a fourth year, to the lowest level since the early 1970s.

Because a large share of the growth in business fixed investment in recent years has gone for items that depreciate relatively quickly—computers being a prime example—net additions to the stock of productive capital have not been as impressive as the data on gross investment expenditures might seem to indicate. Nonetheless, with the further increase in gross investment in 1994, net additions to the capital stock appear to have become more

substantial. Still unclear is the degree to which these increases in the capital stock will ultimately translate into higher rates of increase in output per worker and faster rates of increase in living standards; as discussed in more detail below, the trend of growth in labor productivity, which is affected by the amount and quality of capital that workers have available, seems to have picked up in recent years but by a relatively small amount.

Business investment in inventories picked up sharply in 1994. Earlier in the expansion, firms had refrained from building stocks, even as the economy strengthened. Increased reliance on "just-in-time" systems of inventory control reduced the level of stocks that firms needed to maintain their normal operations, and, with a degree of slack still present in the economy, businesses usually were able to obtain goods quickly from their suppliers and thus were probably reluctant to hold stocks in house. At the end of 1993, the level of real inventories in the nonfarm business sector was only 2 percent larger than it had been at the start of the recovery in early 1991.

Circumstances changed in 1994, however. Markets tightened as demand continued to surge, and supplies became more difficult to obtain on a timely basis. Anticipation of further growth in demand and increased concern about possible bottlenecks apparently prompted businesses to begin investing more heavily in inventories. Some firms may also have been trying to stock up on materials in advance of anticipated price increases. For the year as a whole, accumulation of nonfarm inventories was more than twice what it had been in 1993. This additional accumulation brought to a halt the previous downtrend in the ratio of nonfarm inventories to business sales, but the ratio remained

quite low by the standards of the past quarter-century.

Inventory accumulation in the farm sector of the economy also picked up in 1994. Stocks of farm products had been drawn down in 1993, when farm production fell sharply because of floods in the Midwest and droughts in some other regions of the country. However, crop conditions in 1994 were unusually favorable throughout the year, and the output of some major crops climbed to levels considerably above previous peaks. With the demand for farm output rising much less rapidly than production, inventories of crops increased sharply. Livestock production also rose appreciably in 1994; inventories of livestock, which consist mainly of the cattle and hogs on farms and ranches, continued to expand.

The Government Sector

Federal purchases of goods and services, the part of federal spending that is included in GDP, fell 6.2 percent in real terms over the four quarters of 1994. Real outlays for defense remained on a sharp downtrend, and nondefense outlays, which had risen rapidly early in the 1990s, declined moderately for a second year.

Total federal outlays, measured in nominal dollars in the unified budget, increased 3.7 percent in fiscal 1994, after a rise of 2.0 percent the previous fiscal year. These increases are among the smallest of recent decades. Nominal outlays for defense fell again in fiscal 1994. In addition, the growth of outlays for income security (a category that includes the expenditures on unemployment compensation and welfare benefits) slowed further as the economy continued to strengthen. Increases in social security outlays also slowed somewhat in fiscal 1994; the rise was about 1 per-

centage point less than that of nominal GDP. Outlays for Medicaid slowed as well, but the rate of rise in those expenditures continued to exceed the growth of nominal GDP by a large margin.

Federal receipts were up 9 percent in fiscal 1994, the largest rise in several years. With rapid expansion of the economy giving a strong boost to almost all types of income, the major categories of federal receipts all showed sizable gains. Combined receipts from individual income taxes and social insurance taxes increased a bit more than 7 percent in fiscal 1994, after moving up 5.4 percent in the previous fiscal year. Receipts from taxes on corporate profits increased nearly 20 percent, slightly more than the gain of 1993.

The federal budget deficit declined to \$203 billion in fiscal 1994, an amount that was equal to 3.1 percent of nominal GDP. Earlier in the 1990s, when the economy was sluggish, the federal deficit had climbed to a cyclical peak of 4.9 percent of nominal GDP. The previous cyclical low in the ratio of the deficit to nominal GDP, 2.9 percent, was reached in fiscal 1989. Since fiscal 1989, defense spending as a share of GDP has dropped appreciably, but this source of deficit reduction has been essentially offset by increased outlays for health and social insurance. Thus, the ratio of total federal outlays to GDP has changed little, on net; it was about 22 percent in both fiscal 1989 and fiscal 1994. The ratio of federal receipts to nominal GDP was about 19 percent in both of those fiscal years.

The stronger economy of recent years has provided state and local governments with a growing revenue base and a broadening set of fiscal options. Some governments have responded to these developments by cutting taxes, in most cases by small amounts. Effective tax rates of state and local governments

appear to have edged down a bit, on average, over the four quarters of 1994, and nominal receipts apparently rose somewhat less rapidly than nominal GDP over that period.

Many states and localities also have been trying to restrain the growth of expenditures, but success on that score has been difficult to achieve because of increased outlays for entitlements and rising demand for many of the public services that traditionally have been provided by state and local governments. Transfers of income from state and local governments to persons rose about 9 percent in nominal terms over the four quarters of 1994, roughly the same as the rise during 1993 but less than the increases of previous years; from 1988 to 1992, the average compound rate of growth in these transfers was about 15 percent a year. In categories other than transfers, increases in spending have been fairly restrained in recent years; nominal purchases of goods and services (which account for about 80 percent of the total expenditures of state and local governments) have been trending up less rapidly than nominal GDP since the early 1990s.

In real terms, the 1994 rise in purchases of goods and services by state and local governments amounted to just 2 percent. Compensation of employees, which accounts for about two-thirds of total state and local purchases, increased 1½ percent in real terms over the four quarters of 1994, a gain that was roughly in line with the growth of state and local employment over that period. Construction outlays declined slightly in real terms during 1994, as gains over the final three quarters of the year were not sufficient to offset a first-quarter plunge. Nonetheless, real outlays for structures remained at high levels; a strong uptrend in construction expenditures over the past ten or twelve years has more than

reversed a long contraction that began in the latter half of the 1960s and bottomed out in the first half of the 1980s.

The deficit in the combined operating and capital accounts of all state and local governments (a measure that excludes the surpluses in state and local social insurance funds) amounted to about 0.6 percent of nominal GDP in calendar 1994, little changed from the corresponding figure for 1993 and down only slightly from a cyclical peak of 0.8 percent in 1991. The recent cyclical peak in this measure was larger than the peaks reached in recessions of the 1970s and 1980s, and declines in the deficit during this expansion have not been as large as the declines that occurred during other recent expansions. Historically, the combined operating and capital accounts of state and local governments have been in deficit more often than they have been in surplus; as a share of nominal GDP, the annual surpluses and deficits since World War II have averaged out to a deficit of 0.3 percent.

The External Sector

When adjusted for differing rates of increase in consumer prices, the trade-weighted average foreign exchange value of the U.S. dollar declined 5½ percent against the currencies of the other G-10 countries in 1994. This depreciation was slightly smaller than the almost 6½ percent nominal depreciation of the dollar, as U.S. inflation exceeded foreign inflation by a small amount. An index of exchange rates that also includes the currencies of several of the major U.S. trading partners in Latin America and East Asia showed about the same degree of real depreciation as did the index for the currencies of the G-10 countries. In the first few weeks of 1995, the dollar has weakened, on balance, in nominal

terms against the currencies of the G-10 countries, but it has moved up in terms of the Mexican peso.

Growth of real GDP in the major foreign industrial countries rebounded sharply during 1994, significantly exceeding the pace of recovery widely expected at the start of the year. In the United Kingdom and Canada, where recovery was already well established, growth continued to be vigorous. In Germany, France, and other continental European countries, where activity had been sluggish during 1993, strong expansion of real GDP resumed and strengthened as the year progressed. Recovery was evident in Japan as well, but the pace of expansion there remained somewhat subdued relative to that of the other industrial countries. Although most of these economies clearly had moved past the troughs of their recessions, considerable slack remained. As a result, consumer price inflation remained low and, in some cases, fell further. On average, in the ten major foreign industrial countries, consumer prices rose 2 percent during the year, even less than the price increase in the United States.

Economic growth in the major developing countries in 1994 continued at about the strong pace of 1993. In Asia, the newly industrializing economies grew rapidly, as external demand was sustained by lagged effects of depreciation of their currencies against the yen and by recovery in the industrial countries. Growth in China, although still quite rapid, was somewhat slower than that in 1992–93, as credit conditions were tightened somewhat further and various controls were imposed to damp demand.

In Mexico, real GDP growth rose markedly during the second and third quarters of 1994 from its near-zero rate in 1993, in part because of fiscal stimu-

lus. However, the economic policy program put in place at the end of the year in response to the peso crisis is likely to restrain growth once again in the coming year. The Mexican macroeconomic stabilization program is designed to maintain wage restraint, reduce government spending and development bank lending, and result in significant improvement in the current account deficit in 1995. The program includes guidelines on increases in wages, guidelines on increases in final energy product prices to consumers and to industry, net cuts in public expenditures, and a reduction of lending by development banks. Mexico has committed to maintain the current floating exchange rate regime, and the Bank of Mexico has agreed to restrain the growth of money. Structural reform measures include continued privatization and lessened restrictions on foreign investment. Further measures could be required if inflation and the exchange rate do not respond as projected.

The nominal U.S. trade deficit in goods and services increased to about \$110 billion in 1994, compared with \$75 billion in 1993. Imports grew noticeably faster than exports, as U.S. growth about equaled that of U.S. trading partners and as the lagged effects of dollar appreciation during 1993 continued to be felt. The current account deficit averaged about \$150 billion at an annual rate over the first three quarters. Net investment income moved from a small positive to a moderately negative figure in 1994, reflecting recovery of foreign earnings on direct investment in the United States and the effects of higher interest rates on high and rising U.S. net external indebtedness.

Based on initial estimates for the fourth quarter, exports of goods and services grew 10 percent in real terms during 1994. Computer exports continued

to rise rapidly in real terms, about 30 percent for the year; this gain contributed significantly to the double-digit growth in total exports. After declining in 1993, agricultural exports bounced back last year; the much-improved harvest of 1994 eased supply constraints that previously had been limiting shipments of farm products. Other categories of merchandise exports averaged more than 8 percent real growth during the year, as the pace of activity in the economies of U.S. trading partners improved significantly. Geographically, the increase in U.S. merchandise exports was accounted for by increased shipments both to developing countries in Latin America and Asia and to Canada and Japan.

Imports of goods and services rose about 15 percent in real terms over the four quarters of 1994, reflecting the vigorous growth of U.S. income during the year. Imports of computers continued to expand extremely rapidly in real terms. Of the other import categories, imports of machinery and automotive products were particularly buoyant. Import prices rose about 4 percent in 1994, influenced by depreciation of the U.S. dollar, increases in world commodity prices, and a rebound in oil prices, which had declined in 1993 and early 1994.

In the first three quarters of 1994, recorded net capital inflows were substantially larger than those of 1993, an increase that coincided not only with the growing current account deficit, but also with a sharp swing in unrecorded transactions in the U.S. international accounts, from a positive figure in 1993 to a negative one in the first three quarters of 1994.¹

1. In effect, recorded net capital inflows in the first three quarters of 1994 were larger than necessary to balance the rising current account deficit. Moreover, outflows of currency to foreigners, an item that is not reflected in recorded transactions

Among the recorded capital flows, increases in foreign official assets in the United States were substantial in 1994 but were somewhat smaller than in 1993. In particular, the large reserve accumulations in 1993 by certain developing countries in Latin America experiencing massive private capital inflows were not repeated in 1994.

U.S. net purchases of foreign securities, particularly bonds, fell sharply from record 1993 levels. Private foreign net purchases of U.S. securities also fell, but only slightly. Rising interest rates on bonds denominated in dollars and many other major currencies produced capital losses for U.S. holders of long-term bonds and resulted in flows out of U.S. global bond funds. In the first three quarters of 1994, U.S. investors made heavy net purchases of stocks in Japan; Japan alone accounted for more than one-third of all U.S. net foreign stock purchases. In developing countries, those that received the largest net equity inflows from U.S. investors in 1993 (Hong Kong, Mexico, Argentina, Brazil, and Singapore) were less favored by investors in 1994, while interest picked up in a wide assortment of other developing countries, including South Korea, Chile, Indonesia, China, India, and Peru.

The first three quarters of 1994 also witnessed a revival of foreign direct investment in the United States while U.S. direct investment abroad remained at near-record levels. The direct investment inflow was swelled by takeovers of U.S. companies and by the revival of profits and reinvested earnings reported by affiliates of foreign companies in the United States.

and, therefore, is a part of unrecorded net inflows in the international accounts, increased substantially in 1994, suggesting that the other unrecorded outflows of capital may have been even larger than the published data on errors and omissions indicate.

Labor Markets

Employment rose substantially in 1994. The total number of jobs in the nonfarm sector of the economy increased 3.5 million over the twelve months ended in December, after a gain of 2.3 million during 1993.² About a quarter of a million of the rise in jobs during 1994 was in the government sector, mostly at the local level. Job growth in the private nonfarm sector amounted to 3.2 million, the largest gain since 1984. Increases in employment at nonfarm establishments were sizable in each quarter of 1994. A further gain in payroll employment, smaller than the average increase of the past year, was reported in January of this year; however, total labor input rose considerably faster than employment in January as the workweek lengthened.

Producers of goods boosted employment more than half a million in 1994. The job count in construction increased about 300,000 over the year; employment at general building contractors rose briskly for a second year, as did the number of jobs at firms involved in special trades related to construction. The number of jobs in manufacturing increased about 275,000 during 1994, after five years of decline. Producers of durables accounted for most of the rise in manufacturing employment; among these producers, job gains were widespread. Employment at factories that produce nondurables rose slightly in total, as advances in some industries—such as printing and publishing and rubber and plastics—were partly offset by continued secular declines in the number of jobs in industries such as apparel, tobacco, and leather goods. The average

2. The Bureau of Labor Statistics has announced that the level of nonfarm payroll employment in March 1994 will be raised 760,000 when revised estimates are released this summer. The revision may lead to larger estimates of job growth in both 1993 and 1994.

workweek in manufacturing, which had stretched out in 1992 and 1993 when factory employment was declining, lengthened further in 1994, rising to new highs for the postwar period. The high fixed costs that are associated with adding new workers probably continued to be an important factor in firms' decisions to rely still more heavily on a longer workweek as a way to boost labor input. Growth of factory output surpassed the rise in labor input by a sizable amount in 1994, a reflection of substantial gains in productivity that were realized in this sector of the economy in the most recent year.

Employment in the private service-producing sector rose nearly $2\frac{3}{4}$ million during 1994, after a gain of 2 million in 1993. The number of jobs in retail trade increased about 800,000 over the year. Auto dealers, stores that sell building materials, and those that sell general merchandise were among the retail outlets that reported impressive gains. Hiring at eating and drinking places also moved up briskly; after three years of slow growth around the start of the decade, hiring at these establishments has increased substantially in each of the past three years. Employment at firms that supply services to other businesses rose about 710,000 in 1994, even more than in 1993. Once again, job growth within this category was especially rapid at personnel supply firms—those that essentially lease the services of their workers to other employers, often on a temporary basis. Employment at businesses that supply health services increased a quarter of a million in 1994, about the same as the gain in 1993; hiring at hospitals has flattened out over the past couple of years, but elsewhere in the health sector job growth has continued at a rapid clip.

Strength also was evident in 1994 in data from the monthly survey of house-

holds. After ticking up in January 1994, when a redesigned household survey was implemented and new population estimates were introduced, the civilian unemployment rate turned back down in February and declined in most months thereafter. The rate increased last month, to 5.7 percent, but was still a full percentage point below that of a year earlier.³ Appreciable net declines in unemployment rates have been reported over the past year for nearly all occupational and demographic groups.

Data on the reasons why individuals are unemployed seem to be tracing out patterns fairly similar to those seen in previous business cycles. Most notably, the number of persons who are unemployed because they lost their last job has declined sharply, on net, over the past year. The number of individuals in this category had soared earlier in the 1990s, when the economy was struggling to gain momentum and many large companies were restructuring their operations. However, with the more recent decline, the number of these "job losers," measured as a percentage of the labor force, has moved back toward the lows of the late 1980s. Much of the decline in the number of job losers this past year has been among workers who were permanently separated from their previous jobs. The number of persons unemployed for reasons other than the loss of a job (that is, the sum of "job leavers" and new entrants or re-entrants

3. Research undertaken by the Bureau of Labor Statistics suggests that the unemployment rate would have run about two-tenths of a percentage point lower in 1994 but for the changes that were introduced in January of last year. Other series from the household survey were also affected by the introduction of the new survey and the revised population estimates; therefore, data for the period starting in January 1994 are not directly comparable with those for the period ended in December 1993.

unable to find work) has also declined over the past year. As in other business cycles, the number of these individuals, measured relative to the size of the labor force, has been displaying a cyclical pattern considerably more muted than that of job losers.

Growth of the civilian labor force—which consists of the individuals who are employed and those who are seeking employment but have not yet found it—picked up a bit in the second half of 1994 and in early 1995. However, even with these increases, the cumulative rise in the labor force in the current business expansion has been relatively small compared with the gains recorded in other recent expansions; growth of the working-age population has been slower this decade than it was in the expansions of the 1970s and 1980s, and the share of the population participating in the labor force, which trended up in earlier expansions, has changed little, on net, during this one.

According to preliminary data, output per hour of labor input in the nonfarm business sector increased 1.4 percent over the four quarters of 1994, after a rise of 1.8 percent in 1993 and still larger gains in 1992 and 1991. Over the business cycle, productivity gains typically are largest in the early years of expansion, and, in that regard, the recent experience does not appear to be unusual. Abstracting from cyclical variation, the trend of productivity growth in recent years seems to have picked up somewhat from the unusually sluggish pace that prevailed through much of the 1970s and 1980s, but, at the same time, the pickup has not been nearly so large as some anecdotal reports might appear to suggest. For example, from late 1988 to late 1994, an interval of time that is long enough to capture all the phases that productivity goes through during the business cycle,

the average rate of rise in output per hour in the nonfarm business sector amounted to slightly more than 1¼ percent, up only modestly from an average rate of rise of about ¾ percent during most of the 1970s and 1980s.⁴

The rate of increase in hourly compensation moved down another notch in 1994. The employment cost index for private industry, a measure of hourly labor costs that comprises both wages and benefits, rose 3.1 percent during the twelve months ended in December 1994, after increases of 3.6 percent in 1993 and 3.5 percent in 1992. The rise in the wage component of compensation was slightly less than that of 1993, and the rate of increase in hourly benefits slowed appreciably. Increases in benefits were restrained, in large part, by another year of deceleration in health care costs and a further slowing in workers' compensation insurance costs. The rise in nominal compensation per hour in 1994 was the smallest yearly increase in the fifteen-year history of the series, the previous low of 3.2 percent having come midway through the expansion of the 1980s. Toward the end of that decade, as bidding for labor resources intensified, increases in compensation

4. Whether even this small degree of improvement in the productivity trend will stand up through future revisions of the data is not clear. For example, among the many difficult issues that are involved in the measurement of productivity is the choice of an appropriate set of prices to be used in valuing the output of goods and services. Currently, aggregate output is tallied by using the prices of 1987, but some major changes in relative prices have taken place since then, the most notable of which is a huge decline in the price of office and computing equipment. Using the prices of a more recent year to gauge real output would result in less weight being given to office and computing equipment and, in turn, a smaller contribution from this rapidly growing category to growth of real output. All else equal, the growth of productivity would also be negatively affected by switching to the prices of a more recent year.

moved up for a time to around 5 percent a year.

Unit labor costs in the nonfarm business sector rose 2.0 percent over the four quarters of 1994 after an increase of just 0.6 percent over the four quarters of 1993. In manufacturing, a sector of the economy in which productivity has advanced quite rapidly in recent years, a rise in output per hour of 4.6 percent during 1994 more than offset a modest increase in hourly compensation, and unit labor costs declined noticeably for a second year.

Price Developments

Although price increases picked up in some parts of the economy in 1994, the broader measures of price change continued to yield readings that were quite favorable. The rise in the total CPI was about $2\frac{3}{4}$ percent in 1994, the same as the increase during 1993. The CPI excluding food and energy also rose about $2\frac{3}{4}$ percent over the four quarters of 1994, after increasing slightly more than 3 percent in 1993. The producer price index for finished goods increased $1\frac{1}{4}$ percent during 1994, after edging up just $\frac{1}{4}$ percent during the previous year. As in 1992 and 1993, the past year's increases in all these price indexes were among the lowest readings of the past quarter-century. Measures of inflation expectations held steady in 1994, but continued to show readings that were somewhat higher, on average, than the actual rates of price increase. Price data for January of this year were less favorable than those of 1994: The total CPI moved up 0.3 percent last month, and the CPI excluding food and energy jumped 0.4 percent, the largest monthly rise in that measure since late 1992.

The pickup of price increases last year was confined largely to markets for

materials. Prices of primary industrial inputs, which had moved up sharply during 1993, continued to surge in 1994, and price increases for intermediate materials accelerated as the year progressed. Prices of imports also picked up somewhat, influenced by the depreciation in the exchange value of the dollar; as was true in the domestic economy, the largest price increases for imported goods were those for materials. Gains in productivity apparently enabled manufacturers of finished goods to absorb these increases in the costs of domestically produced and imported materials without raising their own prices very much.

Early this year, materials prices continued to surge. The producer price index for crude materials other than food and energy jumped 3 percent in January, to a level about $17\frac{1}{2}$ percent above that of a year earlier. Further along in the production chain, the PPI for intermediate materials other than food and energy rose 1 percent last month; the index has moved up 6 percent during the past twelve months, the largest such rise since the late 1980s, when the twelve-month rate of increase in intermediate materials prices topped out at slightly more than 7 percent. By contrast, the PPI for finished goods other than food and energy again showed only a modest increase in January. Since mid-January, the prices of a number of industrial commodities have backed away from earlier highs, but, given the volatility that these prices sometimes exhibit, the experience of a few weeks may not signal the emergence of a new trend.

In the CPI, the prices of commodities other than food and energy rose $1\frac{1}{2}$ percent over the four quarters of 1994, about the same as the rise of 1993. Prices of new cars and new trucks, responding to strong demand and, at times, shortages in the supply of some

models, moved up faster than prices in general; prices of used cars rose especially rapidly for a third year. The prices of tobacco products, which had fallen sharply in 1993 when producers made steep one-time price reductions, turned back up in 1994, rising moderately over the four quarters of the year. By contrast, prices of home furnishings changed little over the year, and the CPI for apparel fell noticeably. In January 1995, the CPI for goods other than food and energy jumped 0.4 percent; this rise followed a string of months in which the index had increased very slowly.

The CPI for non-energy services, a category that accounts for about half of the total CPI, rose slightly less than $3\frac{1}{2}$ percent over the four quarters of 1994, after an increase of about $3\frac{3}{4}$ percent in 1993. The increase in these prices in 1994 was just a bit more than half the rise that was recorded in 1990, when CPI inflation hit its most recent peak. Prices of medical services continued to slow in 1994, and airline fares, which have been an especially volatile category in the CPI in recent years, fell appreciably after having risen sharply the previous year. However, auto finance charges turned up, and the rate of rise in owners' equivalent rent, a category that has a weight of nearly 20 percent in the total CPI, rose slightly faster over the four quarters of 1994 than it had during the corresponding period of 1993. Like the prices of goods, the CPI for non-energy services accelerated sharply in January of this year.

In 1994, for a fourth year, neither food prices nor energy prices provided much impetus to the inflation process. The consumer price index for food rose a shade more than $2\frac{1}{2}$ percent over the four quarters of 1994, about the same as the rise of 1993. Food prices in 1994 were restrained, in part, by sharp declines in the prices of domesti-

cally produced farm products, which, in turn, were pulled down by the huge increases in crop and livestock production noted previously. With beef and pork prices declining over the year, the CPI for meats, poultry, fish, and eggs changed little in total. Retail prices of dairy products rose only a small amount. Prices of foods that are more heavily influenced by the costs of non-farm inputs also showed only small to moderate advances in 1994: The increase in the CPI for prepared foods amounted to about $2\frac{1}{2}$ percent, slightly less than the previous year's increase, and, for a third year, the rise in the price index for food away from home was less than 2 percent. Coffee was the only item in the CPI for food to show sustained price acceleration; freeze damage to the crop in Brazil caused world prices of raw coffee to surge and led to a price rise of more than 50 percent at retail over the four quarters of 1994. Fresh vegetable prices, which tend to be especially sensitive to short-run supply developments, took a jump toward year-end after Hurricane Gordon had damaged crops in Florida, but the run-up was partly reversed last month.

The CPI for energy rose about $1\frac{1}{2}$ percent during 1994, after edging down $\frac{1}{2}$ percent in 1993. Gasoline prices increased $4\frac{1}{2}$ percent over the four quarters of 1994, reversing the decline of the previous year. Much of the increase in gasoline prices came in the third quarter and followed, with a short lag, a second-quarter rise in crude oil prices, which were moving back up from the low levels of late 1993 and early 1994. Prices of other energy products exhibited brief periods of rapid increase, but sustained upward pressures in these prices did not materialize. Fuel oil prices shot up temporarily early in 1994, when stocks were pulled down for

a time by cold weather in the Midwest and the Northeast; later in the year, however, stocks were replenished and the earlier price increases were more than reversed. Natural gas prices followed a pattern similar to the price of fuel oil, rising sharply in the first quarter of the year but falling back thereafter, to a fourth-quarter level that was about $2\frac{1}{4}$ percent lower than that of a year earlier. Electricity prices rose only slightly during the year. In January of this year, energy prices were up moderately in the CPI.

With the favorable inflation performance of the past year, the average rate of rise in the total CPI since the business cycle trough in early 1991 has been 2.9 percent at an annual rate. Excluding food and energy, the rate of rise has been 3.3 percent at an annual rate. Inflation rates lower than these have not been sustained through the first few years of any business expansion since that of the 1960s, when both the CPI and the CPI excluding food and energy showed average rates of increase of less than 1.5 percent during the first four years after the business cycle trough of early 1961. Average rates of price increase during the current expansion have been much smaller than those reported during the expansion that began in the mid-1970s. They also have been somewhat smaller than those reported during the first few years of the expansion that began in late 1982, a period when price increases were braked in part by unusually steep declines in oil prices. In measuring the progress that has been made toward bringing the economy closer to the goal of long-run price stability, the ratcheting down of the rate of price advance from cycle to cycle since the 1970s is perhaps an even more meaningful indicator than the favorable trends in the annual price data of recent years.

Monetary and Financial Developments

With the economy generally strong, financial markets in 1994 and early 1995 have been characterized by somewhat more rapid growth in private debt and by higher interest rates. The increase in interest rates reflected, in part, the policy actions of the Federal Reserve. Concerned about inflationary pressures resulting from rapid economic growth and dwindling margins of available resources, the Federal Reserve firmed policy on seven occasions. These actions were taken to foster a financial environment more likely to be consistent with sustained economic growth and low inflation. In total, the policy tightenings raised the federal funds rate by a cumulative 3 percentage points between early February 1994 and early February 1995. Other short-term rates rose by similar amounts. Over this span, the Board of Governors hiked the discount rate on four occasions by a total of $2\frac{1}{4}$ percentage points.

Longer-term rates increased $1\frac{1}{2}$ percentage points to 3 percentage points on balance since January 1994, with the largest increases posted at intermediate maturities. In addition to the policy actions, these rates were boosted through much of 1994 by greater-than-expected underlying strength in the economy and the resulting higher demand for credit, as well as by upward revisions to expectations in financial markets about the policy tightenings that would be required to counter an incipient increase in inflation. Since late last fall, however, the extent of Federal Reserve actions, along with incoming data suggesting some moderation in the pace of expansion, have calmed inflation fears and trimmed estimates of the eventual rise in short-term interest rates. As a consequence, longer-term rates

have retraced some of their earlier upward movements.

Increases in intermediate- and long-term rates over the course of the year caused significant capital losses for some investors. Well-publicized losses at a number of investment funds in the first half of the year, along with substantial portfolio reallocations in view of the changed economic and financial outlook, may have contributed to increased financial market volatility at that time. On the whole, however, risk premiums remained modest, and volatility ebbed over the course of the year. Late in the year, the tax-exempt securities market dipped following the bankruptcy of Orange County that resulted from mounting losses in its investment fund, but the effects, beyond those on the fund's investors, proved to be small and short-lived.

One consequence of the higher and more volatile long-term interest rates was a shift in business borrowing away from the capital markets and toward shorter-term sources, such as banks. This shift, which reversed the move toward long-term financing that occurred as bond yields fell in 1992 and 1993, was marked by the first annual increase in bank business loans in several years. Consumer lending also accelerated in 1994, as the improved economic outlook encouraged increased use of consumer credit. Higher interest rates likely held down household mortgage debt growth, in that the resulting decline in refinancing activity limited the ability of households to "cash out" some of the equity in their homes. Higher rates also encouraged households to shift to adjustable-rate mortgages, which offered lower initial interest costs. The debt of all nonfinancial sectors increased $5\frac{1}{4}$ percent in 1994, about the same increase as in 1993, as the pickup in business and household borrowing was

offset by lower growth in government debt. The effects of the strong economy on government expenditures and receipts, policy moves to reduce the federal deficit, and retirements of tax-exempt securities that had been advance-refunded all contributed to the slowdown in government borrowing.

Banks funded much of the pickup in their loans with nondeposit funds and, in the second half of the year, with sales of securities. As a result, the doubling of loan growth was not reflected in significantly stronger expansion of the monetary aggregates. M3, which was boosted by relatively heavy issuance of large CDs, rose $1\frac{1}{2}$ percent, a somewhat larger increase than in 1993. With banks pricing savings and small time deposits unaggressively as market interest rates rose, M2 grew 1 percent over the year, somewhat below its $1\frac{3}{4}$ percent pace in 1993. The increase in market interest rates relative to rates on transaction deposits slowed the growth of M1 to just $2\frac{1}{4}$ percent from the double-digit increases posted in 1992 and 1993.

The foreign exchange value of the dollar declined in terms of the other G-10 currencies last year, even as the U.S. economy expanded briskly and interest rates rose. In part, the weakness was the result of unexpectedly strong growth abroad, especially in Europe, where the recovery in many countries was more rapid than had been anticipated. As a result, long-term interest rates in many of the other G-10 countries increased by amounts similar to rates in the United States. Heightened concerns about inflation prospects in the United States may also have contributed to the weakness of the dollar. Indeed, the dollar rebounded late in the fall when tighter monetary policy evidently eased those concerns. The dollar declined, however, in early 1995 amid the signs of slower U.S. growth and

concerns about the implications for the United States of turmoil in Mexican financial markets.

The Course of Policy and Interest Rates

In early 1994, short-term interest rates remained at the very low levels reached in late 1992, with the federal funds rate fluctuating around 3 percent—roughly in line with the rate of inflation. The Federal Reserve had maintained an accommodative policy stance throughout 1993. This stance was unusual so far into the expansion phase of a business cycle, but it was believed to be necessary because of a number of extraordinary factors that seemed to be inhibiting growth. These factors included efforts by households, firms, and financial intermediaries to repair strained balance sheets, business restructuring activities, and the fiscal contraction associated, in part, with the downsizing of defense industries.

During the recovery and expansion, however, considerable progress had been made by households and businesses in decreasing their debt-service burdens, and lending institutions had succeeded in rebuilding their capital positions. By late 1993, the economy was expanding rapidly, and incoming data early last year suggested that much of that momentum had likely carried over into 1994. In the circumstances, continued accommodative policy risked pushing the demands on productive resources to levels that ultimately would be associated with increased inflation. Consequently, the FOMC, at its meeting in early February 1994, agreed that policy should be moved to a less stimulative stance.

The pace at which the adjustment to policy should be made was less clear: A rapid shift in policy stance would minimize the risk of allowing inflation

pressures to build, while a more gradual move would allow financial markets time to adjust to the changed environment. Although many market participants seemed to anticipate a firming move fairly soon, it would be the first tightening in many years, and some investors would undoubtedly reconsider their portfolio strategies, possibly causing sharp movements in bond and stock prices. In addition, a slower initial shift would allow more time to assess the strength of the economy and the effects of the change in policy.

In the event, the Committee tightened policy gradually through the winter and early spring. Pressures on reserve positions were increased by relatively small amounts in February, March, and April; once market participants seemed to have made substantial adjustments to the new direction of policy, a larger tightening move was implemented in May. Taken together, the four policy actions raised the federal funds rate about 1¼ percentage points. The May policy action was accompanied by an increase of ½ percentage point in the discount rate, voted by the Board of Governors.

Other interest rates moved up between 1 percentage point and 2 percentage points as a result of these policy moves, with the largest increases coming at intermediate maturities. Besides the effect of the policy actions, longer-term rates were boosted by incoming data suggesting continued robust growth, which heightened market concerns about a pickup in inflation and expectations of further tightening by the Federal Reserve. In addition, uncertainty about the timing and magnitude of future policy actions, as well as the capital losses that followed the tightenings, encouraged investors to shorten the maturity of their investments and reduce their degree of leverage. The resulting portfolio adjustments likely contributed

to increased market volatility and may have intensified the upward pressure on longer-term interest rates.

Incoming data in the late spring and early summer suggested that the economy continued to expand significantly, led by sales of business equipment, a rebound in nonresidential construction following bad weather earlier in the year, and a pickup in inventory investment. Inflation was of growing concern, as commodity prices increased rapidly, and measures of slack suggested that the economy was entering a range in which pressures on broad price indexes might begin to build. In part reflecting this concern, long-term rates moved up, and the dollar weakened. Given the relatively large policy action in May, however, the Committee decided to take no action at the July meeting and to wait for more information on the performance of the economy. The Committee saw the possible need for tighter policy, however, and issued an asymmetric directive to the Federal Reserve Bank of New York suggesting that policy would respond promptly to evidence of increased inflation pressures.

In the interval between the Committee meetings in early July and mid-August, the economy continued to expand robustly, and, coming into the August meeting, it appeared that the markets expected a small further increase in reserve pressures. At its meeting, the Committee agreed that a prompt further tightening move was needed to provide greater assurance that inflationary pressures in the economy would remain subdued, and the members chose a tightening action somewhat larger than had been expected by the markets. A rise of $\frac{1}{2}$ percentage point in the discount rate, voted by the Board of Governors, was allowed to show through fully to the federal funds rate. Short-term market rates rose following

the policy move, while long-term yields declined slightly, perhaps as a result of downward revisions to expectations of future tightening.

In advance of the meeting in late September, most market rates increased as incoming economic data were seen in the market as raising the likelihood of higher inflation and the resulting need for tighter reserve conditions. The data suggested that the economy had not yet been greatly affected by the tightening in monetary policy: Employment was growing strongly, and final sales, especially of consumer goods, appeared to have firmed. Manufacturing activity had continued to expand rapidly, boosted in part by an increase in motor vehicle production. Given the uncertain duration of lags between changes in monetary policy and the resulting effects on the economy, however, it was not clear whether the effects of the earlier interest rate increases were smaller than had been expected or were still in train. Another possibility was that the underlying momentum of the expansion was greater than had been evident earlier. Given these uncertainties, the Committee took no immediate tightening action at its September meeting. As in July, however, the Committee agreed to an asymmetric directive suggesting that the likely direction of any move over the intermeeting period was toward additional restraint.

Broad measures of inflation remained moderate through the fall in spite of continued substantial economic growth in an economy that was running close to its estimated potential. Nonetheless, strong economic data and continued upward pressure on prices at earlier stages of production apparently heightened investors' inflation concerns, as well as expectations of future policy tightenings. Consequently, most market interest rates rose appreciably between

the September and November meetings, with the largest increases occurring at intermediate maturities. At the November meeting, the Committee members agreed that the stance of policy was not sufficiently restrained given the clear risks of higher inflation. As a result, they chose a sizable firming of monetary policy, tightening reserve conditions in line with the increase of $\frac{3}{4}$ percentage point in the discount rate approved by the Federal Reserve Board.

The yield curve flattened appreciably in response to the larger-than-expected policy action. The increase in the federal funds rate pushed up most short-term interest rates. Long-term rates increased initially, but in late November and early December these rates more than reversed the earlier increases. Evidently, market participants ultimately interpreted the substantial policy tightening as demonstrating the Committee's intention to take the actions necessary to contain inflation at relatively low levels. By contrast, intermediate-term rates increased over the weeks following the November meeting as a variety of incoming data indicated that the economy's growth had accelerated further in the fourth quarter and additional tightenings might be required to slow growth to a more sustainable pace. By the time of the December meeting, rates on two-year Treasury notes were only a little below those on thirty-year Treasury bonds, although both yields remained well above short-term rates.

Financial markets were focused in early December on the failure of an investment fund run by Orange County, California, and the subsequent bankruptcy of the county itself. The municipal securities market bore the brunt of these developments, with rates rising for a time relative to those on comparable Treasury issues. The failure had a substantial effect on the finances of the

municipalities that had invested in the fund. In addition, investors had to consider the likelihood of other state and local governments having similar investment difficulties. Over the following days and weeks, however, only a few other problem situations emerged, and they were on a much smaller scale.

In the period leading up to the December meeting, incoming data continued to show robust growth and subdued inflation. The Committee felt that the effects on economic activity of the policy actions during the year, and especially the substantial tightening moves in the second half of the year, were not yet visible, owing to the lags in the effects of monetary policy on the economy. As a result, the Committee decided to take no further policy action at the meeting, and to await additional information on the underlying strength in the economy and the effects of the earlier policy actions. This decision was reinforced by concerns that the financial markets might be somewhat unsettled owing both to the usual year-end adjustments and to uncertainty about the effects and incidence of the sizable market losses sustained by some investors over the year. In view of the substantial strength evident in the incoming data, however, the Committee again chose an asymmetric directive pointing toward further restraint.

In advance of the Committee meeting at the end of January, broad measures of inflation remained modest, although anecdotal reports suggested that some firms intended to raise prices early in the new year. Incoming data on production and employment continued to be upbeat, with healthy growth reported in virtually all industries and regions. Some indicators, however, raised the possibility of a slowing in the pace of the expansion. Nonetheless, output growth in the fourth quarter was the fastest of the year,

and the Committee felt that, with output and employment at or even beyond estimates of their sustainable levels, the risks of rising inflation were still considerable. As a result, the Board of Governors voted an increase of $\frac{1}{2}$ percentage point in the discount rate, and the Committee agreed to allow the increase to be fully reflected in the federal funds rate. Because it had been widely anticipated in the financial markets, other interest rates and the foreign exchange value of the dollar were little affected by the policy action. Interest rates turned down subsequently, as additional information on the economy seemed to reinforce the possibility that a slowdown was in process.

At the same meeting, the Committee also formally adopted two practices that had been followed on a provisional basis during 1994. First, the Committee voted to continue to announce any change in the stance of policy on the day the decision is made. These announcements, which had followed each of the policy tightenings agreed to in 1994, are intended to minimize any confusion and uncertainty about the stance of policy. In addition, a public announcement ensures that all financial market participants have the same access to information regarding changes in monetary policy. Second, the Committee agreed to continue releasing the transcripts of Committee meetings with a five-year delay. The published minutes of Committee meetings, which are available soon after the subsequent meeting, provide a relatively complete summary of the arguments presented and the reasons for a policy choice. The transcripts provide additional information, however, that may be of use to those interested in the details of the policy process. The Committee decided that a five-year delay struck an appropriate balance between the right of interested members of the

public to obtain this added detail and the Committee's need to debate policy issues openly and without the sort of restraint that more rapid disclosure might generate.

Credit and Money Flows in 1994

The debt of all nonfinancial sectors grew $5\frac{1}{4}$ percent in 1994, somewhat below the middle of its monitoring range of 4 percent to 8 percent, and about the same increase as that of a year earlier. More rapid growth of private-sector debt was offset by slower growth of public-sector debt. As long-term rates rose well above their late 1993 lows, private-sector borrowing shifted toward shorter-term sources of funds. In part as a result of this shift, financial intermediaries

Growth of Money and Debt

Percent

Measurement period	M1	M2	M3	Domestic non-financial debt
<i>Year</i> ¹				
1980	7.4	8.9	9.6	9.1
1981	5.4	9.3	12.4	9.9
	2.5 ²			
1982	8.8	9.2	9.9	9.6
1983	10.4	12.2	9.9	11.8
1984	5.5	8.1	10.9	14.4
1985	12.0	8.7	7.6	14.1
1986	15.5	9.3	8.9	13.5
1987	6.3	4.3	5.7	10.2
1988	4.3	5.3	6.3	9.0
1989 .....	.6	4.8	3.8	8.0
1990	4.2	4.0	1.7	6.5
1991	7.9	2.9	1.2	4.6
1992	14.3	2.0	.5	4.7
1993	10.5	1.7	1.0	5.2
1994	2.3	1.0	1.4	5.3
<i>Quarter (annual rate)</i> ³				
1994:Q1	5.5	1.8	.6	5.3
Q2	2.6	1.7	1.3	5.6
Q3	2.4	.8	2.0	4.4
Q4	-1.2	-4	1.7	5.5

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

2. Adjusted for shift to NOW accounts in 1981.

3. From average for preceding quarter to average for quarter indicated.

supplied a larger share of new debt than they had for several years. Much of the depository credit growth was funded with nondeposit funds, however, and growth in the broad monetary aggregates, which consist primarily of deposits, remained subdued.

Debt growth both in the federal and in the state and local government sectors slowed last year. Growth of federal government debt was smaller because of the narrowing of the federal budget deficit. The outstanding volume of state and local government debt actually declined as bonds that previously had been refunded in advance of their earliest call date were retired. Much of the bulge in tax-exempt issues in 1993 had been for the advance refunding of higher-cost debt issued in the 1980s. These offerings subsided early in 1994, as the amount of bonds eligible for advance refunding dwindled and borrowing costs rose.

Household debt growth increased modestly in 1994, as an acceleration in consumer credit was partly offset by slower growth in mortgage debt. The pickup in consumer debt reflected, in part, increased demand for consumer durables. In addition, responses to Federal Reserve surveys of banks indicated that many respondents were more willing to extend credit to households last year, which may have led them to ease terms and standards on consumer loans. Indeed, spreads between consumer loan rates and market rates narrowed significantly last year, as increases in loan rates lagged those in market interest rates. Consumer credit may also have been boosted somewhat by the increased use of credit cards offering rebates or other incentives. Rising mortgage rates in 1994 greatly reduced the volume of mortgage refinancings from the very high levels reached in 1993. The refinancings had contributed to an increase

in mortgage debt because some households had taken the opportunity afforded by refinancing to cash out a portion of the equity in their properties. Higher rates on fixed-rate mortgages also induced many borrowers to shift to adjustable-rate mortgages that carried much lower initial rates. Concessional starting rates and the growing use of adjustable-rate contracts with initial fixed-rate periods lasting several years also may have contributed to this shift. Over the last few months of the year about half of all new home mortgages were of the adjustable-rate variety. The shift to adjustable-rate mortgages and the sluggish adjustment of consumer loan rates mitigated the effect of higher market interest rates on household debt-service burdens.

The debt of nonfinancial businesses expanded in 1994 after three years of stagnation. Earlier efforts to restructure balance sheets by increasing equity capital and refinancing higher-cost credit appeared to leave businesses in a better position to increase debt in 1994, as the sector's debt-service burden had fallen about one-third from its peak five years earlier. A decline in equity issuance, perhaps resulting from the lackluster performance of the stock market, may also have boosted business borrowing. Business financing needs were strengthened by increased spending on capital and inventories, as well as merger and acquisition activity. The total value of mergers and acquisitions increased substantially last year, and the share of such activity requiring cash payments to shareholders—rather than swaps of shares—rose sharply, although it remained below the levels reached in the late 1980s.

Rising and more volatile long-term interest rates encouraged businesses to rely more heavily on short-term debt in 1994. This shift was reinforced by

changes in supply conditions in various markets. Capital losses early in the year likely caused some of those supplying long-term funds to become more cautious; for example, some savers backed away from bond mutual funds. At the same time, banks were loosening terms on business loans as well as easing their underwriting standards. Banks attributed the easing of loan terms and standards to increased competition for business customers from other banks and also from nonbank lenders. The competitive posture of banks likely reflected, in part, the high level of profits earned by banks in recent years and the resultant strengthening of their balance sheets. As a result of these factors, bank business loans increased more than 9 percent, their first annual increase in several years. Other sources of short-term business finance, including commercial paper and finance company loans, also expanded over the year.

The effect of the pickup in business and consumer loans on bank credit growth was partially offset by slower growth in bank securities holdings. Early in the year, banks purchased a significant volume of government securities, and reported levels of other securities holdings were boosted by an accounting change.⁵ Much of this growth was reversed later in the year, however, as banks used sales of securities to fund loan growth. Reported securities growth was also damped by declining securities prices.⁶

5. New Financial Accounting Standards Board rules, effective at the start of the year, limited the ability of banks to net off-balance-sheet items for reporting purposes. The new rules affected items such as swaps and options, the cash values of which are reported on balance sheets in the other securities category.

6. A Financial Accounting Standards Board rule implemented at the start of the year required each bank to divide its investment account securi-

In 1994, thrift sector credit expanded for the first time in several years, as the Resolution Trust Corporation virtually completed its liquidation of insolvent thrift institutions. In part, the increase in thrift sector credit also likely reflected the shift by households toward adjustable-rate mortgages. Thrift institutions and banks find holding adjustable-rate mortgages less risky than holding fixed-rate mortgages, and so adjustable-rate loans are less likely to be securitized and sold.

With bank credit growth picking up and thrift sector credit rising, growth of depository credit in 1994 nearly matched that of total nonfinancial debt. Thus, the share of credit provided by these intermediaries stabilized last year after having declined substantially since 1988. Despite the growth in depository credit, the broad monetary aggregates continued to expand sluggishly. Domestic banks funded much of their credit expansion from non-deposit sources, such as borrowings from their foreign offices, that are not included in the monetary aggregates. Funds from these sources are not subject to deposit insurance premiums, which may help account for their recent rise. The broadest monetary aggregate, M3, did pick up a bit as banks turned, in part, to large time deposits to fund asset growth. M3 expanded about 1½ percent, well above the lower bound of its 0 percent to 4 percent annual range and a somewhat larger increase than that in 1993. Growth in large time deposits topped 7 percent for the year, marking the first annual increase in this component since 1989. Much of the increase in large time deposits was in senior bank notes, which

ties into those that it intended to hold to maturity, which could be reported at book value, and those that were available for sale, which had to be marked to market.

are not subject to deposit insurance premiums.

M2 grew 1 percent in 1994—the lower bound of its annual range. The slow growth reflected, in part, relatively sluggish upward adjustment of retail deposit rates. Rates on savings accounts and other checkable deposits (OCDs), including NOW accounts, responded about as slowly as they have in the past to the increase in market rates, while the response of rates on small time deposits was sluggish relative to historical norms. Evidently, banks believed that generating increased retail deposits would be more expensive than raising wholesale funds given that higher retail rates would have to be paid on existing liquid deposits and on time deposits as they were rolled over, as well as on any new deposits. Increasing retail deposits would also require higher advertising, administrative, and deposit insurance costs.

In contrast to the previous several years, M2 behavior in 1994 was roughly consistent with its long-run historical relation with movements in nominal income and opportunity costs as traditionally defined—that is, the difference between rates on short-term instruments (for example, Treasury bills) and those

offered on retail balances. This consistency suggests that, unlike the past few years, the slow growth in M2 last year was not the result of portfolio shifts toward bond and equity mutual funds. Indeed, the growth in M2 plus long-term mutual funds ran slightly below the 1 percent pace of M2 growth. Net sales of equity mutual funds continued at a high level in 1994, although the pace of sales slowed somewhat late in the year. Equity fund sales were partly offset, however, by outflows from bond mutual funds in the last three quarters of the year. Apparently, falling bond prices and greater market uncertainty, and, perhaps, reports of derivatives losses at some funds, led households to scale back their holdings of bond mutual funds in favor of investments that posed less risk of capital loss. With deposit rates lagging, however, these outflows did not translate into faster M2 growth. Some of the withdrawals from bond funds may have been invested directly in Treasury securities. Reflecting such portfolio shifts, net noncompetitive tenders for Treasury bills, which had been negative in 1993, totaled more than \$16 billion last year, and net noncompetitive tenders for Treasury notes also increased substantially.⁷

Consistent with its historical behavior, M1 growth slowed sharply last year in response to widening differentials between market interest rates and those offered on transaction deposits. M1 expanded only 2¼ percent—down substantially from the double-digit

Monthly Average Net Sales of Shares
in Long-Term Mutual Funds

Millions of dollars

Measurement period	Total	Equity funds	Bond funds
<i>Year</i>			
1991	10,820	3,821	7,000
1992	16,844	7,268	9,576
1993	23,445	11,832	11,634
1994	9,674	11,073	-1,399
<i>Quarter</i>			
1994:Q1	17,438	13,744	3,694
Q2	10,128	10,935	-808
Q3	9,826	11,166	-1,340
Q4	1,306	8,447	-7,141

NOTE. Gross sales of shares less redemptions.

SOURCE. Investment Company Institute.

7. The Treasury permits noncompetitive bids at its auctions to make it easier for smaller, less sophisticated bidders to participate. Those submitting noncompetitive tenders are assured of receiving the security, and the yield on the security they obtain is the average issue rate established at the auction. The level of net noncompetitive tenders during a period is the dollar volume of securities purchased under noncompetitive tenders less the volume of repayments of maturing securities that had been purchased under noncompetitive tenders.

increases recorded the previous two years. Following the typical pattern, demand deposits and OCDs were especially responsive to the rise in short-term interest rates. On balance, demand deposits edged up only $\frac{1}{2}$ percent, compared with growth of $1\frac{3}{4}$ percent in 1993, as higher market rates encouraged deposit holders to economize on these non-interest-earning assets. In addition, the turnaround reflected the decline in home mortgage refinancing activity last year: Demand deposits had been boosted in 1993 because prepayments of securitized mortgages were held primarily in such deposits for a time before they were distributed. The rates offered on OCD accounts adjusted slowly to higher market rates last year, encouraging households to shift funds into higher-yielding assets. OCD growth also was depressed by the introduction of sweep account programs at some large banks. In these programs, the portion of customers' OCD balances in excess of a predetermined level are swept into money market deposit accounts at the end of each day.

In contrast to transaction deposits, the currency component of M1 continued to register strong growth last year. Currency increased $10\frac{1}{4}$ percent, the same rise as 1993 and close to the record increase in 1990. As has been the case since 1990, much of the currency growth appeared to reflect rapid expansion in U.S. currency circulating abroad. Informal reports suggest that foreign demand was particularly strong in 1994 in Russia and the other former Soviet republics.

Foreign Exchange Developments

The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined nearly $6\frac{1}{2}$ percent on balance from December 1993

to December 1994. After displaying some strength at the start of 1994, the weighted-average foreign exchange value of the dollar fell about 10 percent from February through early November. Although U.S. growth continued to be stronger than expected, market perceptions about the strength of economic activity in the other industrial countries were also revised sharply higher as the year progressed. These changed perceptions led market participants to raise their expectations of market interest rates abroad, which, together with increased concerns over potential inflation pressures in the U.S. economy, put downward pressure on the dollar against most foreign currencies. The dollar rebounded somewhat at the end of the year as the greater-than-expected tightening action by the Federal Reserve in November reassured market participants that U.S. inflation risks were being addressed. In early 1995, however, with U.S. growth appearing to moderate and the turmoil in Mexican financial markets raising concerns about possible implications for the United States, the dollar declined on balance, nearly reaching its fall 1994 low.

Long-term interest rates in major foreign industrial countries generally rose during the year. On average, yields on foreign government issues with maturities of ten years increased 200 basis points in the twelve months to December, about the same as in the United States. In Japan, where the evidence for a buoyant recovery remained somewhat mixed, long-term rates rose less. In contrast to long-term rates, foreign short-term rates were little changed on average and even declined slightly in several countries, including France and Germany. Major exceptions were Canada, where short-term market rates rose about 300 basis points, and the United

Kingdom, where they rose 100 basis points. In both countries, official lending rates were increased during the year to contain inflation risks in the face of vigorous economic growth. During the first few weeks of this year, foreign long-term rates on average rose slightly further, but they have since retraced most of that rise.

During 1994 the dollar depreciated 8 percent in terms of the mark and declined by similar amounts in terms of the other currencies in the exchange rate mechanism (ERM) of the European Monetary System. The German economy expanded over the year, and the growth of the targeted monetary aggregate, M3, remained above target until the very end of the year. Market participants trimmed their expectations of further declines in official Bundesbank lending rates, and German long-term interest rates rose. The dollar depreciated by lesser amounts in terms of sterling and the lira, both of which had been withdrawn from the ERM in 1992. The persistent strength of the U.K. recovery raised concerns of renewed inflation pressures there, and the political uncertainties in Italy and, to a lesser extent, in the United Kingdom held back market enthusiasm for the two currencies.

The dollar also depreciated about 8 percent in terms of the yen during the year. At times, the dollar-yen rate fluctuated in response to developments in U.S.-Japanese trade talks. The dollar reached a historic low of 96.11 yen in November and was very weak against the German mark as well, and the Federal Reserve joined the U.S. Treasury in intervention purchases of dollars against yen and marks at that time. Subsequently, the dollar rebounded somewhat in terms of the yen and European currencies. In early 1995 the dollar weakened further, especially against the mark, in part because that currency

attracted funds from markets upset by the peso crisis.

In contrast to its experience in terms of the ERM currencies and the yen, the dollar appreciated in terms of the Canadian dollar nearly 4½ percent during 1994. The relative weakness of the Canadian currency appeared to reflect pressures arising from the increases in U.S. short-term rates, concerns over the large fiscal deficits of the central government and the provinces, and, at times, perceived risks associated with possible secession by Quebec. In the first few weeks of 1995, the Canadian dollar weakened further, as markets apparently became more concerned about the large outstanding Canadian federal and provincial debt and the persistent federal government deficit. As a result, market interest rates have risen further, and the Bank of Canada has moved up overnight rates several times, including an increase to match the upward shift in the U.S. federal funds rate following the most recent FOMC meeting. In response, the Canadian dollar strengthened but, more recently, has given up some of these gains.

The dollar depreciated nearly 5 percent in 1994 against the currencies of major U.S. trading partners in Latin America and East Asia when adjusted for relative changes in consumer prices. The dollar appreciated sharply against the Mexican peso, however, first in March and more significantly during the final two weeks of the year and in early 1995.

In response to continuing downward pressures on the peso and sizable losses of international reserves over the course of 1994, the Bank of Mexico announced on December 20 a 13 percent change in the lower bound of the range that it unilaterally had set for the peso-dollar exchange rate. The peso immediately fell to the new lower limit, from about

3.5 to 4 pesos per dollar, and reserve losses continued. As a consequence, the Bank of Mexico on December 22 permitted the peso to float and activated the North American Swap Facility, which provides up to \$6 billion of short-term funds to the Bank of Mexico, evenly split between the Federal Reserve and the Treasury, and an additional C\$1 billion from the Bank of Canada.

During the following days the peso remained volatile on exchange markets, fluctuating in a range between 5 and nearly 6 pesos to the dollar. On January 2 a package was announced totaling \$18 billion in international financial support for Mexico, including an increase from \$6 billion to \$9 billion in the swap facilities extended by the United States (again split between the Federal Reserve and the Treasury), an additional C\$500 million in the swap facility of the Bank of Canada, \$5 billion in credit supported by other central banks acting through the Bank for International Settlements (BIS), and \$3 billion in credit from commercial banks. On January 6 the IMF began talks with Mexico on a standby arrangement in support of Mexico's economic reform program, and on January 12, against the background of increased turbulence in international capital markets, the Clinton Administration, with the support of the bipartisan leadership of the Congress, announced a proposal to provide \$40 billion in guarantees on securities to be issued by Mexico in an effort to restore investor confidence.

Subsequently, the peso weakened further as support within the Congress for the guarantee proposal appeared to decline. The Mexican stock market also continued to slide, and short-term peso interest rates rose sharply. In late January the peso reached a new low of 6.55 pesos to the dollar amid signs that problems in Mexico were having effects

on financial markets in other countries. In particular, equity markets in Argentina and Brazil had declined in volatile trading. More generally, investors appeared to be retreating from investments in a variety of emerging market economies, some of which have substantial current account deficits, while others maintain fixed exchange rates that pose the risk of becoming overvalued. On January 31 the Administration withdrew the request for approval of the guarantee program and, with the support of the bipartisan leadership of the Congress, announced a new plan to provide \$20 billion to support financial stabilization in Mexico using the resources of the Exchange Stabilization Fund (ESF) and, in the short run, the Federal Reserve. On February 1 the Federal Reserve's swap line with the Bank of Mexico was increased further, to \$6 billion, as part of this package. The package will consist of short-term swaps, which will be provided by the Federal Reserve and the ESF, and swaps with maturities of three to five years and securities guarantees with maturities of five to ten years provided by the ESF. Repayment will be assured from the proceeds of exports of Mexican oil. Additional multilateral support for Mexico included an increase from \$7.8 billion to \$17.8 billion in the funds provided by the International Monetary Fund under a standby arrangement that was approved on February 1 and an increase from \$5 billion to \$10 billion in the short-term credit supported by the central banks of a number of major industrial countries acting through the BIS.

The peso rebounded during the week following the announcement of the January 31 program and, on net, has since held most of that gain in volatile trading. Through mid-February, the dollar on balance has appreciated substantially against the peso since

December 19, the day before the peso's devaluation.

Report on July 19, 1995

Monetary Policy and the Economic Outlook for 1995 and 1996

During 1994, spending by U.S. households and businesses grew at an exceptionally rapid pace, and by the end of the year, demands clearly were taxing the productive capacity of the economy. Pressures on resources were particularly intense in sectors of manufacturing that provide inputs for other producers, and sharp increases in the prices of materials and supplies signaled what could have been the first stage of a broader inflationary process. A weakening of the dollar on foreign exchange markets as 1995 began heightened that risk. To damp these inflationary pressures and foster a sustainable economic expansion, the Federal Open Market Committee in February tightened policy somewhat, extending the series of actions undertaken during 1994, and the Board of Governors approved a $\frac{1}{2}$ percentage point increase in the discount rate.

The economy's growth began to moderate in the first quarter of 1995. Among the factors contributing to the slowing were the lagged effects of 1994's increases in interest rates on housing and other rate-sensitive sectors and the impact on U.S. exports of the sharp contraction in Mexico's economy and fall in the foreign exchange value of the peso. As final sales moderated, businesses scaled back their desired inventory accumulation. In some key sectors, the slackening in sales was greater than anticipated, leaving firms with excess inventories. As businesses took steps to trim stocks, aggregate production decel-

erated further in the second quarter and was probably about flat, as measured by real gross domestic product. The inventory adjustment was especially large in the motor vehicle sector, which accounted for much of the downswing in manufacturing activity in the spring. Homebuilding also showed marked weakness, in part because builders hesitated to start new projects until they could work down stocks of unsold new homes.

While output growth was stalling in the first half of this year, the still-high level of resource utilization of the economy, as well as the effects of rapid increases in materials prices, contributed to a pickup in inflation from its 1994 pace. Nonetheless, by July it appeared likely that pressures on resources and hence on prices were in the process of easing. Materials prices were showing signs of softening, and a period of greater stability in the exchange value of the dollar suggested that the rise of import prices might soon slow. With the threat of future inflation thus reduced, the FOMC elected to ease the stance of policy slightly at its meeting in July.

The moderation in economic growth and improvement in inflation prospects over the first half of 1995 sparked a considerable decline in market interest rates. The greater likelihood of significant progress toward a balanced federal budget also seemed to contribute to the decrease in longer-term interest rates. Intermediate- and long-term yields have fallen $1\frac{1}{4}$ to $1\frac{3}{4}$ percentage points since year-end 1994, with the decline in thirty-year fixed mortgage rates this year reversing most of the increases registered since early 1994. Lower interest rates, solid earnings growth, and prospects for sustained economic expansion helped push most broad stock price indexes to record highs.

The drop in longer-term interest rates in the United States contributed to downward pressure on the foreign exchange value of the dollar in 1995. In terms of the currencies of the other G-10 countries, the dollar has declined 7½ percent on balance. Over the past half-year, foreign long-term interest rates have fallen significantly as growth prospects abroad have weakened, but by less than U.S. long-term interest rates. In addition, the Mexican crisis was seen by market participants as having adverse implications for U.S. growth, especially exports, and it contributed to the dollar's decline in terms of currencies other than the peso in early 1995. With the dollar at times under greater downward pressure than seemed justified by fundamentals, the Federal Reserve, acting on behalf of the Treasury and for its own account, joined other central banks in concerted intervention in support of the currency on several occasions in 1995. In recent weeks, the dollar has fluctuated in a range somewhat above the lows reached in the spring.

Despite the slower expansion of nominal spending this year, net borrowing by households and businesses remained substantial. In fact, total private credit flows strengthened, offsetting slower growth of federal debt and an outright decline in state and local government debt; as a result, total domestic nonfinancial debt expanded at a 5½ percent pace from the fourth quarter of 1994 through May, a little faster than in 1994. Credit supply conditions remained quite favorable, with banks continuing to ease terms and conditions of lending and with risk spreads in securities markets persisting at quite low levels. Household borrowing this year has been a bit more subdued than in 1994 but still appreciable. Nonfinancial businesses have stepped up their borrowing consid-

erably, a move reflecting a widening gap between capital expenditures (including inventory investment) and internally generated funds, and also reflecting the balance sheet restructuring associated with stock repurchases and a surge in merger and acquisition activity. Although the decline in long-term interest rates this year has spurred a significant pickup in bond issuance and fixed rate mortgage borrowing very recently, the increase in credit this year has been concentrated in short-term or floating-rate debt.

Depository institutions, as traditional providers of short-term and floating-rate credit, have enjoyed a sharp increase in loan demand. To fund the growth of their loan portfolios, banks and thrift institutions pulled in more deposits, providing a lift to growth of the broad monetary aggregates. Indeed, M3 expanded at a 6¼ percent pace from the fourth quarter through June, slightly exceeding the upper bound of its revised annual range. In their usual fashion, yields on small time deposits and money market mutual funds have adjusted with a lag to the declines in market interest rates this year. Investors have responded by shifting their portfolios toward these assets, boosting M2 growth from the fourth quarter through June to 3¼ percent at an annual rate. M2 velocity over the first half of 1995 is estimated to have held about steady, in marked contrast to the rise in M2 velocity over the previous five years.

Unlike the broad monetary aggregates, M1 has grown quite sluggishly this year. Low interest returns on transaction deposits have encouraged households and businesses to move excess balances into higher-yielding M2 assets and also into market instruments. This process has been amplified by the expansion of retail sweep accounts offered by a few banks that allow

customers to hold a lower average level of transaction balances. Currency growth—although slower than the double-digit pace of the last two years—has remained strong, boosted again by heavy foreign demands.

Money and Debt Ranges for 1995 and 1996

In setting ranges for money and debt in 1995 and 1996, the Committee noted that the velocities of the monetary aggregates have been behaving more in line with historical patterns than was the case earlier in the decade. However, financial innovation, technological change, and deregulation have blurred distinctions among various financial instruments that can serve as savings vehicles and sources of credit. As a consequence, considerable uncertainty remains about the future relationships of money and debt to the fundamental objectives of monetary policy; the Committee will thus continue to rely primarily on a wide range of other information in determining the stance of policy.

The Committee retained its current range of 1 to 5 percent for M2 for 1995 and chose the same range for 1996. If M2 velocity continues on a more normal

track, growth of M2 in the upper half of this range in 1995 and near the upper bound of the provisional range in 1996 would be consistent with the Committee's expectations for nominal income growth. The existing range was retained for next year in view of the lingering uncertainties about the money-income relationship and to serve as a benchmark for the rate of growth of M2 that would be expected under conditions of reasonable price stability and historical velocity behavior. The Committee also reaffirmed the 3-to-7 percent range for the debt aggregate and carried this range forward on a provisional basis for 1996, concluding that debt growth within this range would be expected to accompany the moderate economic expansion it was seeking to foster.

With regard to M3, the Committee had noted in its February 1995 report to the Congress that the depressed growth of this aggregate in recent years reflected the balance sheet adjustments of banks and thrift institutions in response to the extraordinary strains they experienced in the early 1990s. The Committee observed that, as these institutions returned to health and intermediation resumed more normal patterns, M3 growth could pick up appreciably and the velocity of M3 might begin to stabilize or even decline, as it had on average over several decades before 1990. In the event, M3 has strengthened considerably so far in 1995, apparently for the reasons noted by the Committee in February. As a consequence, the Committee made a technical adjustment in its M3 range at the July meeting—to 2 to 6 percent for 1995—and carried that range forward on a provisional basis into 1996. The Committee stressed that this change simply recognized the return of historical financing patterns and bore no implications for the underlying thrust of monetary policy.

Ranges for Growth of Monetary and Debt Aggregates

Percent

Aggregate	1994	1995	Provisional for 1996
M2	1-5	1-5	1-5
M3	0-4	2-6 ¹	2-6
Debt	4-8	3-7	3-7

NOTE. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated. Figures for debt of the domestic nonfinancial sector are monitoring ranges.

1. As revised at the July 1995 FOMC meeting.

Economic Projections for 1995 and 1996

The members of the Board of Governors and the Reserve Bank presidents, all of whom participate in the deliberations of the Federal Open Market Committee, generally anticipate that, after a weak second quarter, the economy will experience moderate growth in the second half of 1995 and in 1996. For all of 1995, this would produce growth that was somewhat below forecasts made for the February meeting. In line with these expectations, the unemployment rate in the second half of 1995 may move up somewhat from its recent relatively low level.

A number of factors should contribute to a pickup in demand and production over coming months. Lower interest rates, in particular, likely will directly stimulate spending on housing, motor vehicles and consumer durables, and business investment. Moreover,

increases in the value of bond and stock portfolios that have accompanied the decline in interest rates should strengthen aggregate demand more generally. The strong competitive position of the United States likely will bolster net export growth on balance over the remainder of 1995. To be sure, the level of U.S. exports to Mexico probably will remain depressed for some time, but Mexico's external adjustment has already been substantial and further declines in U.S. export demands from this source are likely to be less severe than in the first half of 1995. Finally, the anticipated pickup in spending will help businesses work off excess inventories more rapidly and reduce the need for further production cutbacks to bring inventories back in line with final sales.

The Board members and the Reserve Bank presidents generally expect the rise in the consumer price index over the four quarters of 1995 to end up at

Economic Projections for 1995 and 1996

Percent

Measure	Federal Reserve governors and Reserve Bank presidents		Administration
	Range	Central tendency	
	1995		
<i>Change, fourth quarter to fourth quarter</i> ¹			
Nominal GDP	3¼–5¼	4¼–4¾	5.4
Real GDP	1¾–3	1½–2	2.4
Consumer price index ²	3–3½	3⅛–3¾	3.2
<i>Average level, fourth quarter</i>			
Unemployment rate ³	5½–6¼	5¾–6½	5.5–5.8
	1996		
<i>Change, fourth quarter to fourth quarter</i> ¹			
Nominal GDP	4¾–5½	4¾–5¾	5.5
Real GDP	2½–3	2¼–2¾	2.5
Consumer price index ²	2½–3½	2⅞–3¼	3.2
<i>Average level, fourth quarter</i>			
Unemployment rate ³	5½–6¼	5¾–6½	5.5–5.8

1. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated.

2. All urban consumers.

3. Civilian labor force. Figures for the Administration are annual averages.

around 3¼ percent, the same as in the first half of the year. For 1996, inflation is projected to edge down, to the neighborhood of 3 percent. The first-half slowdown in the industrial sector has reduced pressure on materials prices; moreover, wage trends have been stable, suggesting that labor costs are unlikely to provide an impetus to inflation.

The Administration has not released an update of the economic projections contained in the February *Economic Report of the President*. Those earlier forecasts pointed to real GDP growth of 2.4 percent for 1995, well within the central tendency range in the Federal Reserve's February report. Given the slow start this year, that growth pace for the year appears less likely, and the average unemployment rate for the year probably will be around the upper end of the 5.5 to 5.8 percent range in the Administration's February report. The Administration's 3.2 percent CPI forecast is in line with the Federal Reserve's central tendency.

The inflation rates anticipated by the FOMC are marginally above those prevailing in 1993 and 1994 but are considerably below rates of only a few years ago—and lower than many observers seemed to anticipate for the current economic expansion only a few months ago. Nonetheless, they should be regarded as only a milepost along the path toward the long-term goal of price stability. The Federal Reserve recognizes that eliminating the economic distortions associated with inflation is the most important long-run contribution it can make to the economic growth and welfare of the nation.

The Performance of the Economy

At the end of 1994, resource utilization in the U.S. economy was high: Manufacturing capacity utilization equaled its

1989 peak, and the unemployment rate was close to the low point of the late 1980s. Moreover, economic expansion was still brisk, with real gross domestic product growing at a 5 percent annual rate in the fourth quarter. Although inflation for 1994 as a whole remained moderate, commodity prices, which can signal the onset of inflationary pressures, were rising rapidly at the end of last year.

A deceleration in activity was widely anticipated, and growth in real GDP did moderate to a 2¾ percent annual pace in the first quarter of 1995. But the slowing did not stop there: Spending in several sectors of the economy softened in the spring, industrial production fell, and employment grew relatively little. The level of real GDP appears to have been essentially flat in the second quarter.

A slackening in household demand for big-ticket items was a significant element in the drop-off in economic growth in the first half. After registering sizable gains last year, spending on consumer durables weakened considerably early this year. And residential construction, which continued to grow in the face of rising mortgage rates last year, began to fall this winter and was off sharply in the second quarter. These domestic drags were reinforced by the effects of the plunge in net exports to Mexico, which came in the wake of that nation's financial crisis.

With domestic sales and exports softening, businesses cut orders and production. However, in some cases, the adjustments were not quick enough to avoid an unwanted accumulation of inventories—especially for cars and light trucks, but for some other goods as well. Efforts to trim stocks reinforced the contractionary forces in the manufacturing sector of the economy.

Despite the falloff in growth in the first half, the unemployment rate edged

up only slightly, and although manufacturing capacity utilization fell considerably, it remained above historical averages. Under the circumstances, it is not surprising that the mounting inflationary pressures of the latter part of 1994 carried over into the first part of this year and that materials prices surged further. Rising import prices, related to the depreciation of the dollar, also contributed to domestic inflation. Reflecting these and other factors, the consumer price index increased at a $3\frac{1}{4}$ percent annual rate in the first half of this year, up from a $2\frac{3}{4}$ percent increase for 1994 as a whole.

Nonetheless, increases in hourly wages and benefits remained moderate, holding down unit labor costs. Furthermore, the drop in manufacturing activity in the first half of the year contributed to a flattening in industrial commodity prices, suggesting some lessening of inflationary pressures "in the pipeline." These favorable factors were reflected in some moderation of price increases toward midyear.

The Household Sector

After advancing at more than a 4 percent annual rate in the second half of 1994, growth in consumer spending slowed appreciably on average in the first half of this year. Real personal consumption expenditures increased at just a $1\frac{1}{2}$ percent annual rate in the first quarter, before picking up moderately in the second.

Outlays for consumer durables moved up sharply in 1994, and by the end of the year, the level of spending was high relative to income. Many households may have brought their stocks of durables up to desired levels, limiting further purchases this year. In addition, by early this year, the stimulus to consumer spending from the massive mort-

gage refinancing wave of 1993 and early 1994 likely had been exhausted. The downturn in interest rates this year has led to a comparatively modest rebound in refinancings recently, which may free up some income for additional spending in coming months.

The slackening in consumer demand in the first quarter was concentrated in motor vehicles, where sales fell off after surging in the fourth quarter of 1994. However, real spending on goods other than motor vehicles also grew less rapidly in the first quarter than in the second half of 1994. Some of the deceleration in other consumer durables may have reflected the weakness in home sales because families often purchase new furnishings and appliances when they change houses. Among nondurable goods, outlays for apparel were especially weak, following rapid growth in spending in the second half of 1994.

The slowing of consumer spending growth so far this year has been about in line with the slowing in income growth. Through the first quarter, wage and salary income posted solid gains, bolstered by a healthy pace of hiring. But increases in wage and salary income faded in the spring, reflecting slow growth in employment and a drop in the workweek. The deceleration in labor income was only partially offset by rapid growth in interest and dividend income in the first half of 1995. Dividend income benefited from the improvement in corporate profits. Growth in interest income was strong in the first quarter, reflecting the lagged effects of increases in market interest rates in 1994, but began to flag in the second quarter as the decline in market interest rates this year showed through to interest earnings.

Surveys suggest that consumer confidence remained high through the first half of 1995. Movements in both of the major surveys—from the Michigan Sur-

vey Research Center and the Conference Board—were similar in the first half of 1995: Both spent part of the first half above their 1994 average values, but by June, both had moved back down to their 1994 averages.

Early this year, residential construction activity weakened significantly, and single-family housing starts in the first quarter were 14 percent (not an annual rate) below their fourth-quarter average. Sales of new and existing homes also fell in the first quarter, although not quite so steeply. Single-family starts edged up in April but more than reversed this gain in May; however, building permits, a more reliable indicator, moved up in May. New home sales jumped 20 percent in May, to the highest level since late 1993. Although reported new home sales are volatile, and the initial readings are often revised substantially, other indicators of housing activity also point in a favorable direction: Applications for mortgages to purchase homes rose sharply in May and remained elevated in June, and attitudes of households and builders toward the housing market became more positive in the second quarter.

Like single-family homebuilding, multifamily construction fell early this year, with starts off 11 percent in the first quarter. The drop this year follows a two-year period of recovery, during which starts doubled from their thirty-five-year low reached at the beginning of 1993. Multifamily starts turned back up in April and May. Prospects for a continued gradual increase in multifamily starts appear good, as newly built apartments were quickly filled last year and vacancy rates for apartments continued to move down in the first quarter of this year. However, continuing overhangs of empty apartments in some markets are likely to keep total multifamily starts well below the levels of the 1980s.

The Business Sector

In the second half of 1994, nonfarm inventories increased nearly 5 percent at an annual rate, about keeping pace with growth in final sales, as firms built stocks to ensure adequate supplies—or, in some instances, to beat anticipated price increases. In the first quarter, inventory growth continued at about its late 1994 pace, but growth in final sales moved down to a 2½ percent annual rate, leaving many firms with stocks they did not want.

The first-quarter inventory run-up was disproportionately in motor vehicles, as production increased while sales were falling. To bring inventories back in line, manufacturers cut production sharply; between February and May, output dropped 10 percent. The decline in output of motor vehicles, parts, and related inputs was the most important factor in the 1 percent drop in overall industrial production in this period. Motor vehicle inventories accumulated further in April when sales fell sharply, but there was some progress in trimming excess stocks in May and June. Nonetheless, much of the overhang of vehicles that developed earlier this year remains.

The inventory buildup outside the motor-vehicle sector was also quite large in the first quarter, and it continued at a rapid pace in April. The available data for May suggest a somewhat smaller rate of increase. Although stocks of most goods remained in better alignment with sales than in the motor-vehicle sector, inventory accumulation has been running ahead of sales in a few sectors, particularly in apparel, furniture, and appliances. In response, manufacturers have cut production in these areas. The accumulation of furniture and appliances is likely related to the drop-off in home sales in early 1995, and the revival in home sales that appears

to be under way should boost sales in these areas, helping to trim inventories further.

Business fixed investment rose at an extraordinary pace in the first quarter, with strong gains in both the equipment and structures components. Real spending on equipment increased at a 25 percent annual rate. With the exception of motor vehicles, the growth in equipment spending was widespread in the first quarter. For structures, real outlays increased at a 12 percent annual rate in the first quarter, following a 4½ percent gain over the four quarters of 1994. The first-quarter increase in construction was also widespread across components.

Indicators for the second quarter suggest that growth in capital spending continued to be brisk although not quite as fast as in the first quarter. Shipments of capital goods by domestic manufacturers in April and May were up moderately from their first-quarter average. And permits for nonresidential structures, which tend to lead construction by a few months, indicate that construction should continue to trend upward although at a slower pace than in the early part of this year.

The surge in capital spending in recent years has pushed growth of the capital stock to its fastest pace since the late 1970s. This improvement in the rate of capital accumulation may lead to a pickup in productivity growth, but there is as yet little indication of a significant break with past trends. Indeed, when output is measured using the new chain-type alternative index—which will become the official measure later this year—trends in productivity growth in the nonfarm business sector in the 1990s are little changed from those of the 1970s and 1980s.

Corporate operating profits increased at a 7 percent annual rate in the first quarter, a somewhat faster pace than in the second half of 1994. However, first-quarter profits were boosted by an increase in earnings of U.S. corporations on foreign operations; profits on private domestic operations were about unchanged. The increase in profits on foreign operations resulted in part from the decline in the exchange value of the dollar, which pushed up the value of profits earned abroad. Private domestic financial profits improved in the first quarter, in part because of a surge in bank earnings, which were boosted by strong loan growth. First-quarter earnings on domestic operations of U.S. non-financial corporations declined slightly, following solid gains in 1994. Profits were 10.6 percent of the output of non-financial corporate businesses in the first quarter, about the same as in 1994 as a whole, when the profit share was the highest since the late 1970s.

In the farm sector, indications are that production will fall well short of last year's exceptionally high levels. Weather conditions have been less favorable than those of 1994, with unusually heavy rains keeping plantings behind schedule across large parts of the Midwest. Also, with stocks relatively high after last year's large harvests, the U.S. Department of Agriculture reduced the amount of acreage that farmers contracting for subsidy payments were allowed to plant. However, livestock production has remained strong so far in 1995, which will help cushion the effects of smaller harvests on total agricultural production. Because of the likelihood that production will fall this year, farm inventory investment will probably be smaller this year than in 1994, and stocks of some crops will likely be drawn down appreciably.

The Government Sector

The federal government deficit has continued to shrink in the current fiscal year. For the first eight months of the 1995 fiscal year, the budget deficit was 19 percent below the same period a year earlier. Nominal expenditures over this period were 4 percent higher than a year earlier, while receipts were up 8½ percent. In addition to the strong economic growth of 1994, receipts were boosted by changes in rules that allowed some individuals to defer until 1995 certain tax payments that would have been due in 1994 under previous rules.

Higher interest outlays contributed to the increase in federal spending in the first part of the 1995 fiscal year. Excluding interest outlays, nominal federal spending in the first eight months of this fiscal year increased about 2 percent, compared with the year-earlier period. Defense expenditures continued to decline in nominal terms; they have been the main factor holding down federal spending in recent years. Spending on income security programs, such as unemployment insurance and welfare benefits, also edged down, mostly reflecting the economic expansion. Spending on Medicare and other health programs was up 9 percent in the first eight months of the fiscal year; while still quite rapid, this growth is slower than that of the early 1990s, when these expenditures were rising 10 to 20 percent per year. Spending on social security and on other nondefense functions increased less than the recent trend in nominal GDP.

In real terms, federal purchases of goods and services—the part of federal spending included in gross domestic product—fell at an annual rate of 4 percent in the first quarter of 1995. Falling defense spending more than accounted

for the decline. As of the first quarter, the level of real federal purchases was 17 percent below the peak reached four years ago.

State and local government deficits on combined capital and operating accounts (that is, excluding social insurance funds) totaled \$37 billion in the first quarter of 1995, a small improvement from the deficit a year earlier. Excluding social insurance, tax receipts increased 7 percent between the first quarter of 1994 and the first quarter of 1995, while expenditures were up 6¼ percent. Transfer payments continue to grow faster than other spending, although the rate of increase is well below that earlier in the 1990s.

Real purchases of goods and services by state and local governments have been rising only moderately for some time; in the first quarter of 1995, they were little changed. The slowing in the first quarter was concentrated in construction spending, which fell after three quarters of solid increases. Purchases of other goods and services remained on the gradual uptrend that has been evident over the past few years. State and local employment increased about 14,000 per month, on average, over the first six months of 1995, considerably below the pace of the 1992–94 period.

The small improvement in the budget situation for the state and local sector as a whole masks important differences across levels of government. Available evidence suggests that while state budgets are in relatively good shape, budgets at the local level remain under pressure. State aid to localities, particularly to school districts, has been eroding relative to expenses for several years. Also, local governments rely more heavily than state governments on property taxes, and while sales and incomes have rebounded in the current business

cycle expansion, property values have lagged behind, limiting property tax receipts.

The External Sector

The nominal trade deficit on goods and services widened somewhat in the first quarter, to \$120 billion at an annual rate. However, net investment income improved in the first quarter, as did net transfers, and as a consequence, there was a narrowing of the current account deficit in the first quarter from its fourth-quarter level, to \$162 billion at an annual rate. Nonetheless, the first-quarter current account deficit exceeded the 1994 average of \$151 billion. In April, the trade deficit increased further from the first-quarter average.

The quantity of U.S. imports of goods and services expanded 10 percent at an annual rate during the first quarter, somewhat less rapidly than in 1994. The slower pace of U.S. income growth contributed to the lower import growth; increased imports from Mexico were a partial offset. In April, real imports continued to grow at about the first-quarter pace. The increases in imports in the first four months of the year were widespread across major trade categories.

Non-oil import prices rose at a 3½ percent annual rate in the first quarter, somewhat less than during the second half of 1994, when they were pushed up by large increases in world commodity prices, especially for coffee. In April and May, non-oil import prices rose at a nearly 6 percent annual rate, with increases for most major trade categories. The pickup in price increases for imported goods reflected, in part, the recent dollar depreciation.

The quantity of U.S. exports of goods and services rose at a 5 percent annual rate in the first quarter, more slowly than the double-digit rate of growth over

the four quarters of 1994. In large part, the weaker export performance was the result of the macroeconomic adjustments taking place in Mexico and the reduced Mexican demand for U.S. exports. Preliminary data for April indicated that the quantity of exports expanded a bit further from the first-quarter average. For the first four months of the year, exports to Mexico fell while they increased moderately to most other areas of the world.

Real output in Mexico declined sharply in the first quarter as instability in the financial markets weakened confidence and the government implemented a program of fiscal and monetary restraint. The Mexican economy apparently continued to contract in the second quarter. The crisis and ensuing policy responses induced a dramatic reduction in Mexico's current account deficit during the first quarter of the year. In the wake of the Mexican crisis, the Argentine authorities chose to tighten macroeconomic policies, which has led to a weakening of economic activity in Argentina. In contrast, Brazil experienced very strong growth of real output in the first quarter as consumption spending surged; available indicators suggest some slowing of growth in the second quarter.

In Japan, recovery from the recent recession remains tentative. First-quarter real GDP growth was only 0.3 percent at an annual rate; data for the second quarter also suggest that the recovery may be stalling. Asset prices have continued to fall, adding to concerns about the lack of progress in improving banks' balance sheets and limiting the capacity of banks to extend credit in support of the recovery. In May, the Japanese government announced another package of structural reforms and measures to boost domestic demand. The sluggish pace of activity in

Japan and the rise in the value of the yen have eliminated inflation: Consumer prices were unchanged over the twelve months through June.

In other industrial countries, the rate of economic expansion appears to have slowed from its rapid 1994 pace. In Canada, real GDP growth slowed to less than 1 percent at an annual rate in the first quarter; second-quarter indicators suggest continued sluggishness. In the United Kingdom, where the expansion has been vigorous over the past three years, real GDP continued to grow strongly in the first quarter, although at less than the 1994 pace. In most continental European countries, the rate of real output growth in the first half of 1995 was somewhat lower than the rapid pace during the second half of 1994. In Canada and several major European countries, measures intended to reduce government deficits as a share of GDP have been announced.

Inflation rates in the industrial countries generally remain low. However, in the United Kingdom and Italy, currency depreciation has added upward pressure on prices, and consumer prices in the twelve months through June rose 3½ percent in the United Kingdom and nearly 6 percent in Italy. In western Germany, exchange rate appreciation helped offset domestic inflationary pressures, and consumer prices rose only 2¼ percent in the twelve months through June.

Among our Asian trading partners other than Japan, real GDP growth has remained near the rapid 1994 pace, in part because substantial depreciations of those countries' currencies against the Japanese yen and the German mark stimulated exports. However, economic activity decelerated somewhat in China and Singapore, reflecting past tightening of monetary policy and the reduction of spare capacity in these economies.

Net capital flows into the United States were large in the first quarter of 1995. Foreign official holdings in the United States rose more than \$20 billion, as foreign governments made large intervention purchases of dollars in March in response to strong upward pressure on the foreign exchange value of their currencies. Sizable official inflows continued in April and May. In addition, net private foreign purchases of U.S. securities were considerable in the first quarter, particularly purchases of Treasury bonds and notes and new Eurobond issues by U.S. corporations. Private foreign net purchases of U.S. securities moderated a bit in April and May. In contrast, U.S. net purchases of foreign securities, which had fallen substantially last year from their 1993 peak, continued to decline on balance over the first five months of 1995.

U.S. direct investment abroad was considerable in the first quarter, at \$18 billion. Investment in Western Europe was particularly strong. Foreign direct investment in the United States, at \$10 billion, remained substantial. On net, there was a large outflow of direct investment in the first quarter, after netting to about zero in 1994.

Labor Markets

Employment grew rapidly in 1994, and labor markets tightened considerably. Although job growth slowed in the first quarter of this year, it was still large enough—at 226,000 per month—to keep the unemployment rate at about the same level as in the fourth quarter of 1994. In the second quarter, growth of nonfarm payroll employment slowed to only 60,000 per month and the quarterly average unemployment rate edged up, from 5.5 percent to 5.7 percent.

The deceleration in employment was particularly marked in the goods-

producing sector, where payrolls fell during the second quarter after posting strong gains in the early months of the year. In construction, payroll growth averaged 30,000 per month in 1994 and through the first quarter of 1995, but employment then fell 8,000 per month in the second quarter. Manufacturing job growth also averaged 30,000 per month in 1994. Factory hiring slowed in the first quarter, and in the second quarter, 35,000 jobs per month were lost. The decline in manufacturing employment was widespread across industries. Employers have also trimmed the factory workweek, which in 1994 had reached the highest level since 1945.

Although employment continued to rise in most service-producing industries in the first half of 1995, the rate of growth slowed by the second quarter. In wholesale and retail trade, where 75,000 jobs per month were added in the second half of 1994, the pace of job gains fell in the first quarter, and only 12,000 jobs per month were added in the second quarter. Similarly, in business services, where 46,000 jobs per month were added in 1994, employment decelerated in the first quarter and was about flat in the second. Among sectors showing employment gains in the first half of this year, entertainment industries posted considerable growth, and increases in employment in the health sector continued to run at about the same pace as in the second half of 1994.

The rate of increase in hourly compensation moved down further early this year. The employment cost index for private industry workers, a measure of hourly labor costs that includes both wages and benefits, rose 2.9 percent over the twelve months ended in March 1995, down from a 3.3 percent increase over the preceding twelve-month period. The increase in wages and salaries was

the same in both periods, but the pace of benefits gains declined significantly.

The largest contribution to the deceleration in benefits costs in recent years has come from health insurance. Among the factors restraining the increase in health insurance costs are slower medical-sector inflation, increased use of managed-care plans, and efforts by employers to shift a greater proportion of health care costs to employees. Costs of workers' compensation programs have also contributed to the deceleration in benefits costs; these costs, too, have been affected by lower medical inflation, although regulatory reform has played a role as well. Unemployment insurance costs decelerated sharply over the past two years; firms pay into the unemployment insurance program on the basis of their recent layoff experience, and the improved economy through the first part of this year lowered these payments.

Output per hour in the nonfarm business sector—measured in 1987 dollars—increased at an annual rate of 2.7 percent in the first quarter of 1995. Output per hour increased 2.0 percent over the four quarters ended in the first quarter, down slightly from the rate of growth over the preceding four-quarter period.

Price Developments

The pickup in consumer price inflation so far this year was a bit larger for the index that excludes food and energy than for overall prices: The CPI excluding food and energy increased at a 3.6 percent annual rate over the first six months of 1995, up from a 2.6 percent increase in 1994. The acceleration in the first half was mostly in non-energy services prices, which increased at a 4½ percent annual rate over the first six months of 1995, up from a 3¼ percent

increase over the twelve months of 1994. Airfares increased sharply in the first half of 1995, rising at more than a 40 percent annual rate after falling 10 percent in 1994; this acceleration accounted for two-thirds of the pickup in services inflation in the first half. Auto finance rates also increased rapidly early in 1995—rising at a 38 percent annual rate in the first four months the year—following a large increase in the second half of 1994. However, the CPI for auto finance declined sharply in May and June as interest rates on auto loans began to reflect the declines in market rates in the first half of 1995. Price increases for other services were, on balance, roughly in line with their rate of increase in 1994.

As a result of the brisk expansion of the industrial sector in 1994 and the consequent rapid increases in prices of basic manufactured products, the producer price index for intermediate materials other than food and energy increased at a 7½ percent annual rate over the second half of 1994. In the first quarter of this year, these materials prices rose even faster—nearly 10 percent at an annual rate. The rapid increases in materials prices began to affect finished goods prices in early 1995, and the PPI for finished goods other than food and energy, which covers domestically produced consumer goods and capital equipment, increased at a 3 percent annual rate over the first six months of 1995, up from a 1½ percent rate of increase over the twelve months of 1994.

The consumer price index for commodities other than food and energy increased at a 1½ percent annual rate over the first six months of 1995, about the same as in 1994. Prices accelerated at the retail level for some items for which producer prices have been rising rapidly, such as household paper prod-

ucts. But this pickup was partly offset by declines in prices where there have been large inventory buildups. Notably, apparel prices continued to decline in the first half, and prices of appliances, which had increased in 1994, fell in the first half of 1995.

The slowdown in the industrial sector has begun to relieve pressure on materials prices, and the PPI for intermediate materials other than food and energy increased just 0.2 percent per month in May and again in June, suggesting reduced pressures on finished goods prices in the near term.

Consumer food prices increased at a 1¾ percent annual rate over the first six months of 1995, down about a percentage point from 1994. Coffee prices, which had increased 64 percent in 1994, fell 12 percent over the first six months of this year. The swing in coffee prices can more than account for the deceleration in food prices. Prices of meats continued to fall in the first half of 1995, as production remained strong.

Energy prices increased at a 2 percent annual rate in the first half of 1995, about the same as last year. Natural gas prices have continued to decline. Regulatory changes have led to increased competition among suppliers of natural gas; in addition, natural gas prices were depressed early this year by the relatively warm winter, which held down demand. Gasoline prices increased at a 12 percent annual rate in the second quarter, reflecting the run-up in crude oil prices that occurred between December and April. Since April, crude oil prices have reversed nearly all of their earlier run-up, indicating that gasoline prices will move down in coming months.

Survey data suggest that expectations of inflation have changed little since the end of 1994. According to the survey of households conducted by the Survey Research Center of the University of

Michigan, as of the first half of 1995, the expected increase in consumer prices over the coming twelve months was the same as it was in the fourth quarter of 1994. In the Conference Board survey of households, the expected rate of inflation over the coming year remained at 4¼ percent in the first half of 1995, the same as in each of the four quarters of 1994. Expectations of inflation over longer periods also have not changed much on balance this year. In the University of Michigan survey, the expectation in the second quarter of 1995 for the rate of consumer price inflation over the next five to ten years was the same as it was in the fourth quarter of 1994. Similarly, in the May 1995 survey of professional forecasters conducted by the Federal Reserve Bank of Philadelphia, expectations of inflation over the coming ten years were about 3½ percent, the same as in the survey taken at the end of 1994.

Financial, Credit, and Monetary Developments

In charting the course of monetary policy this year, the Federal Reserve has sought to promote sustainable economic growth and continued progress toward price stability. Despite the tightening actions undertaken during 1994, economic data at the beginning of 1995 suggested that the economy was operating beyond its long-run potential and might continue to do so for some time—a situation that would no doubt lead to a significant pickup in inflation if allowed to persist. Against this backdrop, the Federal Open Market Committee voted in February to tighten reserve conditions somewhat further, resulting in a ½ percentage point increase in the federal funds rate. In the months following the February FOMC meeting, economic activity seemed to be leveling

out, at least temporarily, considerably reducing pressures on resources. In early July, with the risks of a prolonged upturn in inflation fading, the FOMC decided to ease reserve pressures slightly, resulting in a decline in the federal funds rate of ¼ percentage point.

As incoming data in 1995 increasingly suggested slower economic growth and an attendant relief of inflation pressures, intermediate- and long-term interest rates moved down substantially. Additional downward pressures seemed also to arise from the growing conviction of market participants of the commitment of the Congress and Administration to making progress toward a balanced budget. On balance, most longer-term interest rates have declined 120 to 180 basis points since the end of last year, with the sharpest drops at intermediate maturities. The trade-weighted exchange value of the dollar has depreciated about 7½ percent against the other G-10 currencies—in large part reflecting the decline in U.S. long-term interest rates relative to those in the other G-10 countries. In addition, the fall in interest rates, coupled with continued strong corporate earnings, fueled a run-up in equity prices; most major stock price indexes have climbed 15 to 35 percent since the beginning of the year.

Despite slower economic expansion this year, growth rates of broad money and credit have picked up, and the decline in intermediate- and long-term interest rates has only recently begun to leave an imprint on the composition of borrowing. Total domestic nonfinancial debt increased 5½ percent from the fourth quarter of 1994 through May—a little above last year's pace—as stronger private sector borrowing more than offset slower growth of the federal debt and a decline in state and local government debt. Borrowing in the nonfinan-

cial business sector has been largely concentrated in short-term or floating-rate debt such as bank loans and commercial paper. Recently, however, declines in longer-term interest rates have stimulated a sharp jump in corporate bond issuance. Household borrowing this year has been considerable, although below the pace of 1994. Tax-exempt debt is estimated to have declined outright again this year as many state and local units have called securities that had been advance refunded. Federal debt growth has edged down a bit this year, extending the trend toward slower expansion of federal debt that began in 1991.

Depository institutions have been especially important suppliers of credit to both businesses and households this year. Borrowers' demands were concentrated in the types of credit in which depositories are traditional lenders and, on the supply side, commercial banks continued to pursue new lending opportunities aggressively. The health and profitability of depositories have remained solid to date, although federal regulators have cautioned depositories that their lending standards should take account of the potential for deterioration of loan performance in a less favorable economic climate.

The surge in bank lending and the flattening of the yield curve this year have provided a significant impetus for growth of the broad monetary aggregates. M3 advanced $6\frac{1}{4}$ percent at an annual rate from the fourth quarter of 1994 through June—slightly above the upper bound of its revised 2 to 6 percent annual range set at the July FOMC meeting—as banks pulled in deposits to fund loans. The drop in market interest rates has enhanced the attractiveness of M2, which increased at a $3\frac{3}{4}$ percent rate over the same period—a little above the midpoint of its annual range. In

contrast to the expansion of the broad monetary aggregates, M1 growth has been quite weak, reflecting the low yields on these assets and the implementation by a few banks of retail sweep accounts, which move funds out of NOW accounts and into nontransaction balances.

The Course of Policy and Interest Rates

The Federal Reserve entered 1995 having tightened policy appreciably during 1994, thereby boosting short-term rates $2\frac{1}{2}$ percentage points. Nonetheless, data reviewed at the FOMC meeting in December 1994 suggested that pressures on resources were intensifying and that inflation threatened to move higher. Although the Committee took no action to increase rates further at this meeting, it did adopt a directive indicating a bias toward additional tightening in the intermeeting period.

Information reviewed at the February meeting suggested that despite some fragmentary evidence of slowing, the economic expansion remained brisk in an economy already operating at or beyond its long-run potential. The demand for consumer durables and homes was softening, but output and employment had posted substantial gains near year-end, and capacity utilization had moved up from already high levels. In addition, a marked rise in materials prices during the second half of 1994 posed a threat of increased consumer price inflation in coming months. In these circumstances, the Board of Governors approved the pending requests of several Reserve Banks for a $\frac{1}{2}$ percentage point increase in the discount rate, and the Committee agreed to allow this increase to show through fully to the federal funds rate. In light of the tightening of policy called for at this meeting and the anticipated lagged

effects of previous tightenings, the Committee viewed the odds of a need for further policy action developing over the intermeeting period as relatively small and evenly balanced, and therefore issued a symmetric directive to guide any intermeeting changes in reserve conditions.

In subsequent weeks, evidence suggested that economic activity was moderating, especially in the interest-sensitive sectors. Financial markets appeared to view these signs as indicating that the previous policy actions of the Federal Reserve had substantially reduced the odds of rising inflation and thus also the need for additional monetary restraint. Indeed, yields on Treasury securities at maturities ranging from one to ten years fell 60 to 70 basis points between the February and March FOMC meetings.

At its meeting in late March, it was not clear to the Committee whether the deceleration in economic activity was only temporary or was a lasting shift toward a sustainable rate of economic expansion. On balance, the Committee viewed the economy as retaining considerable upward momentum and observed that the decline in longer-term interest rates, the rise in stock prices, and the sharp depreciation of the exchange value of the dollar could be expected to buoy aggregate demand in the months ahead. Moreover, consumer prices, as anticipated, had risen more rapidly in 1995. In these circumstances, the Committee determined that it would be prudent to await further information before taking any additional policy actions, but the Committee's directive included a bias toward additional monetary restraint over the intermeeting period. The asymmetric directive was considered appropriate to emphasize the Committee's commitment to containing and ulti-

mately reducing inflation, in a period when it seemed to be moving higher.

Following the March meeting, incoming data signaled a further deceleration of economic activity. In addition, financial markets appeared to view budget discussions in the Congress as foreshadowing significant fiscal restraint over the balance of the decade. Shorter-term interest rates began to incorporate the possibility of an easing of monetary policy, and yields on longer-term securities—especially those at intermediate maturities—moved down sharply as well.

Information reviewed at the May FOMC meeting provided persuasive evidence that the pace of the economic expansion had slowed, relieving pressures on resources and reducing the threat of a pickup in inflation. The Committee observed that an adjustment to inventory imbalances that had developed earlier in the year was contributing to the slowdown and that the underlying trajectory of final sales was still unclear. The Committee determined that the existing stance of policy was appropriate in these circumstances and adopted a symmetric directive regarding potential policy adjustments during the intermeeting period.

Employment data released shortly after the May FOMC meeting were surprisingly weak, prompting considerable speculation in financial markets of an imminent monetary policy easing. The sharpness of the downward movement in longer-term rates seemed to reflect, in addition to economic fundamentals, trading dynamics associated with the attempts of investors to rebalance their portfolios in light of the substantial change in interest rates. At one point in late June, the spread between the thirty-year Treasury bond yield and the federal funds rate reached a low of 48 basis

points but edged higher in subsequent weeks.

From the information reviewed at the July meeting of the FOMC, it appeared that the economy flattened out during the second quarter as businesses sought to pare inventories to desired levels. This pause in the expansion, in turn, had alleviated the inflation pressures that had loomed large earlier in the year. In these circumstances, the Committee voted to ease reserve pressures slightly, resulting in a $\frac{1}{4}$ percentage point decline in the federal funds rate. Although financial markets had anticipated a decline in the federal funds rate at some point, both bond and equity markets rallied strongly after the change in policy was announced. At the close on July 7, the thirty-year bond rate was down about 165 basis points from its recent high of last November.

Credit and Money Flows

The debt of domestic nonfinancial sectors grew $5\frac{1}{2}$ percent at an annual rate from the fourth quarter of 1994 through May of this year—a modest pickup over the pace of recent years but well within its annual range of 3 to 7 percent. Slower growth of federal debt and a decline in the debt of state and local governments in 1995 were more than offset by strength in business and household borrowing. Although declines in longer-term interest rates and the flattening of the yield curve have stimulated long-term, fixed rate borrowing of late, both households and businesses continued during much of the year to favor borrowing that was short-term or floating-rate. In part, the reliance on such debt contributed to the larger share of private debt intermediated through the depository sector. In meeting

increased credit demands, depositories turned more heavily to time deposits and other liabilities included in M2 and M3. Stronger funding needs and increased reliance on deposits provided a considerable lift to growth of the broad monetary aggregates.

Slower growth of federal debt this year relative to 1994 reflects stronger tax revenues and diminished growth of expenditures, especially defense-related outlays. In the state and local sector, debt outstanding has continued to decline, largely driven by calls of higher-cost debt issued during the

Growth of Money and Debt

Percent

Measurement period	M1	M2	M3	Domestic non-financial debt
<i>Year</i> ¹				
1980	7.4	8.9	9.6	9.1
1981	5.4	9.3	12.4	9.9
	2.5 ²			
1982	8.8	9.2	9.9	9.6
1983	10.4	12.2	9.9	11.8
1984	5.5	8.1	10.9	14.4
1985	12.0	8.7	7.6	14.1
1986	15.5	9.3	8.9	13.5
1987	6.3	4.3	5.7	10.2
1988	4.3	5.3	6.3	9.0
1989 .....	.6	4.8	3.8	7.9
1990	4.2	4.0	1.7	6.5
1991	7.9	2.9	1.2	4.6
1992	14.3	2.0	.5	4.7
1993	10.5	1.7	1.0	5.2
1994	2.3	1.0	1.4	5.1
<i>Quarter (annual rate)</i> ³				
1994:Q1	5.5	1.8	.6	5.2
Q2	2.7	1.7	1.3	5.4
Q3	2.4	.9	2.1	4.2
Q4	-1.2	-3	1.7	5.2
1995:Q1 .....	.0	1.6	4.3	5.5
Q2	-9	4.2	6.7	5.4 ⁴

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

2. Adjusted for shift to NOW accounts in 1981.

3. From average for preceding quarter to average for quarter indicated.

4. Based on data through May.

1980s.⁸ Yields on municipal bonds relative to Treasuries had moved up considerably after Orange County defaulted on its debt late in 1994 but reversed much of this increase early in 1995. The ratio of municipal yields to Treasury bond yields has climbed again more recently as various budget proposals before the Congress raised the prospect of reduced federal tax advantages for municipal debt. In addition, the recent decision by Orange County voters not to raise taxes to cover the county's losses has tended to boost risk premiums for the obligations of many municipalities in California and, to a lesser extent, for other borrowers in the municipal bond market.

Borrowing by households—although off a bit from last year's pace—has generally remained strong this year. Weaker auto sales and the associated slower growth of auto loans resulted in a modest deceleration of consumer credit. Growth of revolving credit—principally credit card debt—trended higher from the already brisk pace recorded last year. The proliferation of incentive programs offered with many credit cards has likely encouraged greater convenience use for transactions in recent quarters.

Growth of home mortgage debt moderated somewhat in the first quarter, a pattern consistent with the overall sluggish demand for housing. As long-term rates moved down this year, the pronounced shift toward adjustable rate mortgages (ARMs) evident last year dissipated. As of May, 60 percent of new mortgage originations were fixed rate mortgages (FRMs). In addition, the

decline in long-term rates in recent months has sparked renewed interest in refinancing. Households carrying ARMs with rates that are (or soon will be) above rates offered on FRMs have reportedly begun to refinance with FRMs.

Household debt-service burdens—measured as the ratio of scheduled principal and interest payments on debt relative to income—have risen in 1995 but remain well below levels reached in the late 1980s and early 1990s. Mortgage refinancings undertaken at lower interest rates in recent years have helped to keep the level of debt-service burdens relatively low despite the growth of household debt relative to income. In fact, some measures of delinquency rates on home mortgages have edged down this year to the lowest levels in more than twenty years. The picture for delinquency rates on consumer credit is less clear: Some measures such as the delinquency rates on consumer installment credit remain quite low, while others—especially auto loans booked at finance companies—have moved up considerably.

Borrowing by nonfinancial businesses has increased in 1995, propelled in large part by a rise in capital expenditures in excess of internal sources of funds and a jump in merger activity. In addition, a number of firms have initiated stock repurchases financed in part with debt. As in 1994, the composition of business borrowing this year has been heavily weighted toward short-term commercial paper and bank loans. Lower long-term interest rates, however, have stimulated a flurry of new bond issues very recently.

Various unsettling developments in financial markets, including the Orange County debacle, losses associated with complex derivatives and cash instruments, the failure of Barings Brothers, and the financial crisis in Mexico, have

8. Many state and local units took advantage of historically low long-term interest rates in 1993 to issue bonds that were targeted to replace existing high-cost debt issued during the 1980s as the call dates on those bonds arrived. Calls on previously issued debt likely will continue to depress net state and local borrowing for some time.

had some limited effects on the specific companies or sectors involved. They have not, however, had a large impact on broad market perceptions of credit risks; spreads of yields on short- and long-term corporate debt over Treasuries have widened only a bit this year, a situation that likely reflects the elevated supply of new corporate debt and perhaps a small uptick in risk premiums.

The gap between the capital expenditures and internal cash flow of nonfinancial corporations (the financing gap) began widening in mid-1994 and has grown even larger in 1995. In part, the bulge in the financing gap is the result of the large buildup of inventories earlier in the year. Most external funding for the purpose of carrying inventories apparently has taken the form of commercial paper or bank loans.

A surge in merger activity beginning in late 1994 has also spurred business borrowing. Many of the largest mergers have been strategic, intra-industry combinations, concentrated especially in areas such as defense, pharmaceuticals, telecommunications, and (most recently) banking. In contrast to the merger and acquisition wave during the late 1980s, the current acquisition boom has not entailed highly leveraged takeovers financed heavily with junk bonds. Indeed, until quite recently, junk bond issuance this year had been anemic. Merger activity in recent quarters has involved substantial use of stock swaps coupled with reductions in financial assets and new investment-grade debt issuance (often in the form of commercial paper). Survey evidence indicates that banks have played only a modest role in directly funding recent mergers, although they have facilitated transactions by providing backup lines for merger-related commercial paper.

Equity retirements associated with mergers have accounted for a sizable

portion of the decline in net equity shares outstanding. In addition, gross issuance of new equity has ebbed as price-earnings ratios have fallen and many firms have repurchased their stock with both accumulated cash and the proceeds of new debt.

The shift to short-term funding in the business sector has been a boon to intermediaries that tend to specialize in short-term lending. Finance companies and commercial banks, in particular, have enjoyed a prominent role as suppliers of credit over the past year. To date, there are few indications that the health of these institutions has deteriorated. Credit ratings for finance companies have been stable, and bank profitability and capital ratios have been solid.

An important factor contributing to the overall strength of depository credit has been the stabilization of the thrift industry, especially savings and loan associations. After several years of sharp contraction, thrift assets expanded slightly over the second half of 1994 and continued a modest recovery in 1995. The number of thrift institutions continues to decline, however, with many filing for bank charters or being acquired by banks.

The growth of bank credit picked up appreciably during the first half of 1995, with strength especially evident in bank loans. Indeed, over the past twelve months, the share of the increase in non-federal domestic debt funded by bank loans climbed to record levels. Surveys of bank lending officers have indicated banks' increased willingness to extend consumer credit as well as continued easing of terms and standards applied to business loans. Data from the Federal Reserve's Survey of Terms of Bank Lending to Business show that spreads of loan rates over the federal funds rate for large commercial loans have been about the same as last year but well

below those prevailing through much of the late 1980s and early 1990s. Comparable spreads for smaller commercial loans are wider than in the late 1980s but have continued the narrowing trend of recent years. The strength of bank lending has been viewed favorably in financial markets—bank stock prices have risen this year about in line with or faster than the climb in broad stock price indexes, while spreads on bank debt relative to Treasuries have widened only slightly.

The continued easing of bank lending standards after more than a year of monetary policy restraint has attracted the attention of federal regulators. The Office of the Comptroller of the Currency warned banks against allowing their standards to fall to a point that could expose them to heavy losses in an economic downturn. In the same spirit, the Federal Reserve issued a supervisory letter cautioning banks that loan terms and standards should be set with a long-term view that takes loan performance in less favorable economic conditions into account.

Banks have funded the bulge in their loan portfolios this year in part by liquidating a portion of the large holdings of securities they had accumulated earlier in the 1990s.⁹ In addition, banks have increased their liabilities. Last year, banks relied heavily on borrowings from their non-U.S. offices to fund growth of their domestic assets. Deposit

growth at the foreign offices of U.S. banks has slowed considerably this year. Consistent with this development, borrowing by domestically chartered banks from their foreign offices has increased in 1995 but not at the pace of last year.

Depositories' shift back into funding with domestic liabilities has helped spur the growth of the broad monetary aggregates this year. From the fourth quarter of 1994 through June, growth of M3 has averaged 6¼ percent, placing the level of M3 above the upper bound of its annual range. Over the same period, M2 growth has averaged 3¾ percent, placing the level of M2 in the upper half of its annual range.

The pickup in M3 growth this year reflects stronger expansion in both its M2 and non-M2 components. The acceleration of "wholesale" funding sources, especially large time deposits, has been quite marked this year. Banks' heavier reliance on wholesale funds is typical during periods in which bank loan portfolios are expanding swiftly. The non-M2 portion of M3 has also been boosted by a sharp jump in institution-only money funds. The yields on these funds tend to lag movements in short-term market interest rates and, as a result, became especially attractive to investors when short-term market interest rates began falling on expectations of a near-term easing of monetary policy.

The acceleration of M2 this year results chiefly from the waning influence of previous increases in short-term interest rates and a marked flattening of the yield curve. On balance this year, the returns on assets in M2 have become more attractive relative to both short- and long-term market instruments. Sizeable inflows to stock mutual funds have continued, but the flatter yield curve has damped the demand for other long-term

9. Published data on changes in securities portfolios at banks may not accurately portray funding strategies because recent accounting changes have increased the share of securities and off-balance-sheet contracts that must be marked to market on banks' balance sheets. Estimates suggest that changes in the market valuation of securities and off-balance-sheet contracts under these accounting rules have added about 1 percentage point at an annual rate to the growth of bank credit from the fourth quarter of 1994 through June of this year.

investments. Inflows to bond mutual funds—while stronger than during the bond market rout last year—have been much smaller than inflows earlier in the 1990s. Also, judging from noncompetitive tenders at recent Treasury auctions, households' direct investments in Treasury securities have dwindled sharply this year. At least a portion of the flows that previously had been directed to mutual funds and direct investments in securities appears to have boosted M2 growth. Growth of money market mutual funds and small time deposits, in particular, has been especially brisk. Indeed, more than half of the increase in M2 since April is attributable to a steep climb in M2 money funds.

In contrast to the marked expansion of the broader aggregates, M1 growth has weakened this year, primarily as a result of wide opportunity costs on transaction deposits and the introduction and expansion of retail sweep accounts at some large banks. Interest rates offered on other checkable deposits (OCDs) have edged up only slightly since the beginning of 1994 despite the sharp rise in short-term market interest rates. Households have responded by reducing balances in these accounts in favor of higher-yielding assets.

The development of sweep accounts by a few large banks for their retail customers has facilitated the shift away from transaction balances. Sweep accounts transfer a customer's OCD account balances in excess of a certain threshold into a money market deposit account (MMDA). Automatic transfers from the customer's MMDA account back to the OCD account are initiated as checks and other withdrawals deplete OCD balances. Such sweep accounts may allow customers to earn more interest and benefit the bank by reducing its

required reserves.¹⁰ Estimates suggest that retail sweep accounts have reduced M1 by about \$12 billion so far this year. These programs affect the composition but not the level of M2 because balances are swept from transaction deposits into other accounts included in M2.

The expansion of retail sweep accounts poses some potential problems for the implementation of monetary policy by the Federal Reserve. To date, such accounts have been offered by large banks that must maintain a balance at a Federal Reserve Bank to meet their reserve requirements. As a result, the reduction in required reserves associated with sweep accounts has implied a nearly equivalent reduction in aggregate required reserve balances; estimates suggest that the \$12 billion dollar decline in OCDs this year translates to a reduction in required reserve balances of nearly \$1.2 billion.¹¹ In early 1991, following the cut in reserve requirements at the end of 1990, unusually low levels of aggregate reserve balances were associated with greater variability in the federal funds rate as banks' volatile clearing needs began to dominate the demand for reserves. If many banks begin to offer retail sweep programs in the future, the aggregate level of

10. Under the current structure of reserve requirements, OCD accounts are subject to a 10 percent reserve requirement at banks with more than \$54 million of net transaction deposits. By law, personal MMDAs are exempt from reserve requirements.

11. The reduction in required reserve balances is not necessarily identical to the reduction in required reserves because banks typically use vault cash in addition to reserve balances to satisfy reserve requirements. The level of vault cash held by banks is primarily determined by their customers' needs. Required reserves for some banks are nearly or even completely satisfied by vault cash. In these cases, a reduction in required reserves due to sweeps would not show through to a decline in required reserve balances on a one-for-one basis.

required reserve balances would likely fall substantially, potentially leading to instability in the aggregate demand for reserves.

The monetary base expanded at a 5½ percent rate from the fourth quarter of 1994 through June. Currency growth this year—at 7¼ percent from 1994:Q4 through June—is off a bit from last year's pace but still quite robust. Foreign demands for U.S. currency have generally remained strong this year. In concert with the decline in transaction deposits, total reserves contracted at a 6 percent rate from 1994:Q4 through June. In the absence of the increase in sweep accounts, the decline in total reserves over this period would have been 2½ percent at an annual rate.

International Financial Developments

At the turn of the year, the foreign exchange value of the dollar was under downward pressure, and that pressure continued through the first months of 1995. On balance, the multilateral trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated about 7½ percent since the end of December 1994. The dollar declined as economic indicators began to suggest that economic growth in the United States was slowing, lowering the likelihood of further increases in U.S. market interest rates. In addition, the Mexican crisis appeared to weigh on the dollar in early 1995. External adjustment by Mexico was rightly expected to involve, to an important extent, a corresponding decrease in U.S. net exports. Primarily for that reason, financial turmoil in Mexico and depreciation of the peso were seen as having possible adverse implications for U.S. growth and external accounts and, in general, as negative for dollar-denominated assets.

The dollar was supported only briefly by the increase in the discount rate and the federal funds rate at the February FOMC meeting. With the U.S. economic expansion softening, market participants came to expect that no further increases in these rates were likely in the near term. Downward pressure on the dollar intensified in late February, and on March 2, in somewhat thin and disorderly market conditions, the dollar fell sharply further against the mark and the yen. The foreign exchange Trading Desk at the New York Federal Reserve Bank entered the market, selling both marks and yen on behalf of the Treasury and the Federal Reserve System. The next day several other central banks joined the Desk in concerted intervention in support of the dollar. Intervention by the Desk on behalf of the Treasury and the Federal Reserve System totaled \$1.42 billion. In a statement confirming the intervention, Secretary Rubin highlighted official concern about the dollar's exchange value. Downward pressure on the dollar continued, particularly against the yen, and on April 3 and 5 the Desk, acting on behalf of the Treasury and Federal Reserve System, again joined several other central banks in intervention to support the dollar. Secretary Rubin issued a statement that these actions were in response to recent movement on exchange markets and that the Administration was committed to a strong dollar.

The dollar fell further through mid-April, particularly against the yen, and on April 19 it touched a record low of less than 80 yen per dollar. After recovering slightly and remaining fairly stable through mid-May, the dollar rebounded sharply but subsequently relinquished some of those gains. On May 31, the Desk—on behalf of the Treasury and the Federal Reserve—joined the central banks of the other G-10 countries in

intervention purchases of dollars. Secretary Rubin stated that the intervention was in keeping with the objectives of the April 28 communiqué of the G-7 finance ministers and central bank governors, which endorsed the orderly reversal of the decline in the dollar in terms of other G-7 currencies. Through May and June, the dollar fluctuated in a range somewhat above its lows of mid-April and early May. On July 7, following moves by both the Federal Reserve and the Bank of Japan to ease monetary conditions, the Desk joined the Japanese monetary authorities in intervention purchases of dollars; the dollar moved up a bit in response.

Long-term (ten-year) interest rates in the major foreign industrial countries have, on average, declined about 100 basis points since December as economic indicators have suggested some slowing of real output growth abroad as well as in the United States. With U.S. long-term rates falling much more, about 170 basis points on balance, the change in the long-term interest differential is consistent with some decline in the exchange value of the dollar. Long-term rates have dropped about 150 basis points in Japan, nearly as much as the decline in U.S. long-term rates. Rates in Germany are down about 90 basis points. Three-month market interest rates in these countries have declined about 90 basis points on average since year-end 1994; central bank official lending rates were lowered in 1995 in several countries, including Japan, Germany, and Canada. Following the Federal Reserve easing on July 6, the central banks of Canada and Japan lowered overnight lending rates.

Since December 1994, the dollar has depreciated about 12 percent on balance against the Japanese yen, despite declines in Japanese long-term rates that nearly matched the decline in U.S.

rates. The yen fluctuated in response to progress, or lack of progress, in the resolution of trade disputes with the United States. Persistent strength in the yen appears to reflect the large Japanese current account surplus and market perceptions that some adjustment of that surplus, through yen appreciation, is inevitable, especially given the slow growth of the Japanese economy. Japanese financial markets more broadly have reflected the weak state of the Japanese economy. Stock prices have fallen considerably so far this year, with the Nikkei down about 16 percent since the end of December, and land prices have fallen further. These declines in asset prices have added to the perceived risks in the Japanese banking system and concerns that the recovery in economic activity is stalling.

Net depreciation of the dollar in terms of the German mark over this period has been about 10 percent. Some of the upward pressure on the mark over the past several months resulted from shifts within the Exchange Rate Mechanism (ERM) of the European Monetary System, as political uncertainties and fiscal problems in Italy, Sweden, Spain, and later France, led at times to the selling of their respective currencies for marks. Realignment within the ERM on March 5 that lowered the values of the Spanish peseta and the Portuguese escudo contributed to the upward movement of the mark. In contrast to the dollar's movement against the yen and the mark since December, the dollar is down only 3 percent in terms of the Canadian dollar. Early in the year, the U.S. dollar appreciated against the Canadian dollar; uncertainty about whether fiscal problems in Canada would be addressed and spillover from the Mexican crisis caused the Canadian dollar to fall. Since then, the Canadian dollar has regained those losses.

Over the past several months, the Mexican peso has recovered somewhat in terms of the U.S. dollar from the lows reached during the height of the crisis. On balance, the peso has depreciated 40 percent in nominal terms from December 19, 1994, before the crisis broke out. Mexican officials have drawn on the Treasury Department's Exchange Stabilization Fund facility and the Federal Reserve's swap line in addressing Mexico's international liquidity problems. Outstanding net drawings to date total \$12.5 billion. The outstanding total of tasebonos, the government's dollar-denominated short-term obligations, has been reduced below \$10 billion. ■

Part 2

Records, Operations, and Organization

Record of Policy Actions of the Board of Governors

Regulation D Reserve Requirements of Depository Institutions

November 14, 1995—Amendments

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

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Phillips and Yellen.¹

Under the Monetary Control Act of 1980, depository institutions, Edge Act corporations, 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 transaction balances and at 12 percent of balances above that amount. Subsequently, the Board lowered the maximum reserve requirement to 10 percent. 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 1995, that amount was \$54 million. Recent decreases in transaction balances warranted a decrease to \$52 million, and

the Board amended Regulation D accordingly.

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 amount based on deposit growth nationwide. By the beginning of 1995, that amount had been increased to \$4.2 million. Recent growth in deposits warranted an increase to \$4.3 million, and the Board amended Regulation D accordingly.

The amendments are effective with the reserve computation period beginning December 19, 1995, for institutions reporting weekly or quarterly.

To reduce the reporting burden for small institutions, the Board allows depository institutions with total deposits below specified levels to report their deposits and reservable liabilities quarterly or less frequently; larger institutions must report weekly. The growth rate of total deposits at all depository institutions increased from June 30, 1994, to June 30, 1995. To reflect that increase, the Board raised the deposit cutoff levels that, used in conjunction with the exemption level, determine the frequency and detail of deposit reporting required for each institution; the cutoff was raised from \$55.4 million to \$57 million for nonexempt depository institutions and from \$45.1 million to \$46.4 million for exempt depository institutions, beginning in September 1996.

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

Regulation E

Electronic Fund Transfers

March 16, 1995—Amendment

The Board approved an amendment to Regulation E to revise the requirements for receipts at automated teller machines, effective April 24, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Phillips and Yellen.

The amendment gives financial institutions flexibility in the amount of identifying information that they include on receipts for transactions at automated teller machines. It eliminates the requirement that a receipt from an electronic terminal disclose a number or code that uniquely identifies the consumer, the consumer's account, or the access device. The amendment makes final an interim amendment that had been in effect since December 1, 1994.

Regulation H

Membership of State Banking Institutions in the Federal Reserve System

March 28, 1995—Interpretation

The Board approved an interpretation of Regulation H concerning the establishment of loan-production offices and back-office facilities by state member banks, effective April 6, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Phillips and Yellen.

Under the interpretation, a back-office facility established by a state member bank is not considered a branch of the bank. The interpretation also provides that loans originated by a loan-production office may be approved at a

back-office location if the proceeds of the loan are received by the customer at a location other than a loan-production office or back-office facility.

June 19, 1995—Amendment

The Board approved an amendment to Regulation H to require that state member banks use the standard flood hazard determination form developed by the Federal Emergency Management Agency, effective January 2, 1996.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Yellen. Absent and not voting: Ms. Phillips.¹

The rule requires that banks use a standard form for determining whether collateral is located in a special flood hazard area. The form also was adopted by the other federal banking agencies, the Farm Credit Administration, and the National Credit Union Administration.

Regulation H

Membership of State Banking Institutions in the Federal Reserve System and

Regulation Y

Bank Holding Companies and Change in Bank Control

February 2, 1995—Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines for state member banks and bank holding companies to limit the amount of capital they are required to hold against certain assets transferred with recourse, effective March 22, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Yellen. Absent and not voting: Ms. Phillips.

To implement section 350 of the Riegle Community Development and Regulatory Improvement Act of 1994, the Board revised its risk-based capital guidelines to limit the amount of capital that banking organizations are required to hold against assets sold with low levels of recourse to the maximum amount of loss possible under the contractual terms of the obligation.

June 30, 1995—Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines for state member banks to incorporate interest rate risk, effective September 1, 1995.

Votes for this action: Messrs. Greenspan and Blinder and Ms. Phillips and Yellen. Absent and not voting: Messrs. Kelley and Lindsey.¹

To implement section 305 of the Federal Deposit Insurance Corporation Improvement Act, the Board stated that in determining a bank's capital needs, the Board will consider a bank's exposure to declines in the economic value of its capital due to changes in interest rates. The other federal banking agencies also adopted the new standard.

July 14, 1995—Interim Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines for state member banks and bank holding companies to afford the same treatment to originated mortgage-servicing rights and purchased mortgage-servicing rights for regulatory capital purposes, effective August 1, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Phillips and Yellen.¹

The Board, along with the other federal banking agencies, eliminated the accounting distinction between originated mortgage-servicing rights and purchased mortgage-servicing rights and included both in regulatory capital when determining tier 1, or core, capital; thus, originated mortgage-servicing rights become subject to the regulatory capital limitations that had previously applied only to purchased mortgage-servicing rights. In connection with this action, the agencies also sought public comment on the interim amendments.

August 21, 1995—Amendments

The Board approved amendments to Regulation H to revise the risk-based and leveraged-capital guidelines for state member banks. The Board approved amendments to Regulation Y to revise the risk-based capital guidelines for bank holding companies to change the regulatory treatment of certain transfers of assets with recourse that involve small business obligations. The amendments became effective September 1, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Phillips and Yellen.¹

The Board specified that a qualifying insured banking organization that transfers small business loans and leases on personal property with recourse needs to include only the amount of the retained recourse in risk-weighted assets when calculating its risk-based capital ratios, provided certain conditions are met. The revision implements section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, and it lowers the capital requirement for small business loans on leases on personal property that have been transferred with recourse.

November 1, 1995—Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines for state member banks and bank holding companies to modify the criteria used to define the OECD-based group of countries, effective January 1, 1996.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Phillips and Yellen.¹

Under the risk-based capital guidelines and the Basle Accord, claims on governments of countries in the Organisation for Economic Co-operation and Development and claims on banks in OECD countries receive lower risk weights than corresponding claims on the governments and banks of other countries. Under the amended guidelines, any OECD country that reschedules its sovereign debt is excluded from lower-risk-weight treatment for five years from the rescheduling. The other federal banking agencies also adopted the revised definition.

Regulation H
Membership of State Banking
Institutions in the Federal Reserve
System and
Rules of Practice for Hearings

February 2, 1995—Amendments

The Board approved a new subpart D and appendix D of Regulation H and a new subpart I to its Rules of Practice for Hearings to establish standards for safety and soundness for state member banks, effective August 9, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and

Ms. Yellen. Absent and not voting: Ms. Phillips.

The Riegle Community Development and Regulatory Improvement Act of 1994 authorized the federal banking agencies to prescribe safety and soundness standards and eliminated bank holding companies from the scope of section 132 of the act. Subpart D and appendix D of Regulation H are the Interagency Guidelines Establishing Standards for Safety and Soundness. Subpart I of the Rules of Practice for Hearings specifies procedures for submitting compliance plans and for issuing orders to correct deficiencies.

Regulation K
International Operations of United
States Banking Organizations

December 21, 1995—Amendment

The Board approved an amendment to Regulation K to expand the authority of strongly capitalized and well-managed banking organizations to make certain foreign investments, effective December 21, 1995.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Phillips and Yellen. Absent and not voting: Mr. Blinder.¹

The Board amended subpart A of Regulation K to permit U.S. banking organizations that are strongly capitalized and well managed to make larger investments in foreign countries without advance approval or review by the Board. The amendment also streamlines the review procedures for notices and applications.

Regulation O

Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates

March 28, 1995—Amendment

The Board approved an amendment to Regulation O, effective April 7, 1995, to allow a member bank to make a loan to an executive officer without the approval of its board of directors if the loan is secured by a first lien on the officer's residence.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen.

The revision implements an amendment to the Federal Reserve Act by the Riegle Community Development and Regulatory Improvement Act of 1994.

June 2, 1995—Amendment

The Board approved an amendment to Regulation O to revise the definition of unimpaired capital and surplus, effective July 1, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Mses. Phillips and Yellen.¹

The amendment conforms the definition of unimpaired capital and surplus to a revision by the Office of the Comptroller of the Currency of the definition of capital and surplus used to calculate the limit on loans by a national bank to a single borrower.

Regulation Y

Bank Holding Companies and Change in Bank Control

April 25, 1995—Amendments

The Board approved an amendment to Regulation Y to permit subsidiaries of bank holding companies to offer a discount on their products to customers who maintain certain combined minimum balances, effective May 26, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen.

The amendment to the antitying provisions of Regulation Y allows subsidiaries of a bank holding company to offer a discount on their products to customers who maintain a combined minimum balance in products specified by the company offering the discount.

June 23, 1995—Amendment

The Board approved an amendment to Regulation Y to eliminate the requirement for certain determinations of control under the Bank Holding Company Act, effective July 6, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Mses. Phillips and Yellen.¹

Under certain conditions the amendment eliminates the need for a bank holding company to file a request with the Board for a determination under section 2(g)(3) of the Bank Holding Company Act that it no longer controls shares or assets that it has sold to a third party with financing. The conditions are that the purchaser is not an affiliate or a principal shareholder of the divesting

bank holding company or of a company controlled by its principal shareholder and that the purchaser has no officers, directors, trustees, or beneficiaries in common with, or subject to control by, the divesting company.

Regulation Z **Truth in Lending**

March 13, 1995—Amendments

The Board approved amendments to Regulation Z to require certain disclosures for reverse mortgages and mortgages with rates or fees above a certain percentage or amount, effective March 22, with optional compliance until October 1, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Phillips and Yellen.

To implement the requirements of the Home Ownership and Equity Protection Act of 1994, the Board amended Regulation Z to require new disclosures for reverse mortgages, which provide periodic advances, usually to elderly homeowners, and rely mostly on the home's value for repayment. The amendments also require that creditors disclose information about the potential cost of the transaction and impose substantive limitations on home mortgage transactions having rates or fees above a certain percentage or amount.

Regulation BB **Community Reinvestment and**

Regulation C **Home Mortgage Disclosure**

April 19, 1995—Revision and Related Amendments

The Board approved a revised Regulation BB to change the standards for

evaluating compliance by financial institutions with the requirements of the Community Reinvestment Act (CRA). The revised regulation is effective January 1, 1996, for small financial institutions and institutions electing to be evaluated under a strategic plan. Wholesale and limited-purpose institutions that have collected data on their community development lending may elect to be evaluated under a separate test after January 1, 1996. Large financial institutions will be subject to the final rule no later than July 1, 1997.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Yellen. Votes against this action: Mr. LaWare and Ms. Phillips.

The Board also adopted related conforming amendments to Regulation C and to the instructions that financial institutions use to comply with the annual reporting requirements under the regulation, effective May 1, 1995. Compliance for loan and application data is mandatory for data collected after December 31, 1995.

Votes for this action: Messrs. Greenspan, Blinder, and Lindsey and Ms. Yellen. Votes against this action: Messrs. Kelley and LaWare and Ms. Phillips.

The revision of Regulation BB was part of a comprehensive effort by the federal financial supervisory agencies to reform their standards for evaluating compliance with the requirements of the CRA. In addition to incorporating new procedures for assessing compliance, the Board provided guidance to financial institutions on those procedures. Parallel regulations were adopted by the other federal banking agencies.

In dissenting, Mr. LaWare thought that the revised Regulation BB and related amendments to Regulation C imposed management mandates that far

exceeded the intent of the original Community Reinvestment Act, and he disagreed with the underlying premise that banks did not satisfactorily meet the credit needs of their communities. Both Mr. LaWare and Ms. Phillips were concerned that these actions would lead to the allocation of credit. Ms. Phillips did not think that the revised Regulation BB achieved the goal of more emphasis on performance with less process and paperwork, and she was concerned about the increased burdens of data collection and processing, increased costs for examinations, and increased requirements for documentation for which she did not see offsetting benefits. Ms. Phillips did not support the amendments to Regulation C because she did not think that expansion of the requirement to collect home mortgage loan data by census tract would be constructive.

Mr. Kelley did not support the amendments to Regulation C because he thought that the expanded reporting requirements would not improve the ability of the agencies to assess CRA performance enough to justify the substantial additional burden on financial institutions.

Regulation DD

Truth in Savings

January 4, 1995—Amendment

The Board approved an amendment to Regulation DD to require that the annual percentage yield on interest-bearing accounts reflect the frequency of interest payments.

Votes for this action: Messrs. Blinder, Kelley, and Lindsey and Ms. Yellen. Voting against this action: Messrs. Greenspan and LaWare and Ms. Phillips.

The Truth in Savings Act requires that depository institutions calculate and disclose an annual percentage yield for interest-bearing accounts that reflects the interest rate paid and the frequency of compounding. The formula for calculating the annual percentage yield assumes that interest remains on deposit until maturity. This assumption produces an annual percentage yield that does not always reflect the time value of money when there are interest payments before maturity. To facilitate the comparison of accounts, the Board revised the definition of the annual percentage yield to reflect the frequency of interest payments.

In dissenting, Messrs. Greenspan and LaWare and Ms. Phillips believed that the costs associated with implementing the amendment would not be offset by increased benefits to consumers arising from an annual percentage yield that assumes all periodic interest payments are immediately reinvested at the contract rate.

January 17, 1995—Reconsideration of Decision, Interim Amendment

The Board agreed to reconsider the January 4, 1995, amendment to Regulation DD, which would have required that the annual percentage yield disclosed by depository institutions on interest-bearing deposits reflect the frequency of interest payments. The Board also approved an interim amendment to the regulation to permit institutions to disclose an annual percentage rate equal to the contract interest rate for certain accounts with maturities greater than one year, effective January 18, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen.

In response to requests from several banking and consumer organizations, the Board agreed to reconsider the January 4, 1995, amendment and sought further public comment on calculation of the annual percentage yield. The Board also approved an interim rule that permits institutions to disclose an annual percentage rate equal to the contract interest rate for time accounts with maturities greater than one year that do not compound and require interest distributions at least annually.

Rules Regarding Access to Personal Information Under the Privacy Act

January 5, 1995—Revision

The Board revised and updated its Rules Regarding Access to Personal Information Under the Privacy Act, effective February 16, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Phillips and Yellen.

The Board's Rules Regarding Access to Personal Information implement the requirements of the Privacy Act of 1974, which is designed to restrict access by third parties to records on individuals that are maintained by the federal government and to give individuals access to their own records. As part of its regulatory review and improvement process, the Board revised the rules to reflect changes in the Board's organization and procedures.

Rules Regarding Delegation of Authority

April 25, 1995—Amendment

The Board approved an amendment to its Rules Regarding Delegation of

Authority to allow the Federal Reserve Banks to approve certain investments designed primarily to promote the public welfare, effective June 5, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and LaWare and Ms. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

Regulation H (Membership of State Banking Institutions in the Federal Reserve System) permits state member banks to make some public welfare investments without advance approval by the Board and to make other such investments with specific approval. The Board delegated to the Federal Reserve Banks the authority to approve certain public welfare investments that otherwise would have required the Board's approval.

Rules Regarding Equal Opportunity

December 27, 1995—Amendment

The Board approved an amendment to its Rules Regarding Equal Opportunity to correct an ambiguity in a provision concerning confidential information in an investigative file, effective February 5, 1996.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Phillips and Yellen. Absent and not voting: Mr. Blinder.¹

The rules require that the file compiled during an investigation of an administrative complaint of discrimination be made available to each complainant on completion of the investigation. The Board amended its rules to clarify that confidential information relevant to the complaint must be included in the investigative file unless it is classified national security information.

March 24, 1995—Guidelines for Appeals of Material Supervisory Determinations

The Board approved a process for appeals by depository institutions of adverse material supervisory decisions, effective March 24, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Phillips and Yellen.

The Riegle Community Development and Regulatory Improvement Act of 1994 required that the Board and the other federal banking agencies establish an independent, intra-agency process to review appeals by depository institutions of material supervisory determinations such as an adverse examination report. To implement the requirements of the act, the Board adopted a set of guidelines for such appeals.

May 22, 1995—Regulatory Ombudsman Policy Statement

The Board approved a policy statement that outlines the responsibilities of the Board's ombudsman for agency regulatory matters, effective August 2, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Ms. Phillips and Yellen.¹

Section 309 of the Riegle Community Development and Regulatory Improvement Act of 1994 requires that each federal banking agency appoint a regulatory ombudsman. The Board adopted a policy statement that provides for the appointment of an ombudsman to act as a facilitator and mediator for the resolution of complaints and to ensure that those complaints are addressed fairly and promptly. The Board also appointed an ombudsman.

August 9, 1995—New Fedwire Closing Times

The Board approved the establishment of a firm closing time for the Fedwire securities transfer service, beginning January 2, 1996.

Votes for this action: Messrs. Blinder, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. Greenspan and Ms. Yellen.¹

The Board established a firm closing time of 3:15 p.m. eastern time for transfer originations and 3:30 p.m. eastern time for reversals of the Fedwire book-entry securities transfer system. The Board also authorized the Federal Reserve Banks to continue to close the service earlier than the regular times on days when the U.S. government and mortgage securities markets observe holidays. The new closing time is expected to benefit market participants by reducing uncertainty about the final closing time of the system.

August 9, 1995—Policy Statement on Payment System Risk

The Board approved revisions of the Fedwire third-party access policy to clarify its applicability and reduce administrative burden, effective August 10, 1995.

Votes for this action: Messrs. Blinder, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. Greenspan and Ms. Yellen.¹

To reduce costs imposed by the policy, the Board made several requirements applicable only to arrangements in which the service provider is not affiliated with the Fedwire participant. The Board also clarified the scope of the policy.

1995 Discount Rates

The Board approved one change in the basic discount rate during 1995, an increase from $4\frac{3}{4}$ percent to $5\frac{1}{4}$ percent in early February. Over the course of the year, the Board also approved numerous changes, including both increases and decreases, in the rates charged by the Federal Reserve Banks for seasonal and for extended credit; rates for both types of credit are set on the basis of market-related formulas, and they exceeded the basic discount rate by varying amounts during the year.

Basic Discount Rate

The Board's decisions on the basic rate are made against the background of the policy actions of the Federal Open Market Committee (FOMC) and the related economic and financial developments that are covered more fully in the minutes of the FOMC and in the monetary policy reports to the Congress that appear elsewhere in this REPORT.

Monetary policy had been tightened considerably during 1994; as part of the process, the basic discount rate was raised in three steps, from 3 percent to $4\frac{3}{4}$ percent. Despite these policy tightening moves, economic activity had continued to advance at a substantial and unsustainable pace, and a number of signs—including high levels of utilization of labor and other producer resources—had pointed to a continued risk of some increase in inflation.

During January 1995 a growing number of Federal Reserve Banks—a total of seven by late in the month—submitted requests to raise the basic discount rate by $\frac{1}{4}$ or $\frac{1}{2}$ percentage point. The Board considered the requests during January but took no action until February 1, when it approved an increase of $\frac{1}{2}$ percentage point. This

action accompanied a corresponding tightening of reserve conditions approved by the FOMC on the same day. The purpose of these actions was to adjust monetary policy to a stance that was judged to be needed to contain inflation and foster sustainable economic growth.

Over the remainder of 1995 the Board considered but took no action on further requests to change the basic rate. All those requests called for reductions of $\frac{1}{4}$ or $\frac{1}{2}$ percentage point in the basic rate. At various times from June through September and then again in December, one to five Reserve Banks had such requests pending before the Board, all but two of which had been withdrawn by year-end. In reaching its decisions not to approve the requests, the Board took account of the slight easing actions implemented by the FOMC in early July and mid-December. Those actions focused on indications of receding inflationary pressures and some associated moderation in inflationary expectations, and given surrounding circumstances, the Board decided not to accompany them with reductions in the basic rate.

Structure of Discount Rates

The basic rate is the rate normally charged on loans to depository institutions for short-term adjustment credit, while flexible, market-related rates generally are charged on seasonal and extended credit. These flexible rates are calculated periodically in accordance with formulas that are subject to Board approval.

Under the seasonal program, whose purpose is to assist smaller institutions in meeting regular needs arising from a clear pattern of intrayearly movements in their deposits and loans, funds may be provided for periods longer than those permitted under adjustment credit.

Since its introduction on January 9, 1992, the flexible rate charged on seasonal credit has been closely aligned with short-term market rates; it is never less than the basic rate applicable to adjustment credit.

A different flexible rate is charged on extended-credit loans, which are made to depository institutions that are under sustained liquidity pressure and are not able to obtain funds from other sources. The rate for extended credit is 50 basis points higher than the seasonal rate and is at least 50 basis points above the basic rate. The first thirty days of borrowing on extended credit may be at the basic rate, but further borrowings ordinarily are charged the flexible rate.

Exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems that are not clearly beyond the reasonable control of the borrowing institution are assessed the highest rate applicable to any credit extended to depository institutions; under the current structure, that rate is the flexible rate on extended credit.

At the end of 1995 the structure of discount rates was as follows: a basic rate of 5.25 percent for short-term adjustment credit, a rate of 5.75 percent for seasonal credit, and a rate of 6.25 percent for extended credit. During 1995 the flexible rate on seasonal credit ranged from a low of 5.60 percent to a high of 6.10 percent, and the flexible rate on extended credit ranged from a low of 6.10 percent to a high of 6.60 percent.

Board Votes

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. Federal Reserve Bank proposals on the discount rate include requests to renew the formulas for calculating the flexible rates on seasonal and extended credit. Votes relating to the reestablishment of existing rates or for the updating of market-related rates under the seasonal and extended credit programs are not shown in this summary. All votes on discount rates taken by the Board of Governors during 1995 were unanimous.

Votes on the Basic Discount Rate

February 1, 1995. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Richmond, Chicago, St. Louis, Kansas City, and San Francisco to increase the basic discount rate $\frac{1}{2}$ percentage point, to $5\frac{1}{4}$ percent.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen. Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Philadelphia, Atlanta, Minneapolis, and Dallas, effective February 2, 1995, and the Federal Reserve Bank of Cleveland, effective February 9, 1995. ■

Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are 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 minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a résumé of the discussions that led to 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.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the record. When members dissent from a decision, they are identified in the record along with a summary of the reasons for their dissent.

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 sets of instructions 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, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. These policy instruments are shown below in the form in which they were in effect at the beginning of 1995. 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, 1995

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 \$8.0 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, 1995¹

The information reviewed at this meeting suggests a further pickup in economic growth in recent months. Nonfarm payroll employment rose sharply in November, and the civilian unemployment rate declined to 5.6 percent. Industrial production registered another large increase in November and capacity utilization moved up further from already high levels. Retail sales have continued to rise rapidly. Housing starts increased appreciably in November. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been trending higher. The nominal deficit on U.S. trade in goods and services widened somewhat in October from its average rate in the third quarter. Prices of many materials have continued to move up rapidly, but broad indexes of prices for consumer goods and services have increased moderately on average over recent months.

On November 15, 1994, the Board of Governors approved an increase from 4 to 4¾ percent in the discount rate, and in line with the Committee's decision the increase was allowed to show through fully to interest rates in reserve markets. In the period since the November meeting, short-term interest rates have risen considerably while long-term rates have declined slightly. The trade-weighted value of the dollar in terms of the other G-10 currencies recovered further over the intermeeting period.

Growth of M2 resumed in November after several months of decline, while M3 expanded moderately further. For the year through November, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months and for the year-to-date it has grown at a rate in the lower half of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. 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 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 modest growth in M2 and M3 over coming months.

Authorization for Foreign Currency Operations

In Effect January 1, 1995

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:

1. Adopted by the Committee at its meeting on December 20, 1994.

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 kroner
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 \$25.0 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	
Regular	3,000
Special	1,500
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, System Open Market Account ("Manager"), 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 for-

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 to appropriate 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, 1995

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.

Procedural Instructions with Respect to Foreign Currency Operations

In Effect January 1, 1995

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager for Foreign Operations, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$300 million on any day or \$600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding \$150 million, or \$300 million when the

operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in I.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

Meeting Held on January 31–February 1, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., starting on Tuesday, January 31, 1995, at 1:30 p.m. and continuing on Wednesday, February 1, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman

Mr. McDonough, Vice Chairman

Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and
Stern, Alternate Members of the
Federal Open Market Committee

Messrs. Broadus, Forrestal, and Parry,
Presidents of the Federal Reserve
Banks of Richmond, Atlanta, and
San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Davis, Dewald, Lindsey,
Mishkin, Promisel, Siegman,
Slifman, and Stockton, Associate
Economists

Mr. Fisher, Manager, System Open
Market Account

Mr. Ettin, Deputy Director, Division of
Research and Statistics, Board of
Governors

Mr. Madigan, Associate Director,
Division of Monetary Affairs,
Board of Governors

Mr. Simpson, Associate Director,
Division of Research and
Statistics, Board of Governors

Mr. Winn,² Assistant to the Board,
Office of Board Members, Board
of Governors

Messrs. Hooper and Reinhart,²
Assistant Directors, Divisions of
International Finance and
Monetary Affairs respectively,
Board of Governors

Mr. Rosine,² Senior Economist,
Division of Research and
Statistics, Board of Governors

Mr. English,² Economist, Division of
Monetary Affairs, Board of
Governors

Mr. Freeman,² Section Chief, Division
of International Finance, Board of
Governors

Ms. O'Day,² Associate General
Counsel, Legal Division, Board of
Governors

Mr. Baer² and Ms. Misback,²
Managing Senior Counsels, Legal
Division, Board of Governors

Mr. Ely,² Senior Attorney, Legal
Division, Board of Governors

Ms. Low, Open Market Secretariat
Assistant, Division of Monetary
Affairs, Board of Governors

Messrs. Barron and Rasdall, First Vice
Presidents, Federal Reserve Banks
of San Francisco and Kansas City
respectively

Messrs. Beebe, Goodfriend, Lang,
Rosenblum, and Sniderman and
Ms. Tschinkel, Senior Vice
Presidents, Federal Reserve Banks
of San Francisco, Richmond,
Philadelphia, Dallas, Cleveland,
and Atlanta respectively

Messrs. McNees and Miller, Vice
Presidents, Federal Reserve Banks
of Boston and Minneapolis
respectively

Mr. Evans and Ms. Krieger, Assistant
Vice Presidents, Federal Reserve
Banks of Chicago and New York
respectively

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1995, and ending December 31, 1995, had been received and that the named individuals had executed their oaths of office.

The elected members and alternate members were as follows:

2. Attended portions of the meeting.

William J. McDonough, President of the Federal Reserve Bank of New York, with James H. Oltman, First Vice President of the Federal Reserve Bank of New York, as alternate;

Cathy E. Minehan, President of the Federal Reserve Bank of Boston, with Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, as alternate;

Michael H. Moskow, President of the Federal Reserve Bank of Chicago, with Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, as alternate;

Thomas C. Melzer, President of the Federal Reserve Bank of St. Louis, with Robert D. McTeer, President of the Federal Reserve Bank of Dallas, as alternate;

Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, with Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first regularly scheduled meeting of the Committee after December 31, 1995, with the understanding that should they discontinue their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

Alan Greenspan	Chairman
William J. McDonough	Vice Chairman
Donald L. Kohn	Secretary and Economist
Normand R.V. Bernard	Deputy Secretary
Joseph R. Coyne	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Ernest T. Patrikis	Deputy General Counsel
Michael J. Prell	Economist
Edwin M. Truman	Economist

Lynn E. Browne, Thomas E. Davis, William G. Dewald, David E. Lindsey, Frederic S. Mishkin, Larry J. Promisel, Charles J. Siegman, Lawrence Slifman, David J. Stockton, and Carl E. Vander Wilt, Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 1995.

By unanimous vote, Peter R. Fisher was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

Secretary's note. Advice subsequently was received that the selection of Mr. Fisher was satisfactory to the board of directors of the Federal Reserve Bank of New York.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 20, 1994, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the December meeting. There were no market transactions for System Account during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period December 20, 1994, through January 31, 1995. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting

period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested a strong further rise in economic activity during the closing months of 1994. Although consumer spending appeared to be less buoyant and housing demand had softened somewhat, growth in business investment, exports, and inventories remained brisk. Industrial production and payroll employment continued to record substantial gains. Broad indexes of prices for consumer goods and services had risen moderately on average over recent months despite shrinking margins of unemployed resources and further sizable increases in the prices of many materials.

Nonfarm payroll employment advanced considerably further in December after a sharp rise in November. Substantial job gains were recorded in December in service industries and in the retail trade sector. Hiring in manufacturing was brisk for a third straight month, with labor demand especially strong in motor vehicles, capital goods, and electronic equipment. Construction payrolls slipped after a large increase in November. The average workweek was unchanged in December, but factory overtime edged back up, matching the highest level reached in the history of this series. The civilian unemployment rate declined to 5.4 percent.

Industrial production registered another large advance in December. Manufacturing accounted for all of the gain; an upturn in mining production offset a decline in the output of utilities associated with unseasonably warm

weather. In manufacturing, the output of motor vehicles and parts surged again and further solid gains were recorded in the production of other goods. The large advance in industrial output in December boosted rates of capacity utilization above already high levels.

Retail sales were reported to have changed little over November and December after substantial advances in September and October; the flattening of sales reflected sharply reduced increases in outlays for non-auto consumer goods. Consumer spending on services rose moderately on balance over November and December, with outlays for energy services held down by unusually mild weather. Although some indicators of housing demand had weakened, housing starts posted sizable gains on balance over November and December; single-family construction remained at a relatively high level despite the rise in mortgage rates in 1994, and multifamily construction continued its gradual recovery from the depressed levels of early 1993. The regional pattern of starts activity suggested that favorable weather accounted for little of the strength in December.

Business fixed investment was estimated to have grown at a very rapid pace in the fourth quarter, with a pickup indicated for business spending on both equipment and nonresidential structures. New orders for nondefense capital goods declined on balance over November and December, but the large backlog of unfilled orders, especially for computers, pointed to a continued strong expansion in spending on business equipment in coming months. Nonresidential construction activity was up considerably in November for a third straight month, with increases in construction widespread by type of structure. Recent data indicated that permits for nonresidential construction were

continuing to trend higher and perhaps were running ahead of construction activity.

Business inventory investment remained brisk in November; in the aggregate, the buildup was in line with shipments and sales. In manufacturing, stocks increased more rapidly in November, but the ratio of stocks to shipments declined further and was at a historically low level. In wholesale trade, inventories rose less rapidly in November, but the inventory-to-sales ratio increased further, although it remained within its range of recent years. Inventory accumulation slowed a little at the retail level, and the inventory-to-sales ratio for this sector remained near the middle of its range of recent years.

The nominal deficit on U.S. trade in goods and services widened somewhat further in November, and for October and November combined the deficit was well above its average rate in the third quarter. The value of exports of goods and services increased more slowly in the October–November period than in the third quarter, largely reflecting reduced growth of exported industrial supplies. The rise in the value of imports of goods and services for the October–November period was led by increased imports of non-oil industrial supplies and automotive, capital, and consumer goods. Available data for the fourth quarter of 1994 indicated continued growth in economic activity, though perhaps at a somewhat slower pace, in the major foreign industrial countries.

Consumer price inflation slowed a little in December despite a jump in food prices that was only partly offset by a decline in energy prices. Excluding food and energy items, consumer prices edged up in December and rose significantly less in 1994 than in 1993. At the producer level, prices of finished goods

also advanced more slowly in December, with a drop in energy prices balancing a surge in food prices. Prices of finished goods other than food and energy increased modestly in 1994 after being held down in 1993 by a sharp drop in the prices of tobacco products. In contrast to prices of finished goods, price inflation at earlier stages of production picked up in 1994. For intermediate goods other than food and energy items, prices rose at a faster rate in the second half of 1994, with the pickup most clearly evident in materials used in manufacturing. Prices of crude materials rose rapidly in the second half of 1994 and for the year as a whole. Increases in labor costs remained moderate. Average hourly earnings were little changed on balance over November and December, and for the year as a whole they advanced only slightly more than in 1993. More broadly, hourly compensation of private industry workers increased more slowly in the fourth quarter than in any of the previous three quarters of 1994, and the rise for the year was significantly less than in 1993.

At its meeting on December 20, 1994, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, the directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest

growth in the broader monetary aggregates over coming months.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. With the need for seasonal credit diminishing over the period, adjustment plus seasonal borrowing trended lower but averaged a little above anticipated levels. Near year-end, the Trading Desk accommodated heavy demands for reserves through System repurchase agreements (RPs). The federal funds rate averaged close to 5½ percent during the intermeeting period.

Most other market interest rates declined slightly on balance over the period after the December 20 meeting. Very short term interest rates fell after the first of the year, reflecting the disappearance of year-end premiums. More broadly, favorable news on inflation and indications of some unexpected slowing in the growth of final demand apparently led market participants to conclude that further tightening of monetary policy, though still expected to be substantial, would be less than previously thought and would be spread over a longer period. Yields on tax-exempt instruments declined considerably as concerns about the implications of Orange County's problems for the financial condition of other municipal governments abated. Strong earnings reports for the fourth quarter boosted major indexes of equity prices.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined somewhat over the intermeeting period. The dollar fell substantially against the mark, which was buoyed by safe-haven inflows from weaker European currencies, but dropped less against the yen. One factor that weighed against the dollar was uncertainty about

the consequences for the U.S. economy of the sharp depreciation of the Mexican peso and the related economic and financial problems in Mexico and other developing economies; market participants expressed some concern that the crisis might constrain U.S. monetary policy in the event of further domestic inflation pressures and that the counterpart to the large prospective reduction in the Mexican current account deficit would lie importantly in the already substantial U.S. deficit.

Growth of M2 and M3 strengthened in December, and data for the first half of January suggested a further acceleration in that month. Much of the pickup in M2 in December was due to rapid expansion in overnight RPs and overnight Eurodollars, which outweighed a further contraction of liquid accounts associated in part with depositor efforts to obtain higher returns by shifting funds into market instruments. The faster growth of M3 reflected, in addition to the acceleration of its M2 component, bank use of large CDs and nondeposit sources of funds to finance relatively robust demands for credit. From the fourth quarter of 1993 to the fourth quarter of 1994, M2 grew at the lower end of the Committee's range for 1994 and M3 in the lower half of its range. Total domestic nonfinancial debt had continued to expand at a moderate rate in recent months, and for 1994 it was in the lower half of its monitoring range.

The staff forecast prepared for this meeting suggested that growth of economic activity would slow substantially over the next several quarters and for some period thereafter would average less than the rate of increase in the economy's potential output. Consumer spending was projected to be well sustained for a time but to be restrained later by smaller gains in real incomes,

the satisfaction of pent-up demands, and the lagged effects of higher interest rates on the demand for durable goods. Business outlays for new equipment were expected to decelerate substantially in response to higher financing costs and slower growth of sales and profits. Homebuilding was anticipated to soften a little in response to slower growth in jobs and income as well as to the increase that had occurred in mortgage rates. Recent developments in Mexico were expected to cut into exports in the near term, but the sustained economic growth elsewhere would keep export demand on an uptrend. Although there was considerable uncertainty regarding the fiscal outlook, in light of the congressional intent to cut the federal deficit the forecast incorporated a somewhat greater degree of fiscal restraint than had been built into recent forecasts. In the staff's judgment, the economy currently was operating beyond its long-run, noninflationary capacity, and there remained a substantial risk that inflation could ratchet higher absent further monetary policy actions.

In the Committee's discussion of current and prospective economic developments, the members agreed that growth in economic activity could be expected to moderate considerably over the course of 1995, although inflation was likely to be higher than in 1994. They acknowledged that their current projections were subject to substantial risks. The expansion continued to display appreciable momentum and signs of slower growth were still quite limited and tentative. Even so, the members remained persuaded that the lagged effects of the policy tightening implemented over the course of 1994 would become increasingly evident in interest-sensitive sectors of the economy as the year progressed. The projected moderation in the growth of final demands,

which probably would be concentrated at least initially in the housing and consumer durables sectors, would undoubtedly reinforce an expected cutback in inventory investment from its unsustainable pace in recent quarters. A key uncertainty in the outlook was whether the slowing in overall economic growth would be sufficient to relieve the current pressures on labor and other producer resources, which many members saw as portending higher inflation, or, indeed, whether such pressures would intensify further. Opinions differed to some degree with regard to both the likely extent of the prospective slowing in economic growth and the outlook for inflation. However, most of the members concluded that some rise in inflation appeared probable over coming quarters, and they were concerned that this upturn would not be reversed and could be extended in the absence of further monetary restraint.

In keeping with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared individual projections of economic activity, the rate of unemployment, and inflation for the year 1995. Measured from the fourth quarter of 1994 to the fourth quarter of 1995, their forecasts of the growth in real GDP had a central tendency of 2 to 3 percent, compared with a growth rate of 4 percent estimated for 1994. Most of the members also anticipated that economic expansion in line with their forecasts would be associated with little change in the unemployment rate, and their projections of the rate in the fourth quarter of 1995 were centered in a narrow range around 5½ percent. The high levels of resource utilization implied by these projections were viewed by most

members as likely to foster somewhat greater pressure on wages and prices. Accordingly, projections of the rate of inflation, as indexed by the consumer price index, had a central tendency of 3 to 3½ percent for the period from the fourth quarter of 1994 to the fourth quarter of 1995, compared with rates of about 2¾ percent in both 1993 and 1994.

In their review of regional economic developments, members referred to widespread evidence of further growth in business activity, but a number also mentioned scattered signs of some softening in a few areas or industries. Several emphasized, however, that the anecdotal evidence did not currently point to any significant moderation in the overall growth of the economy. With regard to financial conditions, members commented that they saw little indication that policy tightening actions over the past year were constraining the availability of credit to any observable degree. Despite higher interest rates, financial conditions remained broadly supportive of further economic expansion. The performance of stock market prices and the relatively narrow quality spreads in debt markets attested to a considerable degree of confidence among investors. Members also took note of the accommodative lending policies of banking institutions. Those policies had encouraged rapid growth in consumer and business loans and evidently were contributing to the ongoing strength of the economic expansion. Some members expressed concern that a number of banks might have eased their lending standards unduly and thus assumed unwarranted risks in their loan portfolios.

In their assessment of developments in key sectors of the economy, members referred to the sluggish behavior of non-auto retail sales in November and

December, but they also noted that the available information on consumer spending during the first few weeks of this year was inconclusive with regard to the possible emergence of a slowing trend. Anecdotal commentary on retail sales was mixed, and evidence of some decline in January sales of motor vehicles needed to be evaluated with caution because of the introduction of a new reporting method. Consumer confidence was at a high level, but some members observed that consumer indebtedness had grown rapidly and was likely to exert a retarding effect on consumer spending at some point. In this regard, however, it was pointed out that rising consumer incomes had kept debt service burdens from increasing significantly thus far. On balance, the members believed that the growth in consumer spending probably would slow over the forecast horizon though such spending might be relatively well maintained for some period, given the ongoing expansion in jobs and incomes and the ready availability of financing to many consumers. In any event, the outlook for this sector of the economy, which was critical to any significant moderation in overall economic growth, was uncertain with regard to both the timing and the extent of possible slowing.

Housing construction was cited as potentially the most important demand sector of the economy that was likely to contribute to more moderate economic growth over the year ahead. As evidenced by nationwide data through the end of 1994, single-family housing starts had held up unexpectedly well despite sizable increases in home mortgage rates, but anecdotal reports from around the country had pointed to weakening demand for new homes for several months and continued to do so. Against the background of current mortgage rate levels and the rise that

had occurred in home mortgage indebtedness, the members continued to anticipate softening demand for housing, at least in the single-family sector. The mild uptrend in the much smaller multifamily sector was likely to continue for some period, given low rental vacancy rates in a number of areas, and further improvement in nonresidential construction was likely to offset to some extent the overall slowing in housing construction.

In the capital goods sector, real business-fixed investment had strengthened further in the fourth quarter, and the members believed, on the basis of rising order backlogs and the strength of permits for new business construction, that considerable momentum had carried into this year. While the growth in spending for business equipment undoubtedly would moderate from its extraordinary pace over an extended period, large business profits and the still relatively low user cost of capital would tend to support appreciable further growth in such investment in the context of elevated levels of capacity utilization and ongoing efforts, induced by strong market competition, to increase productivity. Moreover, non-residential construction was now trending higher, with particular strength evident in industrial and commercial construction.

The pace of inventory accumulation in recent quarters was viewed as unsustainable and a decline in inventory investment was seen as likely over the forecast horizon, though the precise timing and extent were impossible to predict. While slower growth in final demand might in most circumstances stimulate a relatively sharp adjustment in inventory investment, members cited factors that could mute the size of that adjustment and its effects on overall GDP. These included relatively low

inventory-sales ratios across much of the economy and little anecdotal or other evidence of unintended inventory accumulation. Moreover, because an unusually large share of the inventory buildup in recent quarters appeared to involve imports, a cutback in such investment should tend to have a smaller-than-usual impact on domestic production. There was no current evidence that inventory investment was slowing, and indeed recent data on business loans at banks might suggest some acceleration in inventory accumulation since the beginning of the year. Nonetheless, as more moderate growth in final demand began to emerge, concerns about the availability of materials used in the production process or stocks needed to meet market demand should diminish, and business firms could be expected to trim their demand for inventories, perhaps aggressively for a time. Indeed, this sector of the economy might well account for much of the slowing in the expansion for some period of time during the year ahead.

Fiscal policy was under active debate in the Congress, and the members viewed the outcome of that debate as very uncertain. The emergence of a moderately restrictive fiscal policy might be a reasonable assumption to incorporate in current forecasts, albeit an assumption that clearly was subject to a wide range of error. In any event, any progress toward cutting future budget deficits was likely to have a favorable effect on domestic financial markets and perhaps also on the dollar in foreign exchange markets.

Developments in Mexico and their possible repercussions in other developing nations had negative implications for U.S. exports, at least over the short run. Indeed, some members cited anecdotal evidence that reduced trade with Mexico had already emerged since late

1994. Moreover, the effects of the earthquake in Kobe, Japan, seemed to be disrupting trade with that nation in agricultural and other bulk goods and was likely to continue doing so over the near term. Looking beyond the months immediately ahead, the relatively robust growth projected for many industrial countries together with the lower value of the dollar should boost the nation's overall external trade balance, though probably not to the extent of providing substantial stimulus to the economy. One member observed that a number of countries throughout the world faced the potential for important changes in political conditions that could have adverse effects on their growth and trading relationships, with possible repercussions on U.S. exports.

Members commented that the strong growth in economic activity and high levels of resource utilization had fostered relatively rapid increases in the prices of many raw materials and semi-finished goods used in the production process, but contrary to numerous forecasts these developments had not led thus far to a broad pickup in inflation as measured by the prices of final goods and services. This favorable development might be explained in part by lags in the inflation transmission process and perhaps to some degree by various structural changes and productivity improvements in recent years that may have raised both the level and the rate of increase of the economy's potential for sustained activity. Many members observed, however, that it would not be prudent from a monetary policy standpoint to assume that continued rapid economic growth and further pressures on producer resources would not lead to rising inflation over the quarters ahead. While competitive pressures still generally limited the extent to which business firms could pass through rising costs of

raw materials and other producer inputs to the prices of final goods, the members referred to increasingly numerous examples of successful efforts to raise such prices and to apparently growing business expectations that it would be possible to implement such increases over the months ahead. On balance, the members generally were persuaded that the economy had attained levels of labor and capital utilization that implied a strong risk of rising inflation over coming quarters.

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 of the monetary and debt aggregates in 1995 that it had established on a tentative basis at its meeting in July 1994. The tentative ranges included expansion of 1 to 5 percent for M2 and 0 to 4 percent for M3, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at 3 to 7 percent for 1995. The ranges for M2 and M3 were unchanged from those that the Committee had used in 1994, while the range for debt was 1 percentage point lower.

All the members endorsed a proposal to adopt the ranges that the Committee had set on a tentative basis in July 1994. While some acceleration in the growth of the broad monetary aggregates from the pace in 1994 could be anticipated over the year ahead according to a staff analysis, monetary expansion within the ranges in question appeared to be consistent with the moderation in the expansion of nominal GDP that the members were projecting for 1995 and that they viewed as desirable to head off increasing inflation. Moreover, the ranges for the broad monetary aggregates had been

reduced over the past decade to levels that, notably in the case of M2, should now be consistent over long periods with the Committee's objectives for stable prices and maximum sustainable economic growth. This outcome would depend on the restoration over time of the historical velocity patterns linking the monetary aggregates to broad measures of economic performance, including a level velocity trend for M2. It was noted in this regard that until recent years the growth of M3 had tended to exceed that of M2—a pattern that seemed to be re-emerging—and therefore a somewhat higher range might be set for M3 than for M2. However, the members did not believe that a persuasive argument could be made at this juncture for raising the M3 range, though they did not want to rule out the option of doing so later, possibly when the ranges were reviewed at midyear. Indeed, to make the change at this point might convey a misleading message regarding the Committee's policy intentions or its confidence in prospective monetary growth relationships.

The Committee also considered the potential advantages and disadvantages of setting specific targets for bringing inflation down and achieving price stability over time. Such targets might provide an alternative or supplemental approach to the monetary growth ranges, which had been found to be unreliable guides for monetary policy over the past several years. The members discussed a number of aspects of inflation targeting. On the one hand, such targeting would help to anchor the conduct of monetary policy and progress in meeting these objectives could enhance the credibility of the Federal Reserve and perhaps reduce the overall cost of attaining price stability. On the other hand, close adherence to preset inflation targets could unduly constrain

the Federal Reserve in its efforts to counteract the effects of cyclical shortfalls in the performance of the economy. The members agreed that the discussion had been helpful in outlining the issues and that the subject should be revisited. It was noted in this connection that the Committee might be asked to comment during the months ahead on specific congressional proposals for inflation targeting.

At the conclusion of its discussion, all the members voted to approve without change the tentative ranges for 1995 that the Committee had established in July of last year. In keeping with its usual procedures under the Humphrey-Hawkins Act, the Committee would review its ranges at midyear, or sooner if interim conditions warranted, in light of the growth and velocity behavior of the aggregates and ongoing economic and financial developments. Accordingly, the following longer-run policy statement for 1995 was approved for inclusion in the domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee anticipated that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was lowered to 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley,

LaWare, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Mses. Phillips and Yellen. Votes against this action: None.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they could support some firming in reserve conditions, though a few preferred to delay such an action pending the receipt within the next few weeks of significant new information that could help the Committee to evaluate whether and to what extent the economic expansion might be slowing. Most of the members were convinced, however, that current monetary policy should be adjusted promptly to a more clearly restrictive stance. In their view, prompt action was needed to counter inflationary pressures and inflationary expectations in an economy that already seemed to be operating at, and perhaps beyond, sustainable capacity levels and to be continuing to expand at a pace above its long-run potential. In these circumstances, a delay in tightening policy would incur an unacceptable risk of allowing further inflationary momentum to develop in the economy and would require more tightening over time than might otherwise be needed to achieve the Committee's objectives. Part of the risk involved a potential further decline in the dollar at a time when there already was considerable concern about rising pressures on prices. Some tightening of policy at this meeting was generally anticipated in markets, and a failure to take action now was likely in the view of a number of members to raise questions about the credibility of the System's anti-inflation resolve and to generate some unsettlement in financial markets, notably in the foreign exchange market where the dollar already appeared to be vulnerable to further weakness. In terms of balancing the policy risks that were involved, a

prompt move would provide some insurance against what these members viewed as the principal risk in current circumstances—that of rising inflation. The risks of excessive tightening, while not completely absent, were believed to be limited in light of the apparent strength and momentum of the expansion, which many forecasters had underestimated over the past year. One member expressed the view that while monetary growth had been damped, continuing restraint on the growth of the narrow monetary aggregates was desirable to offset a previous buildup in liquidity and to help ensure that inflationary pressures would be contained.

Members who saw an advantage in postponing a decision to tighten policy commented that, in light of some scattered signs of a moderating expansion, it would be helpful to wait for certain key statistics that would become available within the next few weeks to judge the extent of any moderation. Data on retail sales in January might provide particular insights as to whether the softening in such sales in November and December was persisting. The favorable news on inflation in the fourth quarter had lessened concerns about an immediate inflation threat, and if the incoming information confirmed the need for further tightening, the short delay in implementing it would have only a minimal cost. In addition, an increase in monetary restraint would be likely to exacerbate the problems of Mexico and perhaps to some extent those of Canada and would have potentially adverse implications for U.S. trade with both of these key trading partners. Because the probability that incoming information would counsel against any further policy tightening was certainly less than 50 percent so that only a matter of timing was likely to be involved, these members indicated that they would join with the

other members in voting to tighten policy at this meeting.

Concerning the possible need to adjust policy during the intermeeting period, the members were unanimously in favor of adopting a symmetric directive. Given a decision to implement some tightening in monetary policy at this meeting, they did not believe that there should be a presumption toward possible further tightening in this period. A number of members observed that further monetary restraint might not be needed if, in line with their expectations, the incoming evidence on the performance of the economy suggested that the expansion was moderating sufficiently for the economy to return to a growth path consistent with containing inflation pressures. In any event, the Committee's most difficult decision over the next several quarters was likely to be that of determining when further tightening was no longer desirable.

Prior to the end of the meeting, the members were apprised of a disposition on the part of the Board of Governors to approve an increase of $\frac{1}{2}$ percentage point in the discount rate that was pending at several Federal Reserve Banks. In the event that such an increase was approved by the Board, the members agreed that open market operations should be conducted so as to allow that increase to be reflected fully in reserve markets.

At the conclusion of the Committee's discussion, all the members indicated that they could support a directive that called for increasing somewhat the degree of pressure on reserve positions. In the implementation of this policy, account would be taken of a possible increase of $\frac{1}{2}$ percentage point in the discount rate that was under consideration by the Board of Governors. The members also agreed that the directive should not include any presumption

about possible adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater or somewhat lesser reserve restraint would be acceptable during the intermeeting period. According to a staff analysis, the reserve conditions contemplated at this meeting would be consistent with moderate growth in M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests a strong further rise in economic activity during the closing months of 1994. Nonfarm payroll employment was up considerably further in December after a sharp increase in November, and the civilian unemployment rate declined to 5.4 percent. Industrial production registered another large advance in December and capacity utilization continued to move up from already high levels. Current estimates indicate little change in retail sales over November and December, while housing starts posted sizable gains on balance over the two months. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been trending appreciably higher. The nominal deficit on U.S. trade in goods and services widened somewhat in October–November from its average rate in the third quarter. Prices of many materials have continued to move up rapidly, but broad indexes of prices for consumer goods and services have increased moderately on average over recent months.

Most market interest rates have declined slightly on balance since the Committee

meeting on December 20, 1994. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined somewhat over the intermeeting period. The Mexican peso has depreciated sharply against the dollar.

Growth of M2 and M3 strengthened in December and January. From the fourth quarter of 1993 to the fourth quarter of 1994, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months, and for the year 1994 it grew at a rate in the lower half of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee anticipated that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was lowered to 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

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 a possible increase in the discount rate. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, LaWare, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Votes against this action: None.

Temporary Increase in Reciprocal Currency Agreement with the Bank of Mexico and Increase in Agreement to "Warehouse" Foreign Currencies

On December 30, 1994, the Committee approved a temporary increase from \$3 billion to \$4½ billion in the System's reciprocal currency (swap) agreement with the Bank of Mexico and it also approved the activation of that agreement. The Committee approved a further temporary increase of \$1½ billion and activation of that amount at this meeting, thereby raising the swap arrangement with the Bank of Mexico to a level of \$6 billion, consisting of the regular \$3 billion line and a special \$3 billion line. The special \$3 billion line may be drawn on until January 31, 1996. Drawings would be for three-month periods and could be renewed a maximum of three times. Once a drawing on the special line is repaid, the size of the line will be reduced *pari passu*. All drawings on the special line will have to be repaid no later than January 31, 1997. The terms and conditions for use of the permanent \$3 billion swap facility with the Bank of Mexico remain unchanged and drawings, once repaid, will require Committee action prior to subsequent use. The Treasury has undertaken to ensure the repayment of any swap drawing by the Bank of Mexico on the \$6 billion in lines that is outstanding more than twelve months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, and LaWare, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Votes against this action: Messrs. Lindsey and Melzer.

The Committee also approved at this meeting an increase from \$5 billion to \$20 billion in the amount of eligible foreign currencies that the System is

prepared to “warehouse” for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing facility, which has been in place for many years, is to supplement the U.S. dollar resources of the Treasury and the ESF for financing purchases of foreign currencies and related international operations. The size of the warehousing facility had ranged up to \$15 billion in past years, but it was reduced to \$5 billion in February 1992. The expansion of the warehousing agreement at this meeting was intended to facilitate U.S. participation in the Multilateral Program to Restore Financial Stability in Mexico, announced by President Clinton on January 31, 1995, by warehousing up to \$20 billion in German marks and Japanese yen held by the Treasury through the ESF. The Committee will review each year the need to maintain this level of warehousing authority in light of the progress and needs of the Program.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, and LaWare, Ms. Minehan, Mr. Moskow, and Meses. Phillips and Yellen. Votes against this action: Messrs. Lindsey and Melzer.

Members who voted to approve these proposals were persuaded that the nature and severity of Mexico’s financial problems could not be contained without making substantial financial assistance available to the Government of Mexico. The financial support provided by the United States would be accompanied by similar assistance from the IMF and would be conditioned on Mexico’s commitment to implement major changes in its economic policies, including monetary policy. It was emphasized during the Committee’s discussion that the United States had a strong interest in encouraging the restoration of stability in Mexico for numerous reasons, includ-

ing the growth of trade between the two nations and the resulting creation of jobs in both countries. Moreover, Mexico’s financial problems appeared to be spreading to a number of other nations and adversely affecting the dollar in the foreign exchange markets. The participation of the Federal Reserve in this effort was strongly endorsed by the Administration and the overall program had the support of the bipartisan leadership in the Congress. Apart from temporary financial resources, the Federal Reserve was in a position to supply expertise and experience that were not readily available elsewhere. On the negative side, the members acknowledged that there could be no assurances that the rescue program would succeed, but its scale, its multinational character, and the apparent willingness of Mexican officials to pursue the difficult policies needed to ensure success were grounds for optimism.

Messrs. Lindsey and Melzer dissented with respect to increases in both the swap line and the warehousing arrangement with the Exchange Stabilization Fund. They did not believe that the Committee had been provided sufficient information to assess whether developments in Mexico threatened U.S. financial stability, a possible justification for increased central bank lending on a short-term basis. Furthermore, they considered it inappropriate for the Federal Reserve to participate, directly or indirectly, in intermediate- to long-term financing to facilitate debt restructuring. They were concerned that such participation in a fiscal policy matter might compromise, or appear to compromise, the independence of the monetary policy process. Mr. Lindsey added that the latter risks were significantly enhanced given the absence of congressional authorization or more general public support for these measures.

Disclosure Policy

At this meeting, the Committee decided to retain the procedures that it had followed over the past year for providing greater information to the public about its policy actions and discussions. It was the judgment of the members that these procedures strike an appropriate balance between making the Committee's decisions and deliberations accessible to the public as soon and as fully as feasible, while safeguarding the Committee's flexibility in policymaking and preserving an unfettered deliberative process. The procedures in question involve the prompt announcement of the Committee's decisions and the release of minutes and transcripts of FOMC meetings.

The Committee will continue its practice of announcing each change in the stance of monetary policy in a press release on the day the decision is made. This practice removes any uncertainty about the Committee's intentions in regard to reserve conditions and enables all financial market participants and others to receive the information at the same time. When no change is made at a meeting, the Committee normally will announce only the time when the meeting ended and that there are no further announcements. However, in some infrequent circumstances, the Committee may decide to issue a statement even when no change in policy is made.

The full substance of the Committee's deliberations relating to each policy decision will continue to be reported, as is the current practice, in comprehensive minutes of the meeting that are released two or three days following the next regularly scheduled meeting. For historians and other students of monetary policymaking, those minutes will be supplemented by lightly edited transcripts of the discussion at each Committee meeting. For recent and future

meetings, transcripts for an entire year will be released with a five-year lag; earlier transcripts dating back to March 1976 will continue to be released on an ongoing basis as the light editing process is completed. Continuing the practice followed since the beginning of 1994, transcripts prepared by the Committee's Secretariat will be circulated to each participant to verify his or her comments, and only changes that clarify meaning, such as the correction of grammar or transcription errors, will be permitted. A limited amount of material will be withheld from the publicly released version of these documents, primarily to protect the confidentiality of foreign and domestic sources of information that likely would be lost if the information they provide were to be made public. As required by law, a complete, unredacted version of the transcript of each meeting will be turned over to the National Archives after thirty years have elapsed.

For the purpose of preparing the minutes and transcripts, the discussions of monetary policy at Committee meetings will continue to be recorded. The tape recorder may be turned off at the Chairman's discretion when the Committee deals with issues unrelated to monetary policy, such as organizational and personnel matters. The transcripts will indicate that the tape recorder has been turned off and the minutes will provide a summary description of the matters that were discussed. As permitted by the National Records Act, the recordings and unedited transcripts will be discarded after all the participants at the meeting have reviewed and corrected, as necessary, the transcripts prepared by the Secretariat.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 28, 1995.

The meeting adjourned at 3:20 p.m.

Donald L. Kohn
Secretary

Meeting Held on March 28, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Tuesday, March 28, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broadbuss, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Ms. Browne and Messrs. Davis, Hunter, Lindsey, Mishkin, Promisel, Siegman, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Goodfriend, Lang, Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Richmond, Philadelphia, Minneapolis, Dallas, and Cleveland respectively

Mr. Kos, Mr. Judd, and Ms. Rosenbaum, Vice Presidents, Federal Reserve Banks of New York, San Francisco, and Atlanta respectively

Mr. Thornton, Assistant Vice President, Federal Reserve Bank of St. Louis

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 31–February 1, 1995, were approved.

By unanimous vote, responsibility for making decisions on appeals of denials by the Secretary of the Committee for access to Committee records was delegated under the provisions of 271.4(d) of the Committee's Rules Regarding Availability of Information to Ms. Phillips and, in her absence, to Ms. Yellen.

By unanimous vote, the Committee elected Thomas C. Baxter, Jr., as Deputy General Counsel from the Federal Reserve Bank of New York and William C. Hunter as Associate Economist from the Federal Reserve Bank of Chicago to serve until the next election at the first meeting of the Committee after December 31, 1995, with the understanding that in the event of the

discontinuance of their official connection with the Federal Reserve Banks of New York and Chicago respectively, they would cease to have any official connection with the Federal Open Market Committee.

On January 12, 1995, the continuing rules, regulations, and other instruments of the Committee had been distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention to give members an opportunity to raise any questions they might have concerning them.

Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda, and no requests for substantive consideration were received. Apart from the updating of the Manager's title (see minutes of Jan. 31-Feb. 1 meeting), all of the instruments identified below remained in effect in their existing forms:

1. Federal Open Market Committee Rules
 - a) Rules of Organization
 - b) Rules of Procedure
 - c) Rules Regarding Availability of Information
 - d) Open Market Operations of Federal Reserve Banks
 - e) Procedures for Allocation of Securities in the System Open Market Account
 - f) Resolution to Provide for the Continued Operation of the Committee During an Emergency
 - g) Resolution Authorizing Certain Actions by Federal Reserve Banks During an Emergency
 - h) Guidelines for the Conduct of System Open Market Operations in Federal Agency Issues
2. Authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank is unable to function
3. Resolution relating to examinations of the System Open Market Account
4. Regulation relating to Open Market Operations of Federal Reserve Banks

By unanimous vote, the Authorization for Domestic Open Market Operations shown below was reaffirmed.

Authorization for Domestic Open Market Operations

Reaffirmed March 28, 1995

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 \$8.0 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 l(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 U.S. 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. Govern-

ment securities to such foreign and international accounts on the bases set forth in paragraph l(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 l(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.

By unanimous vote, the Authorization for Foreign Currency Operations was amended to reflect the new title of Manager, System Open Market Account (see minutes of Jan. 31–Feb. 1 meeting).

Authorization for Foreign Currency Operations

Amended March 28, 1995

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
 Belgian francs
 Canadian dollars
 Danish kroner
 Pounds sterling
 French francs
 German marks
 Italian lire
 Japanese yen
 Mexican pesos
 Netherlands guilders
 Norwegian kroner
 Swedish kronor
 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 \$25.0 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 dollar 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	
Regular	3,000
Special	3,000
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, System Open Market Account ("Manager"), 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 to appropriate 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.

By unanimous vote, the Foreign Currency Directive shown below was reaffirmed.

Foreign Currency Directive

Reaffirmed March 28, 1995

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.

By unanimous vote, the Procedural Instructions with Respect to Foreign Currency Operations shown below were amended to reflect the new title of Manager, System Open Market Account.

Procedural Instructions with Respect to Foreign Currency Operations

Amended March 28, 1995

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$300 million on any day or \$600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding \$150 million, or \$300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

The Manager of the System Open Market Account reported on developments in foreign exchange markets and on System open market transactions in foreign currencies during the period February 1, 1995, through March 27, 1995. By unanimous vote, the Committee ratified these transactions.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period February 1, 1995, through March 27, 1995. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that the expansion of economic activity had moderated considerably in early 1995. Slower growth in consumer spending, associated in part with a sharp decline in expenditures for motor vehicles, and weakness in housing purchases were factors in the moderation. Despite signs of some weakening in final demand, however, further sizable gains had been recorded in industrial production and payroll employment, and overall rates of resource utilization remained high. Broad indexes of consumer and producer prices had risen more rapidly on average over January and February, but wages had shown no sign of an acceleration.

Nonfarm payroll employment increased considerably over January and February, although the average monthly advance was somewhat smaller than that of 1994. Further brisk job gains were recorded in the January–February period in manufacturing; hiring in retail and wholesale trade and in the service-producing sector slowed a bit; and construction payrolls changed little on balance. The average workweek of production or nonsupervisory workers remained at a high level over the two months. The civilian unemployment rate rose in January but fell back in February to its December level of 5.4 percent.

The expansion in industrial production also moderated in January and February from the rapid pace of last year. Manufacturing production grew less rapidly, with output gains down sharply in February for consumer durable goods and construction supplies. Mining production continued to be sluggish. By contrast, the output of utilities surged during the January–February period as winter temperatures, which had been unusually warm, moved back toward normal. Capacity utilization rates, which were little changed over the

first two months of the year, remained high.

Retail sales fell in February, reversing most of a sizable rise in January. The February declines in sales were widespread, with slippage evident at most types of retail outlets. Most indicators of housing activity had weakened in recent months in lagged response to the earlier rise in mortgage interest rates. Housing starts fell sharply in January and edged still lower in February; these declines more than erased the gains that had been posted on balance over the closing months of 1994. A substantial drop in sales of existing homes in January (latest data) extended the trend that had been evident for some months.

Shipments of nondefense capital goods recorded another strong advance in February. Shipments of office and computing equipment rebounded in February from declines in December and January, and demand for most other types of equipment remained brisk. Business outlays for heavy trucks fell back slightly in February after a surge in January. While there were tentative signs in the recent orders data of some deceleration in business equipment spending, the still-growing backlog of unfilled orders suggested further solid expansion in business spending on equipment. Nonresidential construction activity had been trending appreciably higher over the past two years; however, a slowdown in spending by public utilities in December and January, in an environment of uncertainty related to pending deregulation, and a third straight monthly decline in permit issuance for nonresidential structures in February pointed to some softening in the uptrend.

Business inventory investment surged in January after a slowdown in December; excluding a large increase in stocks of motor vehicles at the wholesale and

retail levels, inventories rose in January at about the average rate of the final three quarters of 1994. In manufacturing, inventory accumulation outpaced sales in January; the stocks-to-sales ratio edged higher but was still near historical lows. At wholesale establishments, inventory accumulation picked up in January as a large rise in automotive inventories more than offset a reduced increase in stocks of other goods. The inventory-to-sales ratio for the sector moved higher in January but remained well within its range of the last several years. At the retail level, inventories jumped in January after a slight decline in December; almost all the rise reflected increased stocks of motor vehicles. The inventory-to-sales ratio for the retail sector as a whole was unchanged in January and remained near the middle of its range of recent years; at automotive dealerships, the inventory-to-sales ratio rose sharply while elsewhere the ratio edged lower.

The nominal deficit on U.S. trade in goods and services widened sharply in January from its December level and its average rate in the fourth quarter; some of the increase in the deficit was due to trade with Mexico, but somewhat distorted seasonal adjustment factors also may have been involved. The value of exports of goods and services declined substantially in January after having increased strongly in November and December. The value of imports rose considerably in January, continuing the pattern of the fourth quarter. The export losses and import gains in January were distributed widely across major trade categories. The pace of economic recovery in the major foreign industrial countries appeared to have moderated in recent months. In the fourth quarter, economic activity declined in Japan and grew more slowly in most of the other major industrial countries; growth had

picked up in Canada. Available data suggested that in the first quarter economic expansion had slowed in all of the major foreign industrial countries except Japan, where growth appeared to be positive despite the Kobe earthquake.

Consumer price increases in January and February were a little larger than the average monthly rise in 1994. Food prices were unchanged on balance over the two-month period, while energy prices were up only slightly. Producer prices of finished goods increased in January and February at the same rate as consumer prices; producer price inflation for the two months also was higher than in 1994, with a steep rise in gasoline prices in January contributing to the pickup. Producer prices of intermediate materials surged in the first two months of this year after having accelerated sharply in the second half of 1994. Average hourly earnings of private production or nonsupervisory workers were unchanged in February after a substantial rise in January. For the two months combined, hourly earnings increased at about the same average monthly pace as in 1994.

At its meeting on January 31–February 1, 1995, the Committee adopted a directive that called for increasing somewhat the existing degree of pressure on reserve positions, taking account of a possible rise of $\frac{1}{2}$ percentage point in the discount rate. The directive approved by the Committee did not include a presumption about the likely direction of any further adjustments to policy during the intermeeting period. Accordingly, the directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater or somewhat lesser reserve restraint would be acceptable during the

intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

On the second day of the meeting, the Board of Governors approved an increase of $\frac{1}{2}$ percentage point in the discount rate, to $5\frac{1}{4}$ percent. The rise was made effective immediately and was passed through fully to interest rates in reserve markets. Open market operations during the intermeeting period were conducted with a view to maintaining the tighter policy stance adopted at the meeting and implemented immediately thereafter. The federal funds rate averaged a little less than 6 percent over the intermeeting interval, and adjustment plus seasonal borrowing was a little below anticipated levels.

Financial market participants generally had expected a firming in reserve market conditions, and consequently market interest rates showed little immediate reaction. Subsequently, most market interest rates declined considerably in response to both incoming data that were seen as indicating an appreciable slowing in the pace of economic expansion and statements by Federal Reserve officials that were viewed as suggesting that the period of monetary policy tightening might be coming to a close. The largest declines in yields were concentrated in intermediate- and long-term obligations. Stronger-than-expected earnings reports coupled with heightened prospects for sustained, moderate economic expansion and continued low inflation boosted major indexes of equity prices to record levels.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies fell substantially further. The dollar's decline was particularly sharp against the Japanese yen and the German mark,

and post-World War II record lows against these two currencies were recorded. Declines in U.S. interest rates and concerns about the persistence of large U.S. trade and fiscal deficits appeared to have contributed to the dollar's drop. Continuing economic and financial problems in Mexico, which resulted in further depreciation on balance of the Mexican peso against the dollar, also seemed to add to negative sentiment toward the dollar because the process of adjustment in the Mexican economy to the lower value of the peso was viewed as implying reduced imports from and increased exports to the United States.

M2 declined, and growth of M3 slowed in February after sizable January gains; data for the first part of March pointed to some recovery in both aggregates. M2's weakness in February partly reflected an unwinding of temporary increases in January of its volatile components, including demand deposits, overnight repurchase agreements, and overnight Eurodollars; the weakness also appeared to be associated with depositor efforts to obtain higher returns by shifting funds into market instruments. The slowdown in growth of M3 in February was entirely attributable to the decline in M2; its non-M2 component increased substantially further as banks continued to rely heavily on managed liabilities to fund loan growth. Expansion of total domestic nonfinancial debt had picked up a little in recent months.

The staff forecast prepared for this meeting suggested that growth of economic activity was slowing and for some period ahead would average a little less than the rate of increase in the economy's potential output. The pace of the expansion seemed to have slackened somewhat more than had been anticipated at the last meeting; however, the

recent declines in long-term interest rates and the rally in stock prices were expected to provide additional support for aggregate demand later in the year. Moreover, the substantial depreciation of the dollar against the yen and several European currencies was acting to offset some of the effects on demand of the previous tightening of reserve conditions. The forecast continued to anticipate that in the period ahead consumer spending would be restrained by smaller gains in real incomes, the substantial degree to which pent-up demands had been satisfied, and the lagged effects of earlier increases in interest rates on the demand for durable goods. Business outlays for new equipment would decelerate substantially in response to slower growth of sales and profits. Homebuilding was projected to decline somewhat further in the near term and to remain at somewhat subdued levels for a time in reflection of the damping effects on housing demand of slower growth in jobs and incomes and of the earlier rise in mortgage rates. Developments in Mexico were likely to interrupt only briefly a strong uptrend in U.S. exports, based on sustained growth in the economies of other U.S. trading partners. Considerable uncertainty continued to surround the federal fiscal outlook but, as in the previous forecast, a moderate pace of deficit reduction was assumed over the forecast horizon. In the staff's judgment, the economy was operating beyond its long-run, noninflationary capacity, and there remained a risk that higher inflation could emerge if the expansion did not moderate sufficiently.

In the Committee's discussion of current and prospective economic developments, the members agreed that the pace of the economic expansion was moderating, though the extent of the slowdown was not yet clear. The effects of the policy tightening implemented since

early 1994 seemed to be showing through in interest-sensitive sectors, and those effects were expected to be reinforced by some cutback in inventory accumulation from the unsustainable rates of previous quarters. Quarters of fairly slow growth were not unusual in a period of expansion. On the whole, however, the economy appeared to retain considerable forward momentum, with current imbalances seemingly of a relatively minor nature and in the process of being corrected. Moreover, the recent declines in long-term interest rates, if these persisted, could provide fresh support for interest-sensitive spending later in 1995 and in 1996. While opinions differed somewhat with respect to both the likely extent of the slowdown and the prognosis for inflation, the members generally agreed that the economy appeared to be on a trajectory toward a more sustainable path for economic activity. However, a number of members expressed concern that the slowdown might not be sufficient to relieve the persisting pressures on labor and capital resources, thereby portending higher inflation.

In the course of the Committee's discussion, members reported on widespread signs that business activity, while still quite strong in many areas, was growing less rapidly on balance. Still, a number of factors pointed to continued solid expansion. Business sentiment was generally described as quite positive, though somewhat less ebullient than in earlier months. Likewise, recent surveys suggested that consumer confidence remained very favorable, though down slightly from recent peaks by most measures. In addition to the favorable recent developments in financial markets, bank lending policies remained quite accommodative, although business loan growth had slowed recently after a period of unusual strength.

In their review of developments in key sectors of the economy, members took note of the sluggishness in consumer spending that had emerged in recent months in much of the country. To a considerable extent the recent weakness reflected a sharp reduction in spending for motor vehicles, but there also were signs in the most recent data of broader declines in spending, especially for durable goods other than automobiles. Some reduction in spending for durable goods could be expected in lagged response to the policy tightening over the past year, but a few members noted that unusual weather might have led to the temporary postponement of some discretionary purchases. In assessing the recent spending patterns, it was difficult to determine whether they represented a temporary pause or a more prolonged pullback by consumers. On balance, however, growth in consumer spending probably would slow somewhat further to a rate more in line with the expansion in jobs and incomes. Consumer spending would tend to be sustained, however, by the ready availability of consumer financing and the rise in bond and stock prices, which had strengthened household balance sheets and perhaps was helping to bolster consumer confidence.

The housing market had weakened noticeably according to incoming data and anecdotal reports from around the country. The decline in home sales that began in the latter part of 1994 had persisted, and housing starts had fallen sharply in the early part of the year as a consequence of the weaker sales and a larger inventory of unsold homes. Partly because of the higher mortgage rates that had prevailed for some time, members anticipated still soft housing demand, particularly for single-family houses. There had been some reports that recent declines in mortgage interest

rates were having a mitigating effect. In some parts of the country, the weakness in housing construction was being countered by further improvement in nonresidential construction activity. In other areas where commercial real estate conditions remained soft, declines in vacancy rates seemed to be preparing the way for a pickup in commercial building activity.

Committee members anticipated that growth of business investment in plant and equipment would moderate from the extraordinary rate of the last two years but that such investment would continue to support growth in aggregate final demand during the forecast period. The demand for durable equipment was expected to increase more gradually as the growth of economic activity slowed and business profits tended to flatten out, and the available data on equipment expenditures thus far in 1995 appeared to be in line with that expectation. However, some anecdotal reports suggested that investment in plant and equipment might be stronger than expected in an environment of tight labor supply and elevated levels of capacity utilization, intense desires to control costs and improve competitiveness, and a still relatively low user cost of capital. The desire for additional production capacity was reflected in spending for the construction of commercial and industrial structures, which remained on an uptrend.

The rapid rise in business inventories in recent quarters had been sustainable in the context of briskly increasing final sales, but with some further accumulation early in the first quarter and economic growth projected to moderate, the rate of inventory investment would have to adjust downward as well. While the timing and extent could not be anticipated with any precision, a short-term inventory correction process might

already be under way, with firms initiating cutbacks to production schedules to reflect smaller-than-expected gains in sales over recent months. Members noted that inventory-to-sales ratios already were at generally low levels, and they anticipated that any desired adjustments to production would be made quickly. In the circumstances, the size of the inventory correction and its effect on economic activity would be limited. Moreover, reports of inventory shortages in some industries suggested that many firms might raise their desired inventory levels to protect against shortfalls in materials needed in the production process.

The defeat of the balanced budget amendment in Congress had clouded the outlook for deficit reduction. Nonetheless, a moderately restrictive fiscal policy that would provide for some progress toward a balanced budget during the forecast period was seen as a reasonable assumption. One member observed that there was a risk of a more restrictive fiscal policy arising out of the dynamics of the current political debate. In any event, any progress toward a balanced budget might be expected to have a favorable effect on domestic financial markets and perhaps also on the dollar in foreign exchange markets.

Members commented that considerable uncertainty surrounded the outlook for the external sector, but for now it seemed reasonable to forecast that this sector would make a small positive contribution, on balance, to the growth of economic activity over the forecast period. In the near term, economic developments in Mexico were leading to lower U.S. exports and higher imports; anecdotal reports suggested that the effects on trade flows and local business activity tended to be felt most strongly in states that border Mexico. However, there were signs that conditions were

stabilizing in Mexico, and more generally the relatively robust growth projected for the major trading partners of the United States and the lower value of the dollar now prevailing were expected to foster improvement in the nation's trade balance.

Members noted that while the pace of the expansion evidently had slowed, economic activity and utilization of labor and other producer resources were still at very high levels. Prices of many materials inputs to the production process had risen sharply, but thus far there had been only a small pickup in consumer prices. Likewise, the persisting tightness in many labor markets had not to this point fostered appreciable increases in wages. The absence of a significant rise in prices of finished goods or in wages might reflect in some measure the lags in the inflation transmission process, the fruits of heavy business investments in new capacity and more productive equipment in recent years, and perhaps structural changes in business organization that were raising the economy's capacity for sustained, noninflationary activity. Members were concerned, however, that despite continuing competitive pressures and some recent abatement in materials prices, business firms were reporting greater success in passing cost increases through to prices. The depreciation of the dollar also would add to inflationary pressures in the economy. In these circumstances, the members generally concluded that some increase in inflation was likely in coming months.

In the Committee's discussion of monetary policy for the intermeeting period ahead, all the members endorsed a proposal to maintain an unchanged degree of pressure in reserve markets. The policy tightening that had been implemented since early 1994 appeared to be exerting a desired restraining effect

on the growth of economic activity and associated demands for goods and services. But the extent of the slowing in growth and its effects on inflationary pressures were not yet clear. On balance, though, the available evidence tended to suggest that the economy might be moving toward a growth path for economic activity that would be consistent with limiting the uptick in inflation that was currently being experienced. In discussing their policy choices, several members noted the relatively steep decline in the value of the dollar. However, they believed that policy should not be directed toward the achievement of a specific level for the dollar but rather toward the implementation of an effective anti-inflationary monetary policy, taking account of all the factors bearing on the economic outlook. In current circumstances, and given the substantial uncertainties that were involved, the members believed that it would be prudent to pause and assess developments before taking any further policy action.

With regard to possible adjustments to policy during the intermeeting period, most members expressed a preference for an asymmetric directive tilted toward restraint. These members indicated that near-term developments were not likely to call for an adjustment to policy in either direction. Nonetheless, with the economy expected to be operating in the neighborhood of its potential, the recent rise in inflation and the risk of an unexpected impulse that could ratchet inflation even higher suggested that an asymmetric directive would be more consistent with the Committee's objective of moving over time toward price stability. The economy retained considerable forward momentum and, as had often happened in the past, the recent slowdown in growth could prove to be temporary, with additional monetary

tightening needed at some point to contain inflation. In this connection a few members indicated that further tightening might well be needed sooner rather than later. An asymmetric directive also would provide a clear signal of the Committee's intention to resist higher inflation.

A few members preferred a symmetric directive. These members agreed that additional policy tightening might be needed if inflation began to pick up. However, they saw an undesirably weaker economic performance as being about equally likely, and in their view this balance in the risks to the outlook called for the adoption of a symmetric directive. The Committee's determination to keep inflation under control would be appropriately conveyed, in their view, through future actions rather than through the adoption of a tilt toward restraint. However, these members indicated that they could accept an asymmetric intermeeting instruction.

At the conclusion of the Committee's discussion, all the members indicated that they preferred or could support a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the expansion of economic activity has moderated considerably in early 1995. Nonfarm payroll employment rose appreciably further in January and February, but at a pace below the average monthly gain in 1994; the civilian unemployment rate, after rising in January, fell back in February to its December level of 5.4 percent. Advances in industrial production also moderated in January and February, and capacity utilization rates generally changed little from already high levels. Total retail sales were about unchanged over the two months. Housing starts have declined somewhat after posting sizable gains on balance during the closing months of 1994. Orders for nondefense capital goods point to a still strong expansion of spending on business equipment, but with tentative signs of some deceleration; nonresidential construction has been trending appreciably higher. The nominal deficit on U.S. trade in goods and services widened sharply in January from its average rate in the fourth quarter. Broad indexes of consumer and producer prices increased faster on average over January and February.

On February 1, 1995, the Board of Governors approved an increase from $4\frac{3}{4}$ to $5\frac{1}{4}$ percent in the discount rate, and in keeping with the Committee's decision at the January 31–February 1 meeting, the increase was allowed to show through fully to interest rates in reserve markets. Nonetheless, most market interest rates have declined somewhat since the Committee meeting; the largest declines have been concentrated in intermediate- and long-term obligations. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was down substantially further over the intermeeting period. The Mexican peso has continued to depreciate against the dollar.

M2 and M3 weakened in February, though data for the first part of March pointed to

some rebound. Growth of total domestic nonfinancial debt has picked up a little in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting on January 31–February 1 established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee anticipated that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was lowered to 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 23, 1995.

The meeting adjourned at 1:15 p.m.

Donald L. Kohn
Secretary

Meeting Held on May 23, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Tuesday, May 23, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broadus, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Davis, Dewald, Hunter, Mishkin, Promisel, Siegman, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, Goodfriend, Lang, and Rosenblum and Ms. Tschinkel and White, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Dallas, Atlanta, and New York respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston

Mr. Altig, Assistant Vice President, Federal Reserve Bank of Cleveland

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Secretary's note. Advice had been received that Ernest T. Patrikis had been elected by the board of directors of the Federal Reserve Bank of New York as an alternate member of the Federal Open Market Committee for the period June 1, 1995, through December 31, 1995, and that he had executed his oath of office.

Program for Safeguarding FOMC Information

At this meeting the Committee amended its "Program for Security of FOMC Information." The changes included an increase in the number of staff at the Federal Reserve Banks who could be given access to confidential Class I and Class II FOMC information. The Committee also liberalized its rule relating to attendance at FOMC meetings to allow first vice presidents of the Federal Reserve Banks to attend meetings on a rotating basis. Other changes of a technical or updating nature also were made to the program. The Committee's brief discussion of this organizational matter was not recorded, in keeping with the decision made at the meeting on Jan-

uary 31–February 1, 1995, normally not to record discussions unrelated to monetary policy.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 28, 1995, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets and on System foreign currency transactions during the period March 28, 1995, through May 22, 1995. By unanimous vote, the Committee ratified these transactions.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period March 28, 1995, through May 22, 1995. By unanimous vote, the Committee ratified these transactions.

The Manager requested a temporary increase of \$2 billion, to \$10 billion, in the limit on intermeeting changes in outright System Account holdings of U.S. government and federal agency securities. He advised the Committee that the current leeway of \$8 billion might not be sufficient to accommodate the potentially large need for additional reserves over the intermeeting period to meet an anticipated seasonal rise in the domestic demand for currency as well as continued currency outflows to foreign countries. By unanimous vote, the Committee amended paragraph 1(a) of the Authorization for Domestic Open Market Operations to raise the limit to \$10 billion for the intermeeting period ending with the close of business on July 5, 1995.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the eco-

nomic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that the expansion of economic activity had slowed considerably further and that rates of resource utilization had declined. Although business investment in equipment and structures had remained strong, overall final sales had expanded less rapidly and inventories had continued to build. Manufacturing output appeared to be down appreciably, in large measure reflecting cutbacks in motor vehicle production, and the slump in housing starts since the turn of the year was depressing construction activity. Broad indexes of consumer and producer prices had increased a little faster thus far this year, while advances in labor compensation costs had remained subdued.

Nonfarm payroll employment posted reduced gains in the first quarter and changed little in April; special factors and seasonal adjustment difficulties may have depressed reported job growth in April. Hiring in service-producing industries was down sharply from the pace in previous months, with jobs in personnel supply services falling for a second consecutive month after three years of rapid growth. Employment in manufacturing decreased further, and the number of construction jobs contracted after a sizable weather-related surge in March. Initial claims for unemployment insurance increased considerably in recent weeks, and the civilian unemployment rate rose to 5.8 percent in April.

Industrial production fell further in April, with manufacturing registering a substantial decline. The drop in indus-

trial output largely reflected a cutback in the production of motor vehicles and parts, but declines in output also were evident in other cyclically sensitive sectors, such as non-auto consumer durables and construction supplies. Production of business equipment other than motor vehicles registered a small gain. Total utilization of industrial capacity continued to decline in April; however, operating rates in manufacturing remained at relatively high levels.

Retail sales were down in April after having risen moderately over the first quarter; a steep drop in sales of motor vehicles accounted for all of the April decline. Total expenditures on other types of goods edged higher in April, even though sales of apparel, furniture, and home appliances were noticeably weaker. Housing starts changed little in April after having declined sharply in the first quarter, and the inventory of new homes for sale remained relatively large. On the other hand, sales of both new and existing homes rose moderately in March after sizable declines in February, and recent surveys indicated some improvement in attitudes toward homebuying.

Shipments of nondefense capital goods remained on a strong uptrend in March, with outlays for office and computing equipment registering another sharp increase. Manufacturers of heavy trucks continued to operate at capacity to meet demand; by contrast, business expenditures for motor vehicles reportedly plunged in April. Data on orders for nondefense capital goods pointed to further strong expansion of spending on business equipment in the months ahead, although gains appeared likely to be smaller than those of the past several quarters. Nonresidential construction continued to rise in March, and data on permits for new construction suggested that building activity would advance fur-

ther in coming months, though perhaps at a somewhat slower rate.

Business inventories surged again in March, and the pace of inventory accumulation over the first quarter was substantially higher than the average rate for the second half of 1994. Much of the first-quarter increase in stocks reflected a buildup in inventories of motor vehicles at the wholesale and retail levels. Non-auto stocks also increased at a brisk pace in the first quarter, accompanied by the emergence of scattered signs of inventory imbalances in furniture, appliances, and apparel at the retail level and in construction supplies at earlier stages of production and distribution. The stock-to-sales ratio in manufacturing was unchanged in March from the very low fourth-quarter level. At the wholesale level, the ratio of inventories to sales rose in March but remained within the range of the past several years. Inventory accumulation in the retail sector slowed in March despite a further rise in inventories of motor vehicles. For the retail sector as a whole, the inventory-to-sales ratio increased in March to the top end of its range of the past two years; when the motor vehicle components of stocks and sales are excluded, however, the ratio was near the middle of its range in recent years.

The nominal deficit on U.S. trade in goods and services was little changed in March from the February level and remained substantially narrower than in January. On a quarterly average basis, the trade deficit widened in the first quarter as growth in the value of exports slowed while the expansion in the value of imports continued unabated. A drop in shipments to Mexico was among the factors holding down export growth in March. Data available for the first quarter indicated that economic recovery continued in the major foreign industrial countries as a group but that the pace

varied significantly across countries. There were signs of sustained growth in the United Kingdom, slower growth in Canada, renewed recovery in Japan, and weakness in France and Italy.

Inflation had picked up somewhat in the early months of 1995. At the consumer level, prices rose a little more rapidly in the first quarter, despite unchanged food prices and lower energy prices. In April, a surge in food prices and a rebound in energy prices contributed to a further step-up in consumer inflation. At the producer level, prices of finished goods followed a roughly similar pattern, increasing at a slightly faster pace in the first quarter and then more briskly in April. The April rise partly reflected a sharp jump in the prices of finished energy goods, but prices of non-energy, nonfood items also advanced at a somewhat faster rate. At earlier stages of production, prices of intermediate materials continued to increase rapidly in April. By contrast, trends in labor compensation costs remained subdued. Gains in hourly compensation of private industry workers slowed further in the first quarter of 1995, with a continuing moderation in the cost of benefits accounting for all of the deceleration in compensation.

At its meeting on March 28, 1995, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, the directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The

reserve conditions associated with this directive were expected to be consistent with moderate growth in the broader monetary aggregates over coming months.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Adjustment plus seasonal borrowing trended higher over the period, reflecting a rising need for seasonal credit at the beginning of the planting season, while the federal funds rate continued to average close to 6 percent.

Most market interest rates moved lower over the intermeeting period in reaction to weaker-than-expected incoming economic data, which market participants interpreted as signaling a considerable slowing of the economic expansion and a growing likelihood that the next monetary policy move would be in an easing direction. Market assessments that the prospects for major reductions in budget deficits were improving also seemed to contribute to the drop in rates. In this environment, the release of data indicating large increases in consumer and producer prices for April only temporarily interrupted the decline in rates. Intermediate- and long-term interest rates posted the largest declines over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined substantially further over the first half of the intermeeting period. In mid-April, the dollar reached a record low against the Japanese yen and approached a record low against the German mark. The dollar's weakness appeared to have been related in part to further indications of softening economic activity and related declines in interest rates in the United States and to

increasing trade tensions with Japan. Late in the period, the dollar reversed its course and moved up sharply against the yen and the mark; monetary easing abroad, improving prospects for reductions in the U.S. budget deficit, and stabilizing financial conditions in Mexico appeared to contribute to the turnaround. The dollar ended the intermeeting period higher on balance against the other G-10 currencies.

The growth of M2 picked up further in April, reflecting in part the need for additional liquid balances to make unusually heavy final tax payments; these payments resulted from the stronger economy in 1994 and from new tax regulations allowing individuals to delay a larger portion of their tax payments until April. The expansion of M2 also appeared to be boosted by the increased relative attractiveness of small time deposits and money market funds following declines in market interest rates. For the year through April, M2 grew at a rate in the lower half of its range for 1995 while M3 expanded at a rate somewhat above its range. The persisting strength of M3 in April largely reflected the needs of commercial banks to fund continuing heavy credit demands by households and businesses. Total domestic nonfinancial debt had grown at a rate a little above the midpoint of its monitoring range in recent months.

The staff forecast prepared for this meeting suggested that growth of economic activity was slowing somewhat more than previously anticipated, with the recent plunge in motor vehicle sales prompting a deeper-than-expected reduction in the production of cars and light trucks. Economic expansion would average less than the rate of increase in the economy's potential output for a number of months, but the favorable wealth and interest-cost effects of the extended rally that had occurred in stock

and bond markets were expected to provide underlying support for aggregate demand later in the year and in 1996. The forecast continued to anticipate that consumer spending would be restrained by smaller gains in real incomes and the satisfaction of pent-up demands for motor vehicles and other durable goods. Business outlays for new equipment were expected to decelerate substantially in response to the slower growth of sales and profits. Homebuilding was projected to pick up somewhat in lagged response to the recent decline in mortgage rates. Developments in Mexico might depress U.S. exports further, but mainly in the very near term given the size of the adjustments already evident in the Mexican current account. With this influence waning, sustained growth in the economies of other U.S. trading partners was expected to boost export demand. Considerable uncertainty continued to surround the fiscal outlook, but the forecast maintained the greater degree of fiscal restraint that had been assumed since early in the year. In the staff's judgment, the prospects for some easing of pressures on resources suggested that price inflation would likely moderate from its recently higher level.

In the Committee's discussion of current and prospective economic conditions, members reported on statistical and anecdotal indications of further slowing in the expansion of economic activity and some related easing of pressures on labor and other producer resources. A number commented that they anticipated a relatively sluggish economic performance over coming months as production was cut back to bring inventories into better balance with sales. However, underlying demand was likely to remain sufficiently robust, especially in light of developments in financial markets, to avert a cumulative decline in business activity and, indeed,

to return economic growth to a pace broadly in line with potential. Members cited in particular the strength in business fixed investment and the potential for improvement in housing activity and the trade balance as factors that should help to sustain the expansion. Nonetheless, the longer-run outlook remained subject to considerable uncertainty, especially given the undecided course of fiscal policy and the ongoing inventory correction; the ultimate extent of that correction and its effects on overall economic performance were subject to a cyclical dynamic whose outcome could not be predicted with confidence. A worsening in key measures of inflation, including the consumer price index and the producer price index for finished goods, was a disappointing—if not unexpected—development. A number of members expressed concern that the risks were still tilted in the direction of some further step-up in inflation; however, others were more inclined to the view that inflation was not likely to rise much further in a climate of moderate growth in demand, intense competitive pressures in many markets, and relatively subdued increases in labor costs.

Members commented that a reduction in the rate of inventory investment was likely to be the dominant influence on the near-term performance of the economy. Some also saw a risk that a significantly greater-than-expected softening in inventory accumulation might have adverse, and possibly cumulative, effects of a longer-term nature on production and incomes and thus on consumer and business spending. With the exception of the motor vehicle industry, however, current inventory levels generally were quite low in relation to sales and potential inventory adjustments were likely to be limited in size. Once further inventory adjustments were completed, the rate of accumulation could

be expected to remain well below the unsustainable pace experienced over the past year and perhaps settle into a pattern where changes in inventories became a relatively neutral factor in the ongoing economic expansion.

In their comments about broad factors underlying the economic outlook, members reported that current business and consumer sentiment remained generally favorable across the nation. Despite the softening demand in some markets or industries, notably that for motor vehicles, business contacts continued to express optimism about the outlook for their firms, though some of their comments were tempered by greater caution than had been observed earlier. A number of members referred to the general financial climate as an important element in the outlook for sustained economic expansion. They noted that the decline in interest rates had favorable implications for demand in interest-sensitive sectors of the economy. The rise in equity prices also was contributing to reductions in the cost of capital to businesses, and banks continued to ease terms and standards on loans. In addition, the rise in stock and bond prices had increased the net worth of many households, though some concern was expressed about the sustainability of the stock market's strong performance.

With regard to developments in key sectors of the economy, the slowdown in the growth of consumer spending was somewhat more pronounced than anticipated earlier. Some rebound in consumer demand seemed likely and already appeared to be occurring in the motor vehicle industry in May. Underlying conditions for further growth in consumer spending were viewed as relatively favorable; these conditions included strengthened balance sheets stemming from developments in financial markets, continued growth of

incomes, and aggressive extensions of consumer credit by a number of lenders. In at least one view, however, consumer credit had been growing at a pace that could not be sustained, and the inevitable correction could coincide with and exacerbate emerging weakness in consumer demand. On balance, growth in personal consumption expenditures was seen as likely to continue over coming quarters but at a reduced pace given the apparent satisfaction of a large portion of earlier pent-up demands for consumer durables and some expected moderation in the growth of jobs and incomes.

Business investment remained on a strong uptrend as numerous firms continued to respond to the need to relieve pressures on existing capacity and to increase operating efficiencies in the face of vigorous competition. Rapid growth in profits and a ready availability of financing also were cited as factors tending to support business investment spending. The increase in such spending was likely to moderate over the projection horizon, though to a still brisk pace, as declining growth in demand and easing pressures on capacity induced growing caution in business investment decisions. Indeed, the growth in expenditures for producer durable equipment already appeared to be moderating from an extremely rapid pace, though non-residential construction was reported to be posting solid gains in several parts of the country.

Members also expected some strengthening in residential construction following the large declines in mortgage interest rates that had occurred since late 1994. Housing construction had trended lower since the start of the year, but several indicators pointed to a revival. The latter included surveys showing improving homebuyer attitudes and builder assessments of the outlook for new home sales, and rising applications

to purchase homes. Sizable inventories of unsold new homes would probably continue to damp construction activity for some months, but contacts in the real estate and mortgage finance industries were more optimistic about the outlook for housing.

The foreign trade sector likewise was expected to make an appreciable contribution to the expansion of economic activity in coming quarters. The robust uptrend in U.S. exports during 1994 had been slowed to a considerable extent thus far this year by the sharp adjustment in trade with Mexico, but in the view of several members that adjustment might now be largely completed. In that event, gains in exports could be expected to resume at a fairly brisk pace despite indications of reduced economic growth in some key foreign countries. This assessment was supported by anecdotal reports of rising foreign demand for some U.S. products in the context of the generally improved international competitive position of the United States. Concurrently, growth in imports would tend to be held down by the projected slowing in the expansion of domestic demand. On the negative side, some members referred to the possibility that a longer period might be needed to resolve the difficulties being experienced by Mexico, and several expressed particular concern about the potential for relatively severe disruptions to trade if current negotiations with Japan were not successfully concluded.

Fiscal policy was seen as a major uncertainty in the economic outlook. Federal purchases of goods and services were expected to continue trending lower and the growth of transfer payments was likely to be trimmed, but the extent and timing of fiscal restraint could not be determined while federal deficit reduction continued to be debated in the Congress. In the view of at

least some members, however, a larger fiscal contraction than was commonly expected might well materialize, perhaps starting later this year. The course of fiscal legislation undoubtedly would continue to affect financial markets and, in the opinion of some members, would need to be taken into account in the formulation of monetary policy.

Concerning inflation, several members commented that the rise in consumer prices and some other broad measures of inflation in recent months appeared to reflect cyclical developments relating to the tightening of resource and product markets over the past year, including the partial pass-through of sizable increases in prices at earlier stages of production. In addition, higher import prices might have been playing a role. A number of members expressed concern that, with the economy already producing at or even slightly above its sustainable potential, inflation pressures were likely to intensify if the current pause in the expansion were to be followed by a period of above-average growth. On the other hand, members who saw the odds as pointing to a more moderate rebound after a period of relatively sluggish economic performance were inclined to the view that an upward trend in inflation was likely to be averted. In addition, the ongoing competitive pressures in many markets, the restraint in compensation increases, and the continuing efforts to cut production costs would help to contain pressures on prices over time.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to maintain the current stance of policy. The higher interest rates of 1994 clearly had damped demand, but since year-end intermediate- and long-term market rates had declined, stock market prices had risen, bank lending terms had con-

tinued to ease, and the dollar had fallen against the currencies of many major industrial countries. On balance, it appeared that the current configuration of financial market conditions and degree of monetary restraint was likely to be consistent with moderate expansion in nominal GDP and prices following a period of some weakness in the economy as inventory imbalances were corrected. The risks of a different outcome, in either direction, seemed to be reasonably balanced. In the circumstances, because the dimensions of the near-term deceleration and the potential strength of underlying demand remained uncertain, the members concluded that it was desirable to monitor developments carefully and wait for additional information before deciding on the next policy move.

With regard to the possible need to adjust policy during the intermeeting period, all the members were in favor of shifting to an unbiased instruction that did not incorporate any presumption with regard to the direction of potential intermeeting changes. The members agreed that no compelling case could be made at this point for potential adjustments to policy in either direction during the period ahead, and retaining a bias in the directive would give a misleading indication of the Committee's current intentions for the period. One member expressed the view that the costs of being wrong currently seemed higher in the direction of accommodating too much inflation, though signs of a possible cumulative deterioration in economic activity could not be ignored should they materialize. Another member, who saw the longer-term risks to the economy as tilted to the downside of current projections, indicated that while the recent performance of the economy might argue for some easing of monetary policy, a steady policy course with-

out any bias in the intermeeting instruction was appropriate for now in light of the generally accommodative financial and banking markets.

At the conclusion of the Committee's discussion, all the members supported a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater or somewhat lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over the months ahead.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the expansion of economic activity has slowed considerably further. In April, nonfarm payroll employment was about unchanged after posting reduced gains in the first quarter, and the civilian unemployment rate rose to 5.8 percent. Industrial production fell in April, largely reflecting a cutback in the production of motor vehicles, and capacity utilization rates declined somewhat. Reflecting markedly weaker demand for motor vehicles, total retail sales were down in April after rising moderately over the first quarter. Housing starts were unchanged in April after declining sharply in the first quarter. Orders for nondefense capital goods point to further strong expansion of

spending on business equipment; nonresidential construction has continued to trend appreciably higher. The nominal deficit on U.S. trade in goods and services widened in the first quarter from its average rate in the fourth quarter. Broad indexes of consumer and producer prices have increased faster on average thus far this year, while advances in labor compensation costs have remained subdued.

Intermediate- and long-term interest rates have declined considerably further since the Committee meeting on March 28, while short-term rates have registered small decreases. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies, after falling to low levels, rose on balance over the intermeeting period.

M2 and M3 strengthened in March and April. For the year through April, M2 expanded at a rate in the lower half of its range for 1995 and M3 grew at a rate somewhat above its range. Total domestic nonfinancial debt has grown at a rate a bit above the midpoint of its monitoring range in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting on January 31–February 1 established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee anticipated that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was lowered to 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Mses. Phillips and Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Wednesday–Thursday, July 5–6, 1995.

The meeting adjourned at 12:15 p.m.

Donald L. Kohn
Secretary

Meeting Held on July 5–6, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Wednesday, July 5, 1995, at 2:30 p.m. and continued on Thursday, July 6, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broadus, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Ms. Brown and Messrs. Davis, Dewald, Hunter, Lindsey, Mishkin, Promisel, Siegelman, and Slifman, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Ms. Johnson, Assistant Director, Division of International Finance, Board of Governors

Messrs. Clouse³ and Roberts,³ Economists, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Connolly, First Vice President, Federal Reserve Bank of Boston

Messrs. Beebe, Goodfriend, Lang, Rosenblum, and Sniderman and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Dallas, Cleveland, and Atlanta respectively

Ms. Krieger and Mr. Miller, Vice Presidents, Federal Reserve Banks of New York and Minneapolis respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 23, 1995, were approved.

3. Attended portion of meeting relating to the Committee's review of the economic outlook and policy discussion.

The Manager of the System Open Market Account reported on developments in foreign exchange markets and on System foreign currency transactions during the period May 23, 1995, through July 5, 1995. By unanimous vote, the Committee ratified these transactions.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period May 23, 1995, through July 5, 1995. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for growth of money and debt in 1995 and 1996, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that the level of economic activity was about unchanged in the second quarter. Consumer spending apparently remained sluggish, and business spending on plant and equipment rose less rapidly than in other recent quarters. With final sales flagging, firms sought to hold down production and employment in order to keep inventories under control. Broad indexes of consumer and producer prices had increased faster on balance thus far this year, but signs of some moderation in inflation were evident in recent price data. Growth of labor compensation costs remained subdued.

Nonfarm payroll employment fell substantially in May after a small decline in April and reduced gains in the

first quarter. Payrolls in the services industry continued to rise in May, but the pace of hiring was well below the average rate of increase over other recent months. In manufacturing and construction, employment contracted further in May, although part of the job decline in construction might have been temporary, reflecting heavy rains and floods in the South. The civilian unemployment rate edged lower in May, to 5.7 percent, but was somewhat above its average for the first quarter.

Industrial production continued to weaken in May, and incoming data suggested a further decline in June. Manufacturing output fell in May for a fourth consecutive month, reflecting another cutback in the production of motor vehicles. Output of non-auto manufactured goods was unchanged, with increases in the production of nondurable consumer goods and non-auto business equipment offsetting declines in output elsewhere. Utilization of manufacturing capacity dropped again in May but was still at a relatively high level.

Nominal retail sales were about unchanged over April and May. Purchases at furniture and appliance stores were up slightly on balance over the two months. Sales at automotive dealerships and apparel outlets fell in April but revived somewhat in May. Spending at building materials stores fell in both months. The retail sales reports, in combination with data on consumer prices and unit motor-vehicle sales, suggested that inflation-adjusted spending for consumer goods had changed little since the fourth quarter of last year. Housing starts were unchanged on balance over April and May; a reduction in starts of single-family homes was offset by a rise in starts of multifamily units. Adverse weather in some parts of the country might have contributed to the sluggishness in starts. Home sales were higher

in May: Sales of new homes turned up sharply, and sales of existing homes also advanced somewhat.

Shipments of nondefense capital goods increased considerably in May after being unchanged in April. Shipments of computing equipment remained robust on balance over April and May, but growth of shipments of other business equipment slowed significantly. Sales of heavy trucks rebounded strongly in May from an April decline. Recent data on new orders for nondefense capital goods suggested that spending on business equipment might moderate somewhat in the months ahead after an extended period of rapid expansion. Nonresidential construction continued to trend appreciably higher in April; particularly large gains were recorded in the public utility, industrial, and institutional categories.

Business inventories grew at a little slower rate in April than in the first quarter. In manufacturing, inventory investment remained brisk in April but slowed somewhat in May; the inventory-to-sales ratio for the two months was at the high end of the range for the past year. At the wholesale level, the rate of increase in stocks in April equaled the first-quarter pace and the ratio of stocks to sales reached its highest level in several years. Inventory accumulation in the retail sector was more moderate in April. More than half the rise occurred at automotive establishments. The inventory-to-sales ratio for retailers other than auto dealers had remained stable for a number of months and was near the middle of its range for recent years.

The nominal deficit on U.S. trade in goods and services widened substantially in April from its average rate for the first quarter. The value of imports was up sharply, with increases posted in nearly all major import categories. The

value of exports rose modestly from the first-quarter level; increases in exports of aircraft and industrial supplies were partially offset by declines in exports of automotive products to Canada and Mexico. Available data indicated that, on average, economic growth in the major foreign industrial countries had been sluggish in the first quarter and apparently had remained so in the second quarter; growth had been particularly weak in Canada and Japan.

Incoming data suggested that price inflation might be slowing a little after having picked up early in the year. Consumer prices rose a bit less in May; energy prices recorded another sizable increase, but food prices changed little and prices of other items advanced more slowly. However, for the twelve months ended in May, prices of nonfood, non-energy consumer items increased slightly more than in the preceding twelve months. At the producer level, prices of finished goods were unchanged in May, reflecting declines in the prices of finished foods and finished energy goods; excluding food and energy, prices of finished goods rose in May at the same rate as in April. For the year ending in May, producer prices rose moderately after being essentially unchanged in the previous year. At earlier stages of production, producer prices grew at a considerably slower rate or declined in May, suggesting some easing of cost pressures over the next few months. Average hourly compensation in the nonfarm business sector accelerated in the first quarter of the year, owing in large part to temporary developments. Over the year ended in March, this compensation measure increased somewhat more than it had over the previous year. Average hourly earnings declined in May, but the change in hourly earnings over the past twelve months was slightly larger than

the advance over the preceding twelve-month period.

At its meeting on May 23, 1995, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, the directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in the broader monetary aggregates over the months ahead.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. The federal funds rate generally remained near 6 percent, but most short-term interest rates were down on balance in response to incoming economic data, particularly the employment report for May, that were seen by market participants as increasing the likelihood that monetary policy would be eased in the near future. Longer-term interest rates also declined in reaction to growing indications that efforts to narrow substantially the U.S. budget deficit might be successful. Yields on corporate and municipal obligations fell less than Treasury rates and risk spreads widened a little, particularly for junk bonds. Major indexes of equity prices rose over the intermeeting period, partly in response to lower interest rates.

In foreign exchange markets over the intermeeting period, the trade-weighted

value of the dollar in terms of the other G-10 currencies declined considerably on balance. The dollar fell sharply in the week after the May meeting on further news of weakening in the U.S. economy but rebounded somewhat at the end of the month when concerted central-bank intervention was carried out. The dollar remained relatively stable over the balance of the period.

Growth of M2 strengthened substantially in May and June. Downward adjustments in returns on deposits and retail money fund shares had lagged declines in market interest rates in recent months, and investors evidently responded by shifting funds from market instruments into these M2 assets. For the year through June, M2 expanded at a rate in the upper half of its range for 1995. M3 also accelerated in May and June; and for the year through June, this aggregate grew at a rate well above the annual range set in February. The pickup in M3 growth importantly reflected more rapid inflows to institution-only money funds, whose yields also adjusted sluggishly to falling money market rates. Total domestic nonfinancial debt had grown at a rate in the upper half of its monitoring range in recent months.

The staff forecast prepared for this meeting suggested that economic activity would expand sluggishly over the next few months as business firms adjusted production schedules to bring inventories into better alignment with sales. Subsequently, as inventory positions were corrected, and with underlying support for final sales from the favorable wealth and interest-cost effects of the extended rally in the equity and debt markets, the economy would begin to expand at a moderate pace. The forecast assumed a modest step-up in the pace of consumer spending in response to some diminution of concerns about job prospects and incomes

as well as improved financial conditions and household balance sheets. Homebuilding was projected to pick up somewhat in lagged response to the recent decline in mortgage rates and the related improvement in housing affordability. Business outlays for new equipment were expected to slow from the very rapid pace of the past few years in response to the slower growth of sales and profits, but lower costs of capital and the ready availability of financing would help to sustain appreciable growth in such investment. Export expansion would pick up in response to some anticipated strengthening in the economies of major U.S. trading partners. Considerable uncertainty continued to surround the fiscal outlook, but in light of recent developments the forecast now reflected a greater degree of fiscal restraint. In the staff's judgment, the prospects for some easing of pressure on labor and other resources suggested that price inflation likely would moderate from its recently higher level.

In the Committee's discussion of current and prospective economic developments, members commented that the apparent pause in the expansion was likely to prove temporary, and their forecasts generally pointed to an upturn in overall economic activity to a pace in the neighborhood of the economy's potential by the latter part of this year or early 1996. Many emphasized that the prospects for a strengthening economy were enhanced by the drop in intermediate- and long-term interest rates and the rise in equity prices. In the view of most members, however, the risks to the outlook were tilted to the downside. Several stressed that the ongoing adjustments to business inventories could prove to be more pronounced and of longer duration than they anticipated, with negative repercussions on production and incomes

and in turn on consumer spending and business investment. Other downside risks included the adverse implications for exports of potentially less-than-projected expansion in a number of major foreign economies. Nonetheless, recent developments suggested that the period of maximum risk to the domestic expansion might have passed. With pressures on resources having diminished and likely to ease somewhat further and with labor costs remaining subdued, the risk of continuing increases in inflation had fallen considerably; indeed, in the view of many members inflation should moderate over the projection period.

In keeping with the practice at meetings when the Committee sets its long-run ranges for the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided their individual projections of the growth in real and nominal GDP, the rate of unemployment, and the rate of inflation for the years 1995 and 1996. The forecasts of the rate of expansion in real GDP for 1995 as a whole had a central tendency of $1\frac{1}{2}$ to 2 percent, reflecting expectations of a pickup in growth to a moderate pace in the second half of the year; for 1996, projections of growth in real GDP centered on a range of $2\frac{1}{4}$ to $2\frac{3}{4}$ percent. With regard to the expansion of nominal GDP, the growth forecasts were concentrated in a range of $4\frac{1}{4}$ to $4\frac{3}{4}$ percent for 1995 and $4\frac{3}{4}$ to $5\frac{3}{8}$ percent for 1996. The rate of unemployment associated with these forecasts was expected to edge higher in the second half of this year to a consensus range of $5\frac{3}{4}$ to $6\frac{1}{8}$ percent in the fourth quarters of both 1995 and 1996. Projections of the rate of inflation, as measured by the consumer price index, pointed to a small decline over the projection horizon; the projections con-

verged on rates of $3\frac{1}{8}$ to $3\frac{3}{8}$ percent for 1995 and $2\frac{7}{8}$ to $3\frac{1}{4}$ percent for 1996.

In the course of the discussion, members indicated that much of the economic information that had become available since the May meeting had suggested a greater softening in the economy than they had anticipated and had raised concerns about the timing and strength of the upturn over coming quarters. However, the most recent data and some of the anecdotal reports from around the country had a better tone. Among the positive factors in the economic outlook, members gave particular emphasis to the favorable financial climate, including the stimulative effects of lower interest rates on interest-sensitive sectors of the economy, the ready availability of financing from market sources and banking institutions, and the impact of rising equity and bond prices on balance sheets. Business and consumer sentiment also remained generally favorable, though anecdotal reports suggested a heightened degree of caution among business contacts in many parts of the nation. Members observed that the expansion did not appear to have produced overall imbalances in the economy aside from an apparent overhang of inventories in some industries. The ongoing adjustments needed to bring these inventories down to desired levels were seen as the most serious threat to the expansion. Some members commented that the inventory correction in the second quarter appeared on the basis of the available evidence to be less than was expected earlier and that the period of inventory adjustment might therefore be more extended in time than they had anticipated. While such a development might not in itself be sufficient to tilt the economy into recession, in the possible context of relatively sluggish growth in final demands, the economy would be

vulnerable to adverse domestic or external shocks. On balance, while the timing remained uncertain, a resumption of growth at a moderate rate was viewed as a likely prospect, given the underlying strength of the economy.

In their review of prospective developments in key sectors of the economy, members noted that consumer expenditures had fallen short of earlier expectations, but signs of some firming were visible, notably the indications of an improvement in sales of motor vehicles since early spring. While a continued sluggish performance of the consumer sector could not be ruled out, the members generally expected a resumption of moderate growth in consumer spending. The upturn undoubtedly would be limited to some extent by the apparent exhaustion of much of the earlier pent-up demands and perhaps by concerns about job prospects and incomes, but the effects of reduced interest rates on borrowers and the wealth effects from gains in values of financial assets should help to sustain moderate growth. Moreover, if the strengthening in housing activity materialized as projected, sales of consumer durables would be favorably affected. While consumer confidence had declined earlier, recent surveys indicated that confidence had stabilized or even edged up more recently and was in any event at relatively high levels in most parts of the country.

Business fixed investment appeared to have moderated since earlier in the year, though expenditures for both producer durable equipment and nonresidential structures were still registering strong gains. Further moderation was anticipated over the course of coming quarters in association with slower growth in business sales and decreased pressures on producer resources. While some concern was expressed about the

vulnerability of capital spending to a downturn in the growth of sales, the members generally expected this sector of the economy to remain a positive factor in the expansion. The ready availability of financing on favorable terms and the ongoing need to modernize equipment and other producer resources for competitive reasons, notably to take advantage of continuing improvements in computer and other technologies, should foster continued overall growth in business investment. Members also noted that the strength in business profits, though likely to moderate cyclically at some point, remained a favorable factor undergirding business capital spending.

Housing activity had stagnated in recent months, but this sector of the economy also was expected to provide some stimulus to the expansion as home buyers responded to reduced mortgage rates. Although the latest available data indicated that housing starts were still relatively depressed, home sales and mortgage loan applications for home purchases had strengthened recently. With some exceptions, building industry contacts in local areas tended to confirm broader indications that improvement in housing activity was occurring. Members also noted that rising occupancy levels and rents should support fairly robust construction of multifamily housing in many areas.

With regard to the outlook for fiscal policy, members gave considerable emphasis to recent developments in the Congress that suggested there could be greater deficit reduction over the years ahead than had been built into many forecasts. The direct effects of deficit cutbacks would tend to hold down the growth in final demand and act as a restraining influence on overall economic activity over the projection horizon. But those cutbacks also would have

favorable effects on financial markets, thereby stimulating to an extent offsetting increases in spending. Over the longer run, deficit reduction should enhance the performance and growth of the economy, though monetary policymakers would need to carefully monitor possible transition effects.

A considerable downside risk in the view of many members was the outlook for exports. Economic activity in the major foreign industrial nations had been more sluggish than anticipated during the first half of the year, and this raised questions about the strength of the expansion in those countries and the related prospects for faster growth in U.S. exports. Most of the major economies in Latin America also were projected to strengthen, and indeed such expectations were reflected in financial markets, but substantial problems remained that could undermine the favorable outlook. On the positive side, members observed that U.S. exports were now quite competitive in world markets, as evidenced by continuing gains in exports to numerous countries, and such a perception was reinforced by anecdotal reports of increasing foreign sales of a variety of products by firms around the country. On balance, some growth in exports remained a reasonable prospect but it might fall below current expectations.

The members generally agreed that the inflation risks in the economy had diminished, though some still saw the potential for little or no progress in unwinding the recent uptick in inflation. Many referred to indications of easing pressures on resources in recent months, and they generally felt that such pressures would be contained over the projection horizon if economic growth were to materialize in line with their forecasts. Developments seen as consistent with such an expectation included per-

sisting anecdotal reports of highly competitive markets that made it very difficult for business firms to pass on cost increases or to raise profit margins. Moreover, despite continuing reports of labor scarcities in some areas and industries, increases in nominal labor costs generally had remained subdued across the nation. Prices of many raw materials and semifinished goods had increased sharply in earlier months and these increases would continue to put upward pressure on the prices of finished goods, but there recently had been signs of some abatement of inflation at the earlier stages of production. Similarly, earlier declines in the foreign exchange value of the dollar were placing upward pressure on the prices of many imported products, but the recent stability of the dollar promised a diminution of such pressure over time. On balance, most of the members believed that the underlying trend of inflation was now tilted toward gradual deceleration in the context of marginally higher rates of unemployed labor and other resources, but they acknowledged that the risks to such an outcome remained substantial.

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 1995, and it decided on tentative ranges for growth in those aggregates in 1996. The current ranges set in February for the period from the fourth quarter of 1994 to the fourth quarter of 1995 included expansion of 1 to 5 percent for M2 and 0 to 4 percent for M3. A monitoring range for growth of total domestic non-financial debt had been set at 3 to 7 percent for 1995.

In the Committee's discussion, the members took account of the acceler-

ated rates of M2 and M3 growth since early spring that, for the year to date, had lifted the expansion of M2 to the upper half of the Committee's range and the expansion of M3 further above its range. According to a staff projection, the growth of both aggregates was likely to moderate over the balance of the year, assuming an unchanged monetary policy, as rates paid on various components of the aggregates were adjusted more fully to the reductions in market interest rates that had occurred since early in the year. Even so, the projected growth of the broad aggregates would remain well above that experienced over the last several years. These developments implied velocity behavior for these aggregates that was more in line with historical patterns after several years of pronounced and atypical velocity increases. The members noted that financial innovations, technical changes, and deregulation had obscured historical distinctions among various financial instruments and had affected the extent to which holders might shift funds into or out of components of the monetary aggregates in response to changing interest rate patterns. As a result, substantial uncertainty remained about projections of money growth and the future relationships of money and debt to the basic objectives of monetary policy. Against this background, members expressed somewhat differing views regarding appropriate ranges for the growth of M2 and M3 in 1995 and 1996.

With regard to M2, a majority of the members favored or could accept a proposal to maintain the existing 1 to 5 percent range for both years. These members noted that M2 growth was projected to remain within the current range, though in the upper half in 1995 and at the top in 1996. While recognizing that expansion at a rate above that range could not be ruled out, especially for

1996, they suggested that an increase in the range, at a time when substantial uncertainties continued to surround the relationship of M2 to broad measures of economic performance, would imply a degree of confidence regarding the relationship that the Committee did not possess at this point. Moreover, if the more normal behavior of velocity over the past several quarters were to continue, a 1 to 5 percent range for growth of M2 likely would prove consistent with the Committee's ultimate objectives of sustained economic expansion and reasonable price stability. There was concern that an increase in the M2 range could foster a misreading of the Committee's intentions, especially if some easing in policy were to be approved during this meeting, explanations of the technical reasons notwithstanding.

Members preferring a somewhat higher M2 range emphasized that expectations for growth of this aggregate in 1995 and 1996 were around the upper end of the current range. In their view, under the Federal Reserve Act, the Committee's target ranges—and normally their midpoints—should be consistent with the Committee's expectations for growth in nominal GDP and money. From this perspective, a higher M2 range was clearly defensible and the reasons for it easily communicated. Indeed, a failure to adjust the range upward could be interpreted by observers as indicating an intent to tighten policy should M2 growth remain high in relation to its current range.

With regard to M3, all the members indicated that they preferred or could accept an increase in its range to 2 to 6 percent for both years. The current 0 to 4 percent range was quite low in relation to the range for M2, judging by the average historical growth of this aggregate relative to that of M2. The range had been adopted in the light

of unusual developments that had depressed M3 growth over much of the 1990s. Those developments, which also had served to curb M2 growth though to a lesser extent, involved a reduced role of banking institutions in the intermediation of flows of funds between savers and borrowers. That reduced role had been induced to a large degree by balance sheet adjustments undertaken in response to extraordinary strains experienced by banks and thrifts. Against the background of favorable economic developments, the financial health of depository institutions had improved markedly over the past few years, and the increased ability and willingness of these institutions to serve as financial intermediaries appeared to be working toward strengthening the growth of M3 and lowering its velocity. In the circumstances, the members believed that the contemplated increase in the M3 range was essentially a technical response to developments that were tending to restore both traditional financing patterns and the historical pattern of somewhat faster growth in M3 than in M2. In this respect, the increase in the M3 range did not have any implications for the underlying thrust of monetary policy, though the higher range could prove to be more consistent over time with sustainable and noninflationary economic growth. As in the case of the current M2 range, that conclusion assumed the eventual restoration of historic relationships between M3 and measures of overall economic performance.

The Committee was unanimous in its view that the current monitoring range for the growth of total domestic non-financial debt should be retained for 1995 and extended to 1996. This view took into account staff projections indicating that the debt aggregate was likely to grow at rates well within its 3 to

7 percent range—indeed, not far from the midpoint—in both years.

At the conclusion of this discussion, the Committee voted to reaffirm the range of 1 to 5 percent for growth of M2 in 1995 and to set the same range on a tentative basis for 1996:

Votes for this action: Messrs. Greenspan, McDonough, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips. Votes against this action: Mr. Blinder and Ms. Yellen.

Mr. Blinder and Ms. Yellen dissented on a technical judgment, not a policy difference. They noted that if growth in the demand for M2 were close to historic norms in 1995 or 1996, as indeed it had been for some time, then the Committee members' projections for nominal GDP would likely imply M2 growth near the top of, or even above, the current range. While the relationship between the growth of M2 and that of nominal GDP remained subject to a great deal of uncertainty, they were persuaded that the range—in fact, the midpoint of the range—should normally be consistent with members' forecasts of nominal GDP growth. This would be truer to the spirit of the aggregates targeting provision in the Federal Reserve Act. From this perspective, they viewed a higher M2 range for 1995 and 1996 as clearly preferable in communicating the Committee's objectives for the economy and its expectations for money growth.

The Committee then voted to raise the range for growth of M3 to 2 to 6 percent for 1995 and to extend that higher range provisionally to 1996:

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Votes against this action: None.

The Committee voted to retain the 3 to 7 percent monitoring range for growth of total domestic nonfinancial debt for 1995 and to extend that range on a tentative basis to 1996:

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Votes against this action: None.

These votes constituted approval of the following paragraph for the directive that would be issued at the end of the meeting:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the range it had established on January 31–February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the course of the Committee's discussion of its monetary growth ranges, members commented on the failure of the monetary aggregates to provide a reliable nominal anchor for the conduct of monetary policy in recent years. Moreover, the restoration of historic relationships, or the emergence of new but stable relationships between money

growth and measures of progress toward broad economic objectives could not be predicted with any degree of confidence. Some members expressed the view that in these circumstances the Committee needed to continue to look at potential alternative approaches to guide the formulation of policy and to communicate its intentions to the public, especially with respect to the Committee's objective of promoting price stability over time.

In the Committee's discussion of policy for the intermeeting period ahead, nearly all the members indicated that they favored or could support a proposal to ease slightly the current degree of pressure on reserve positions. Preferences for an unchanged policy stance and for somewhat greater easing also were expressed. In support of at least slight easing, members commented that they viewed current monetary policy as somewhat restrictive, judged in part by the level of the inflation-adjusted federal funds rate. This degree of monetary restraint had been appropriate early in the year when the economy was operating at or possibly beyond its long-run potential and inflation pressures appeared to be mounting. Some modest easing was desirable now that the growth of the economy had slowed considerably more than anticipated and potential inflationary pressures seemed to be in the process of receding. Although inflation was higher than in 1994 and the economy was still operating at an elevated level, looking forward many members saw prospects for declining inflation and the possibility of shortfalls in economic growth. The members agreed that under present economic conditions a slight easing of the stance of policy would incur little risk of stimulating increased inflation and would be entirely consistent with their commitment to continued progress

toward price stability over time. Several members also observed that any move toward less restraint should be cautious at this point because easing would represent a change in the direction of policy and its repercussions on financial markets, including the foreign exchange markets, could be relatively pronounced.

A few members preferred somewhat greater easing. They stressed that such a move was warranted by the recent pause in the expansion and the apparent vulnerability of the economy to a variety of downside risks. Indeed, a move from what they saw as a restrictive monetary policy toward a more neutral policy stance was somewhat overdue in their view. While they could support a slight adjustment to policy at this point, these members were persuaded that the stance of monetary policy probably would need to be eased by more than a slight amount over time to accommodate the intermediate- and long-term needs of an expanding economy. Moreover, the risks of increasing inflationary pressures appeared to be relatively remote in the context of the current and anticipated performance of the overall economy. The declines in intermediate- and long-term interest rates were helping to support the expansion, but those declines rested in part on market expectations of significant monetary policy easing; failure to ratify such expectations could well result in at least a partial reversal of those desirably lower rates.

Members who leaned toward an unchanged policy remained concerned about the persistence of inflationary pressures and whether a somewhat easier policy stance would be consistent with the objective of capping inflation and setting the stage for further progress toward price stability. The available evidence on the economy's current performance remained mixed, and most forecasts pointed to moderate strengthening

ahead; in the circumstances an easing move did not appear to be needed at this time. One member emphasized that, while the risks of greater inflation seemed small, the costs of a policy error in the direction of too much easing would be high in terms of its effects on the credibility of the System's anti-inflationary policy and the need to rein in inflationary growth next year. Although their preference would be to wait for further evidence on the performance of the economy, all but one of these members indicated that, given the current uncertainties surrounding the economic outlook and the small amount of easing that was proposed, they would not dissent from the majority position.

With regard to possible adjustments to policy during the intermeeting period, most of the members who favored some easing also preferred an asymmetric directive, including a marked preference on the part of those who supported greater easing than the majority. An asymmetric directive was consistent with the view shared by most members that the risks to the expansion were biased to the downside, but no member expressed a strong presumption about the likely need to ease policy during the weeks ahead. The Committee would, of course, monitor and respond as needed to the incoming economic information.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could support a directive that called for some slight easing in the degree of pressure on reserve positions and that included a bias toward possible further easing of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee

decided that slightly greater monetary restraint might be acceptable or slightly lesser monetary restraint would be acceptable during the intermeeting period. According to a staff analysis, the reserve conditions contemplated at this meeting would be consistent with moderate growth in M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the level of economic activity was about unchanged in the second quarter. Nonfarm payroll employment fell in April and May after posting reduced gains in the first quarter, and the civilian unemployment rate, at 5.7 percent in May, was up somewhat from its first-quarter average. Industrial production continued to decline in May, reflecting another cutback in the production of motor vehicles, and capacity utilization was down somewhat further. Total retail sales have been sluggish on average in recent months. Housing starts were about unchanged over April and May, but sales of new homes turned up sharply in May. Orders for nondefense capital goods have moderated somewhat in recent months but still point to considerable further expansion of spending on business equipment; nonresidential construction has continued to trend appreciably higher. The nominal deficit on U.S. trade in goods and services widened in April from its average rate in the first quarter. Broad indexes of consumer and producer prices have increased faster on average thus far this year, though there were signs of some moderation in the most recent data; advances in labor compensation costs have remained subdued.

Most interest rates have declined somewhat further since the Committee meeting on May 23. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined considerably over the intermeeting period.

M2 and M3 strengthened substantially in May and June. For the year through June, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate well above its range. Total domestic nonfinancial debt has grown at a rate in the upper half of its monitoring range in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the range it had established on January 31–February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Vote against this action: Mr. Hoenig.

Mr. Hoenig dissented because he believed the stance of monetary policy

should remain unchanged at this time. With the pace of economic activity likely to return to trend growth later this year and inflation expected to be higher this year and next than in 1994, he felt an unchanged policy in the near term would enhance the prospects of achieving the Committee's long-run objectives of sustainable economic growth and price stability.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 22, 1995.

The meeting adjourned at 12:20 p.m.

Donald L. Kohn
Secretary

Meeting Held on August 22, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Tuesday, August 22, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broadbuss, Forrester, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
 Mr. Bernard, Deputy Secretary
 Mr. Coyne, Assistant Secretary
 Mr. Gillum, Assistant Secretary
 Mr. Mattingly, General Counsel
 Mr. Baxter, Deputy General Counsel

Ms. Brown and Messrs. Davis, Dewald,
 Hunter, Lindsey, Mishkin,
 Promisel, Siegman, Slifman, and
 Stockton, Associate Economists

Mr. Fisher, Manager, System Open
 Market Account

Mr. Madigan, Associate Director,
 Division of Monetary Affairs,
 Board of Governors

Mr. Simpson, Associate Director,
 Division of Research and
 Statistics, Board of Governors

Ms. Johnson, Assistant Director,
 Division of International Finance,
 Board of Governors

Mr. Ramm,⁴ Section Chief, Division
 of Research and Statistics,
 Board of Governors

Ms. Low, Open Market Secretariat
 Assistant, Division of Monetary
 Affairs, Board of Governors

Ms. Strand, First Vice President,
 Federal Reserve Bank of
 Minneapolis

Messrs. Beebe, Goodfriend, Rolnick,
 Rosenblum, and Sniderman and
 Ms. Tschinkel and White,
 Senior Vice Presidents, Federal
 Reserve Banks of San Francisco,
 Richmond, Minneapolis, Dallas,
 Cleveland, Atlanta, and
 New York respectively

Mr. Meyer, Vice President, Federal
 Reserve Bank of Philadelphia

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 5–6, 1995, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets and on System foreign currency transactions during the period July 6, 1995, through August 21, 1995. By unanimous vote, the Committee ratified these transactions.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period July 6, 1995, through August 21, 1995. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity was expanding more rapidly after increasing at a sluggish pace in the second quarter. Consumer spending appeared to be growing at a moderate rate, housing demand seemed to be rebounding sharply, and business investment remained on a solid uptrend. With efforts to adjust inventories still under way, industrial production had changed little in recent months, and employment gains had been modest. After increasing at elevated rates in the early part of the year, consumer and producer prices had risen more slowly in recent months. Advances in labor compensation costs remained subdued.

Nonfarm payroll employment rose further in July after a modest second-

4. Attended portion of meeting relating to the Committee's economic discussion.

quarter gain; the July advance was held down by continuing employment losses in manufacturing that were widespread by industry. Outside of manufacturing, payrolls continued to increase at a relatively slow pace in July; reduced job growth in the services industry reflected smaller increases in employment at business and health service establishments. The civilian unemployment rate rose slightly in July, returning to its second-quarter average of 5.7 percent.

Industrial production edged higher in July, but it was unchanged on balance over the three months ending in July after declining in earlier months. Manufacturing output fell further in July; a sharp contraction in the production of motor vehicles and parts accounted for the entire decline. Within manufacturing, output of business equipment other than motor vehicles continued to advance as additional strong gains were recorded in the production of office and computing equipment. The output of non-auto consumer goods weakened; a cutback in the production of home furnishings offset an increase in the manufacture of appliances. With capacity continuing to expand rapidly, total utilization of industrial capacity dropped somewhat further.

Despite edging down in July, revised data for earlier months suggested that total retail sales had risen appreciably on balance since early spring. The July decline entirely reflected weakness in motor vehicles; elsewhere, spending on furniture and appliances continued to firm, and purchases of other durable goods and of apparel rose sharply. Housing market activity picked up considerably in June, with sales of both new and existing homes increasing significantly. Housing starts were up strongly in July after changing little in previous months.

Shipments of nondefense capital goods, led by surging purchases of com-

puting equipment, continued to grow rapidly in the second quarter. However, business spending for transportation equipment, notably heavy trucks and aircraft, was lackluster. New orders for nondefense capital goods edged lower in the second quarter after rising sharply early this year, although the elevated level of order backlogs pointed to considerable further expansion of spending on business equipment over coming months. Nonresidential construction activity posted a solid gain in the second quarter, and recent data on permits suggested further increases in building activity in coming months.

Business inventory accumulation slowed markedly further in June, and inventory-to-sales ratios for most types of business establishments declined again. In manufacturing, the aggregate inventory-to-sales ratio was only a little above the historical low reached around the end of 1994. In the wholesale sector, the ratio of stocks to sales in June was slightly below the top of the range prevailing over the last year. At the retail level, inventories changed little in June, and the inventory-to-sales ratio for this sector was near the middle of its range for recent years.

The nominal deficit on U.S. trade in goods and services widened in June, with exports declining marginally more than imports. For the second quarter as a whole, the deficit was substantially larger than in the first quarter. Exports were up considerably in the second quarter despite declines in automotive products shipped to Canada and Mexico, but imports rose even more, with increases widely spread across most major trade categories. In the major foreign industrial countries, economic growth appeared to have ranged from weak to moderate in the second quarter, and the limited available evidence suggested that subdued expansion contin-

ued into the third quarter. Economic activity remained particularly weak in Japan. In Europe, expansion apparently was still under way, though somewhat unevenly across countries.

Consumer prices rose more slowly in June and July, with food and energy price movements having little effect on the overall index; price increases for nonfood, non-energy items were somewhat smaller than those seen earlier in the year. Over the twelve-month period ended in July, however, this measure of consumer inflation rose at about the same rate as in the preceding twelve months. Producer prices of finished goods edged lower on balance in June and July, reflecting substantial declines in prices of finished energy goods. Excluding food and energy, producer prices rose more over the year ended in July than over the preceding year. At earlier stages of production, increases in producer prices had diminished sharply in recent months, perhaps suggesting some abatement of pressures on production capacity and prices. Total hourly compensation for private industry workers increased somewhat more in the second quarter than in the first; however, the rise in compensation costs for the year ended in June was smaller than that for the previous year, primarily reflecting slower growth in costs of benefits. Average hourly earnings grew faster in July than in June; for the year ending in July, earnings rose somewhat more than in the preceding year.

At its meeting on July 5–6, 1995, the Committee adopted a directive that called for some slight easing in the degree of pressure on reserve positions and that included a tilt toward possible further easing of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic

growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Immediately after the meeting, open market operations were directed toward implementing the slight easing in the degree of reserve pressure that had been adopted by the Committee. Thereafter, operations were conducted with a view to maintaining this slightly more accommodative reserve posture, and the federal funds rate remained near $5\frac{3}{4}$ percent over the intermeeting interval. Adjustment plus seasonal borrowing averaged somewhat above anticipated levels, largely reflecting heavy adjustment borrowing activity on the August 2 reserve settlement day when demands for excess reserves were unexpectedly large.

Treasury yields declined across the maturity spectrum in response to the announcement of the easing action on July 6; market participants perceived the policy move as an indication of the Federal Reserve's concern regarding the state of the economy and, based on historical precedent, as likely the first in a series of easing steps. Subsequently, however, interest rates rebounded in response to incoming economic data that were seen as suggesting stronger economic performance and reduced chances for further monetary policy easing. On balance, short-term market interest rates posted mixed changes over the intermeeting period, while intermediate- and long-term rates rose appreciably. With unexpectedly favorable corporate earnings reports outweighing the effects of higher interest rates, major indexes of

equity prices were up moderately on balance over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies appreciated substantially over the intermeeting period. The dollar's gain occurred partly in response to the improving outlook for the U.S. economy and the related rise in long-term interest rates in the United States. Declines in long-term yields in the major European industrial countries probably contributed to a higher value of the dollar in terms of the German mark and most other European currencies. In addition, the dollar appreciated sharply against the Japanese yen, largely in response to actions by Japanese authorities to reduce official interest rates, to encourage capital outflows from Japan, and to make large intervention purchases of dollars during a period when the dollar already was rising against the yen.

M2 and M3 continued to register sizable increases in July and appeared to be expanding considerably further in August. The recent strength of M2 seemed to reflect in part the relatively greater appeal of interest rates on M2 assets in the wake of the declines in market interest rates that had taken place this year, particularly at longer maturities. Robust M3 growth was associated with the continuing requirements of commercial banks for additional whole-sale funds needed to meet persisting strong loan growth. For the year through July, M2 expanded at a rate in the upper half of its range for 1995, and M3 grew at a rate above its upwardly revised range. Total domestic nonfinancial debt had been in the upper half of its monitoring range in recent months.

The staff forecast prepared for this meeting suggested that growth in economic activity would pick up from the weak pace of the second quarter. The

inventory adjustment process appeared to be well under way, and moderate expansion of final sales would be supported by the favorable wealth and interest-cost effects of the extended rally in the debt and equity markets. In response to improved financial conditions and balance sheets, consumer spending was anticipated to keep pace with the growth of incomes. Homebuilding was expected to strengthen somewhat in response to the earlier decline in mortgage rates and the related improvement in housing affordability. Accompanying slower growth of sales and profits, business investment in new equipment and structures was projected to slow from the very rapid pace of the past few years, although the lower cost of capital and the ready availability of financing would help to sustain appreciable expansion in such investment. Export growth would pick up in response to some expected strengthening in the economies of major trading partners. Considerable uncertainty surrounded the fiscal outlook, but the staff continued to anticipate the greater degree of fiscal restraint that had been projected at the time of the last Committee meeting. In the staff's judgment, the prospects for some further easing of pressure on labor and other resources suggested that price inflation likely would not deviate significantly from recent trends.

In the Committee's discussion of current and prospective economic developments, the members focused on recent indications of some strengthening in the expansion of economic activity after a period of limited growth during the spring. Further growth in final demand was generating an improvement in overall business activity, despite a more rapid adjustment in inventory investment than many had expected. This configuration suggested that the risks of recession or an extended period of

subpar growth were now reduced, and sustained expansion at a moderate pace was seen as the most likely course for the economy. Although the risks to the economy now seemed to be more evenly balanced than at the time of the July meeting, they were still sizable in both directions. In particular, uncertainties about federal budget policies and their effects on the economy remained substantial. With respect to prices, members noted that the recent pause in the expansion had eased pressures on resources, and the economy appeared to be in a better position to accommodate moderate growth over the forecast horizon without adding to inflation. Indeed, some members were optimistic that growth of the economy at a pace in line with their expectations would be consistent with modest further decreases in inflation. Others expressed concern, however, that the uncertainties surrounding the outlook for the economy included questions about the persistence of inflationary sentiment and the prospects for further progress toward stable prices over the next several quarters.

Members gave particular attention to the ongoing discussions involving the Congress and the Administration regarding future federal budget deficits. There was a great deal of political support for reducing the federal deficit substantially over the years ahead; indeed, in the view of one member the political dynamics might very well result in larger reductions than many now anticipated. Nonetheless, the actual outcome remained particularly uncertain. From the perspective of its macroeconomic stabilization effects and its implications for monetary policy, enactment of legislation involving substantial fiscal restraint would raise the issue of fiscal drag; however, the latter's impact on the economy would have to be judged in the context

of attendant adjustments in market interest rates and, more broadly, in the light of emerging economic conditions. A legislative package containing strong fiscal restraint measures would be expected to ease pressures in debt markets—indeed, enhanced prospects in this regard were probably already contributing to reduced long-term interest rates. On the other hand, a package that included only modest deficit reduction might well lead to upward pressure on interest rates. The continuing uncertainty concerning the size of future budget deficits might be complicated by a delay in passing appropriations legislation in the months ahead, with potentially dislocative effects on many federal government operations. Accordingly, federal budget developments were seen as the major factor likely to bear on the performance of the economy over coming months and quarters, and these developments might well differ considerably from current forecasts.

Members described current business conditions across the nation as ranging from sluggish in some regions to robust in a number of others, with at least some improvement occurring recently in many parts of the country. There were anecdotal reports of strengthening retail sales in numerous areas, with the notable exception of motor vehicles, and of relatively high levels of confidence among consumers and many retailers. Sustained growth in consumer spending was seen as a reasonable expectation for the projection period through 1996. However, diminished pent-up demands and possibly the increasing level of consumer indebtedness would tend to inhibit consumer spending, keeping its growth below that in recent years. These negative factors might be offset to some extent by the wealth effects of the rise in stock market prices and by a higher level of housing activity that should

help to support demands for household durables.

Members referred to recent indications, including widespread anecdotal reports, of considerable gains in housing activity after a period of pronounced weakness during the earlier months of the year. Homebuyers were reacting favorably to the declines in rates on fixed-rate mortgages from their highs around the turn of the year. Homebuilders in a number of areas were reported to be optimistic about the outlook for further gains in housing demand, at least for single-family homes. The prospects for multifamily construction seemed less promising; while robust activity characterized such construction in a number of areas, still high vacancy rates and associated overbuilding across much of the nation suggested little, if any, overall impetus from this sector of the housing industry.

The expansion in nonresidential construction was projected to slow from its pace in recent quarters in line with more moderate growth in overall economic activity and reduced pressures on capacity. Even so, with the slowing occurring only gradually as projects under construction were completed, this sector of the economy was expected to remain a positive factor in the overall expansion of economic activity over the next several quarters. The members also anticipated more moderate growth in outlays for producers' durable equipment over the forecast horizon in conjunction with slower growth in final sales. However, current trends pointed to further sizable increases in outlays for office and computing equipment, and such expenditures were expected to buttress still considerable overall growth in spending for business equipment, though at a pace well below the exceptional rate experienced in recent years.

Members commented that the adjustment in business inventories appeared to have progressed a considerable distance but probably was not yet completed for the business sector as a whole. Nonetheless, inventory investment seemed likely to become a more neutral factor in its effects on the overall economy as desired inventory ratios were reached in an increasing number of industries. The recent tendency for order patterns to stabilize was a tentative indication of such a development. In any event, the recent upturn in final sales, apart from its probable effects on desired inventory levels, had allowed a larger-than-expected amount of inventory correction to occur without preventing the economy from regaining at least moderate expansionary momentum.

The external sector of the economy remained subject to particular uncertainty. The members generally viewed some improvement in the country's net export position as a reasonable expectation, but several questioned the potential for much expansion of exports to many of the nation's important trading partners. While recent policy actions in Japan might have diminished concerns about the outlook for overall exports, a number of members indicated that they continued to anticipate fairly limited growth in foreign demands for U.S. goods and services, with the result that the external sector was likely in their view to make a relatively small, if any, contribution to the growth of the domestic economy over the projection period.

Members generally viewed the near-term outlook for inflation as more encouraging than it had appeared to be earlier this year. The pause in the expansion during the spring had eased pressures on resources, as evidenced in part by anecdotal reports of lessening labor shortages in some areas and reduced use of overtime work by some firms, and the

higher rate of inflation experienced during the early months of the year seemed unlikely to persist. The members differed somewhat, however, in their assessment of the longer-term outlook for inflation. Some emphasized the reduction that had occurred in inflationary pressures, and with labor costs remaining subdued they felt that economic growth in line with current forecasts should prove compatible with moderating inflation over time. Further, the recent appreciation of the dollar should contribute marginally to a more favorable inflation outcome after some lag. Other members expressed reservations about the prospects for an improved inflation performance over coming quarters. They cited indications of persisting inflationary expectations such as the recent weakness of the bond markets and survey results that pointed to expectations of some rise in inflation from current levels. They also referred to the possibility that favorable labor cost developments would not persist indefinitely in an economy that was operating in the vicinity of its potential.

Turning to monetary policy for the intermeeting period ahead, all the members accepted a proposal to maintain an unchanged degree of pressure in reserve markets and to adopt a directive that was not biased in either direction with regard to potential intermeeting adjustments. For the near term, current trends in economic activity and inflation appeared favorable and likely to remain so with an unchanged policy stance. A steady policy also seemed appropriate pending a clearer assessment of the outlook for fiscal policy. Over the longer term, the members generally believed that consideration would need to be given to an adjustment in the Committee's policy stance, especially if substantial fiscal restraint were to be enacted. The extent to which an adjustment might

be needed later in the stance of monetary policy—characterized by some members as slightly to the restrictive side at least in terms of the inflation-adjusted federal funds rate—would have to be assessed in terms of its consistency with the Committee's continuing objectives of fostering price stability and promoting sustained economic growth.

At the conclusion of the Committee's discussion, all the members indicated that they would vote for a directive that called for maintaining the existing degree of pressure on reserve positions. They also favored a directive that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with more moderate growth in M2 and M3 over the months ahead.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests a strengthening in the expansion of economic activity in the current quarter from the weak second-quarter pace. Nonfarm payroll employment increased in June and July after declining in May; the advance was held down by continuing employment losses in manufacturing. The civilian unemployment rate in July was at its second-quarter average of 5.7 percent. Industrial production changed

little in recent months after falling earlier while capacity utilization was down somewhat further. Total retail sales have risen appreciably on balance since early spring, but they edged down in July, reflecting weakness in motor vehicles. Housing starts were up sharply in July after changing little in previous months. Orders for nondefense capital goods still point to considerable further expansion of spending on business equipment over coming months; nonresidential construction has continued to trend appreciably higher. The nominal deficit on U.S. trade in goods and services widened in the second quarter from its average rate in the first quarter. After increasing at elevated rates in the early part of the year, consumer and producer prices have risen more slowly in recent months. Advances in labor compensation costs have remained subdued.

Short-term interest rates have posted mixed changes since the Committee meeting on July 5-6, while intermediate- and long-term rates have risen appreciably. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies appreciated substantially over the intermeeting period, with the gain occurring since the beginning of August.

M2 and M3 continued to register sizable increases in July and appeared to be expanding considerably further in August. For the year through July, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate above its upwardly revised range. Total domestic nonfinancial debt has grown at a rate in the upper half of its monitoring range in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the range it had established on January 31-February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth

of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 more moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen.
Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 26, 1995.

The meeting adjourned at 12:25 p.m.

Donald L. Kohn
Secretary

Meeting Held on September 26, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Tuesday, September 26, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley

Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broadus, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Davis, Dewald, Hunter, Lindsey, Mishkin, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Mr. Hooper and Ms. Johnson, Assistant Directors, Division of International Finance, Board of Governors

Mr. Ramm,⁵ Section Chief, Division of Research and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Pianalto, First Vice President, Federal Reserve Bank of Cleveland

Messrs. Lang, Rolnick, and Sniderman and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Minneapolis, Cleveland, and Atlanta respectively

Messrs. Cox, Hetzel, Judd, and McNees, Vice Presidents, Federal Reserve Banks of Dallas, Richmond, San Francisco, and Boston respectively

Ms. Meulendyke, Adviser, Federal Reserve Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 22, 1995, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the August meeting. There were no transactions in these markets for the System Account during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period August 22, 1995, through September 25, 1995. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of

5. Attended portion of meeting relating to the Committee's economic discussion.

the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity was expanding at a moderate rate in the current quarter. Consumer spending appeared to be advancing somewhat further after a sizable gain in the second quarter; housing demand had strengthened in response to earlier reductions in mortgage rates; and business investment remained on a solid uptrend. Although business efforts to pare inventories apparently were still in progress, both production and employment were advancing moderately. After having increased at elevated rates in the early part of the year, consumer and producer prices had risen more slowly in recent months.

Private nonfarm payroll employment increased considerably in August after changing little in July. Much of the rise reflected a pickup in hiring in the services industry, notably in business services. Manufacturing payrolls were up modestly in August; the gain followed substantial declines in the previous four months. Construction employment changed little on balance over July and August, with only small changes being posted each month. The civilian unemployment rate edged down to 5.6 percent in August, remaining in the narrow range that had prevailed since late 1994.

Industrial production jumped in August to a level moderately above its average for the second quarter. Manufacturing output rose sharply, posting its first increase since January; a surge in the production of motor vehicles and parts accounted for some of the advance, but the output of non-automotive consumer goods in August more than reversed a sizable drop in July, and

the production of business equipment recorded another robust gain. A steep rise in electricity generation associated with unusually hot weather over much of the country more than offset a decline in mining production. Total utilization of industrial capacity moved higher in August but remained below the average rate for the first quarter.

Retail sales were up slightly on balance over July and August after having risen appreciably in the previous two months. Abstracting from the volatile sales of motor vehicles during this period, spending on goods changed little on balance over the two months, as increased outlays for durable goods were offset by flagging purchases of apparel. Spending on services rose in July (latest data available), in part because of elevated demand for energy-related services during that month's unseasonably warm weather. Housing market activity increased further in July and August. Sales of both new and existing homes in July (latest data) reached their highest levels in more than a year, and housing starts edged up in August after a substantial rise in July.

Shipments of nondefense capital goods fell appreciably in July after having risen rapidly over the first half of the year, and sales of heavy trucks also were down substantially. New orders for nondefense capital goods declined steeply in July; however, the still-large backlog of outstanding orders, coupled with the favorable effects on the user cost of capital of lower interest rates and higher equity prices this year, pointed to further substantial expansion of spending on business equipment over coming months. Nonresidential construction posted another sizable gain in July. Outlays for office, industrial, and institutional structures registered healthy increases, but other commercial building activity was unchanged.

Business inventory accumulation slowed in June and July from a very rapid rate earlier in the year; stockpiling continued at a brisk pace in manufacturing and wholesale trade, but retail stocks were drawn down. In manufacturing, stocks increased in July at about the average rate seen in the second quarter; however, the stocks-to-shipments ratio rose somewhat, reflecting in part a reduction in shipments that might have been exaggerated by difficulties of seasonal adjustment. Wholesale inventories also advanced at about the second-quarter pace, and the inventory-to-sales ratio for this sector moved up to the upper end of its range for recent years. At the retail level, reduced stocks at automotive dealers accounted for much of the July decline in inventories; the ratio of inventories to sales edged lower but remained near the middle of the range for recent years.

The nominal deficit on U.S. trade in goods and services widened slightly in July from its average rate in the second quarter. The value of both exports and imports decreased. For exports, the largest decline was in aircraft and automotive products. The decrease in imports was concentrated in automotive products and gold. Available indicators of economic activity suggested that expansion was continuing in most of the major foreign industrial countries in the third quarter and that the average rate of growth remained near the subdued pace of the first half of the year.

As in other recent months, consumer prices rose more slowly in August than in the early months of the year. Sizable declines in energy prices were a contributing factor, but price increases also had moderated for nonfood, non-energy items; the moderation largely reflected a downturn in automobile finance charges and used-car prices along with smaller increases in airline fares. For the twelve

months ending in August, nonfood, non-energy prices rose by the same amount as in the year-earlier period. At the producer level, prices of finished goods edged lower in August after being unchanged in July. Although declines in prices of finished energy goods held down the overall index in both months, prices of finished goods other than food and energy rose more slowly than in the early months of the year; for the twelve months ending in August, nonfood, non-energy prices of finished goods increased slightly more than in the comparable year-earlier period.

At its meeting on August 22, 1995, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with more moderate growth of M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. Adjustment plus seasonal borrowing and the federal funds rate generally were in line with expectations, with the funds rate averaging close to $5\frac{3}{4}$ percent. Other market interest rates fell appreciably over much of the period, though these declines were partially reversed near the end of the period. Further evidence of subdued price pressures, indications that the

rebound in growth of GDP would be modest, and increasing confidence that significant reductions in federal deficits might be in train contributed to the drop in rates. The lower interest rates, optimistic assessments of corporate earnings, and the brisk pace of merger announcements and share buybacks helped lift major indexes of equity prices to new record levels during the period, though they ended the period below those highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined over the intermeeting period. The dollar moved higher over most of the period, partly in response to monetary easing actions in Germany, which were quickly followed by similar steps in other European countries, and in Japan. The policy easing in Japan was accompanied, *inter alia*, by statements by U.S. and Japanese officials that they would welcome a weaker yen. The dollar reversed course late in the intermeeting period, however, following the announcement of a new Japanese fiscal package and emerging uncertainties about the prospects for European monetary union. On balance over the period, the dollar moved lower against most European currencies while appreciating significantly further against the yen.

After further strong expansion in August, M2 and M3 appeared to be growing at a somewhat more moderate rate in September. The still-brisk demand for M2 assets was associated with the lower market interest rates now prevailing and the related decline in the opportunity costs associated with holding these assets. The relatively robust growth of M3 reflected inflows to institution-only money market funds as well as bank acquisitions of wholesale funds to meet loan demand. For the year through August, M2 expanded at a rate

somewhat below the upper end of its range for 1995 and M3 grew at a rate appreciably above its range. Total domestic nonfinancial debt had grown at a rate around the midpoint of its monitoring range in recent months.

The staff forecast prepared for this meeting suggested that growth in economic activity over the forecast horizon would be higher than the weak pace of the second quarter. The process of bringing inventories into better alignment with sales was well under way, and the favorable wealth and interest-cost effects of the extended rally in the debt and equity markets would tend to support moderate expansion of final sales. Consumer spending was expected to grow at a pace generally in line with incomes; the favorable effects on spending of higher prices for financial assets held by households would be offset to a degree in this forecast by less robust labor market conditions and the difficulties that growing numbers of households would encounter in servicing their enlarged debts. Homebuilding was expected to be somewhat stronger in response to the earlier decline in mortgage rates and the related improvement in housing affordability. In anticipation of slower growth of sales and profits, business investment in new equipment and structures was projected to slow from the very rapid pace of the past few years, although the lower cost of capital and the ready availability of financing would help to sustain appreciable expansion in such investment. Export growth would pick up in response to some expected strengthening in the economies of major trading partners. A great deal of uncertainty surrounded the fiscal outlook, but the staff continued to build a considerable degree of fiscal restraint into its forecast. In the staff's judgment, the prospects for some further easing of pressures on labor and other resources

suggested that price inflation likely would not deviate significantly from recent trends.

In the Committee's discussion of current and prospective economic developments, members commented that the information available since the August meeting had tended to confirm earlier indications of a pickup in the expansion after a period of sluggish growth during the spring. The economy did not display uniform strength across industries or regions, but it appeared on balance to have considerable and desirable expansionary momentum. Growth at a pace averaging close to, or perhaps slightly below, the economy's potential was viewed as the most likely prospect for the year ahead. The outlook for economic activity remained subject to a variety of uncertainties, including the still unsettled course of the federal budget, and many members saw the risks of a shortfall from expectations as slightly greater than those of significantly faster growth. With regard to inflation, the slower increases in key measures of consumer and producer prices since earlier in the year were a welcome development, and a number of members commented that inflation was likely to remain contained, given likely developments. Many expressed concern, however, that significant further progress toward achieving stable prices might not be made over the next year or two.

In keeping with indicators of nationwide economic performance, anecdotal and other reports on regional activity suggested somewhat uneven business conditions in different parts of the country, but collectively the reports pointed to moderate overall growth. Business activity in most regions had tended to improve or to remain firm during the summer months, though declining growth or very sluggish activity characterized some areas. The level of busi-

ness confidence generally appeared to have stayed high, but several members indicated that they sensed from their contacts that business expectations were somewhat fragile and vulnerable to adverse developments.

In their discussion of developments in key sectors of the economy, members generally viewed comparatively moderate growth in consumer spending as a likely prospect over the forecast period. After recording sizable gains in late spring, retail sales had been well maintained in recent months, with some strengthening in the motor vehicles sector in August apparently carrying over to September. Favorable factors in the outlook for consumer spending included the increases that had occurred in the value of financial assets and the demand for household appliances and other durables that was expected to be generated by stronger housing activity. On the other hand, overall gains in consumer spending were likely to be restrained by cyclically waning pent-up demands for consumer durables, especially motor vehicles; still widespread concerns about job security associated with ongoing business restructuring and downsizing activities; and higher consumer debt loads.

Housing demand was continuing to respond to more attractive mortgage rates, as evidenced by nationwide data and anecdotal reports from many parts of the country. Increases in construction activity were lagging the improvement in housing demand and had been limited thus far, but considerable strength in homebuilding activity could be expected over the next several months. The extent of further lagged responses to reduced mortgage rates could not be foreseen with any degree of certainty, and in any event housing demand would depend on broad economic developments such as trends in employment and income.

Housing activity appeared to have weakened over recent months in one major market where economic conditions were described as relatively sluggish. In many other areas, however, persons in the real estate industry were reported to be optimistic about the outlook for housing.

Business fixed investment remained a strongly positive factor in the economy and was expected to provide further impetus to growth over the next several quarters. The contribution of this sector could be expected to lessen, however, as capital spending was adjusted to expectations of a maturing expansion characterized by the emergence of slower growth in final demand and business profits. In particular, the outsized growth in business spending for equipment did not appear to be sustainable under foreseeable economic conditions.

Diminished growth in inventories still seemed to be retarding the expansion in overall business activity, as evidenced in part by continuing reports of efforts by various business firms to bring their inventories into better balance with sales. Nonetheless, such adjustments now appeared to have been largely completed, or were expected to be completed over the months immediately ahead, so that inventory investment could be expected to have little effect on the course of the economy during 1996. It was noted, however, that projections of inventory behavior were subject to a high degree of uncertainty.

A number of members commented that fiscal policy developments constituted a major uncertainty in the outlook for economic activity. While measures incorporating substantial reductions in spending from current trends were widely expected to be enacted into law, it was not possible to predict the outcome of the continuing debate on the federal budget in the Congress and the Administration. Further complicating

any efforts to assess the potential dampening influence of prospective fiscal policy were uncertainties regarding the time frame during which the new expenditure and tax measures would be put in place—including the extent to which they would be implemented over the year ahead—and the effects of the new fiscal measures on economic incentives and financial markets. Favorable business and financial market reactions would tend to mitigate, at least for a time, the restraining effects of fiscal measures on aggregate demand. On the other hand, if the deficit reduction measures that eventually were enacted were to fall substantially short of current expectations, there would be adverse repercussions in financial markets and possibly on business confidence.

The nation's trade deficit was expected to diminish somewhat over the next several quarters and in the process to exert less restraint on domestic economic activity. The better trade performance was projected to result from a number of factors, including the improved competitive position of U.S. producers and the lagged effects of earlier declines in the value of the dollar in foreign exchange markets. It also was associated with forecasts of somewhat stronger growth in economic activity abroad than in the United States. While there were continuing anecdotal reports of expanding export markets, some members expressed reservations about the extent to which the economies of major foreign trading partners would strengthen over the forecast period and the related prospects for growth of foreign demand for U.S. goods and services.

Views on the outlook for inflation centered on forecasts of little change or some slight decline in the rate of increase in consumer prices over the year ahead. The appreciable moderation

in inflation in recent months had checked the deteriorating trend that seemed to be emerging during the early months of the year, but the members generally believed that recent developments did not point to a significant further decline in inflation. Pressures on producer resources had eased since the early part of the year, but the labor market remained tight and capacity utilization was still above its historical average. In this connection, a few members commented that current forecasts were subject to a range of error that included a risk of some intensification of inflationary pressures.

One uncertainty bearing on the outlook for inflation was the extent to which potentially greater pressures on labor costs would be translated into higher prices. Increases in labor expenses had been held down by markedly reduced advances in the costs of benefits, notably medical benefits. The economies from the latter source might well lessen over coming quarters as the most easily implemented reductions in the costs of providing medical care were achieved. Moreover, the rise in worker compensation had been unusually restrained in recent years in relation to the strong demand for workers, evidently reflecting the effects of worker concerns about job security in a period of business restructurings and downsizings, but continued strength in the demand for labor might be expected to induce more rapid increases in labor compensation over time. Some members commented, however, that the underlying factors affecting employment costs were not likely to change greatly over the forecast period. In addition, the prospect that intense competitive pressures would persist in many markets under projected economic conditions suggested that business firms would continue to find it very difficult to pass

on rising costs through higher prices. It also was possible that the rates of capacity utilization and employment associated with a steady rate of inflation had changed in the direction of providing the economy greater leeway to operate at a somewhat higher level without generating more inflation.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged degree of pressure on reserve positions. The expansion seemed for now to have a desirable and sustainable momentum that did not call for any change in policy. Furthermore, the outlook remained clouded by the uncertainties stemming from the ongoing federal budget debate. In any event, the Committee would need to remain alert to a broader range of developments that might warrant a policy change at some point. In this connection, several members expressed the opinion that policy might have to be eased eventually in light of the downside risks that they saw in the economy and a current policy stance that they viewed as slightly restrictive. However, the current performance of the economy suggested that the timing of an easing action was not an immediate concern. Other members who preferred an unchanged policy placed more emphasis on current forecasts of little or no progress in reducing inflation from recent levels. They thought it would be premature to ease policy without greater assurance that inflation had been contained in the current cyclical expansion and that prospects for significant further progress toward the long-run objective of price level stability had improved. Indeed, the direction of the next policy move was not clear in the view of some members, and they believed that any easing should await a firm indication that the outlook for economic activity was

becoming less favorable or that inflation was decreasing more rapidly than expected.

With regard to possible adjustments to policy during the intermeeting period, the members all endorsed a proposal to retain an intermeeting instruction in the directive that did not incorporate any bias concerning the direction of possible intermeeting policy changes. At this juncture, there was no specific reason to anticipate developments that would call for an adjustment to policy during the weeks ahead. While a change in policy certainly could not be ruled out, the reasons for the change likely would involve sensitive issues that would warrant Committee consultation regardless of the intermeeting instruction.

At the conclusion of the Committee's discussion, all the members indicated a preference for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with growth in M2 and M3 over the balance of the year at a pace near that experienced in recent months.

The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that economic activity is expanding at a moderate rate in the current quarter. Nonfarm payroll employment increased considerably in August after essentially no growth in July; the civilian unemployment rate edged down to 5.6 percent in August. Industrial production posted a large increase in August to a level moderately above the average of the second quarter. Total nominal retail sales rose slightly on balance over July and August after registering appreciable gains in the prior two months. Housing starts were up a little in August after increasing sharply in July. Orders for non-defense capital goods have softened but still point to substantial expansion of spending on business equipment over coming months; non-residential construction has been strong of late. The nominal deficit on U.S. trade in goods and services widened slightly in July from its average rate in the second quarter. After increasing at elevated rates in the early part of the year, consumer and producer prices have risen more slowly in recent months.

Market interest rates have fallen somewhat 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 has declined over the intermeeting period, with most of the decline occurring over the past several days.

M2 and M3 continued to register sizable increases in August but growth of those aggregates appears to have moderated somewhat in September. For the year through August, M2 expanded at a rate somewhat below the upper end of its range for 1995 and M3 grew at a rate appreciably above its range. Total domestic nonfinancial debt has grown at a rate around the midpoint of its monitoring range in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the range it had established on January 31–February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domes-

tic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 in M2 and M3 over the balance of the year near the pace of recent months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Mes. Phillips and Yellen.
Votes against this action: None.

Discussion of Proposed Legislation

At this meeting, the Committee discussed a bill, titled the "Economic Growth and Price Stability Act of 1995," that recently had been introduced in the U.S. Senate. The bill would make price stability the primary long-run policy goal of the Federal Reserve and require the Federal Reserve to establish a numerical definition of price stability and to implement a policy that would effectively promote such stability over time. It would repeal the Full Employment and Balanced Growth Act of 1978 (the "Humphrey-Hawkins Act") and certain related provisions in the Employ-

ment Act of 1946 and the Congressional Budget Act of 1974. The Federal Reserve had not yet been asked its views of the bill, but testimony was likely at some point and a preliminary discussion would help to identify important issues.

The members had not had time to review the bill in detail or to consider fully all its implications. Nonetheless, their initial reaction was favorable in regard to the overall thrust of the bill's monetary policy provisions. These would make clear that price stability was the primary long-run objective of monetary policy and would restructure the monetary policy reporting requirements to permit the Congress to carry out its oversight responsibilities more effectively. Many members felt that in the context of seeking and maintaining price stability, monetary policy should have the flexibility to react to short-run fluctuations in output and employment, and they believed the bill would be improved if its intent in this regard were clarified. A few members expressed strong reservations about the part of the bill that would delete the employment objectives set forth in the Employment Act of 1946.

It was agreed that the next meeting of the Committee would be held on Wednesday, November 15, 1995.

The meeting adjourned at 1:20 p.m.

Donald L. Kohn
Secretary

Meeting Held on November 15, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Wednesday, November 15, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and
Stern, Alternate Members of the
Federal Open Market Committee

Messrs. Broadbuss, Forrester, and Parry,
Presidents of the Federal Reserve
Banks of Richmond, Atlanta, and
San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Assistant General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Davis, Hunter, Lindsey,
Mishkin, Promisel, Siegman,
Slifman, and Stockton, Associate
Economists

Mr. Fisher, Manager, System Open
Market Account

Mr. Winn, Assistant to the Board,
Office of Board Members, Board
of Governors

Mr. Ettin, Deputy Director, Division of
Research and Statistics, Board of
Governors

Mr. Madigan, Associate Director,
Division of Monetary Affairs,
Board of Governors

Mr. Simpson, Associate Director,
Division of Research and
Statistics, Board of Governors

Mr. Reinhart,⁶ Assistant Director,
Division of Monetary Affairs,
Board of Governors

Mr. Ramm,⁶ Section Chief, Division of
Research and Statistics, Board of
Governors

Ms. Low, Open Market Secretariat
Assistant, Division of Monetary
Affairs, Board of Governors

Messrs. Beebe, Goodfriend, Lang,
Rolnick, and Rosenblum, Senior
Vice Presidents, Federal Reserve
Banks of San Francisco,
Richmond, Philadelphia,
Minneapolis, and Dallas
respectively

Messrs. Gavin and Kopcke and
Ms. Krieger and Rosenbaum,
Vice Presidents, Federal Reserve
Banks of St. Louis, Boston,
New York, and Atlanta
respectively

Mr. Stevens, Consultant, Federal
Reserve Bank of Cleveland

By unanimous vote, the minutes of
the meeting of the Federal Open Market
Committee held on September 26, 1995,
were approved.

The Manager of the System Open
Market Account reported on recent
developments in foreign exchange mar-
kets and on System foreign currency
transactions during the period Septem-
ber 26, 1995, through November 14,
1995. By unanimous vote, the Commit-
tee ratified these transactions.

The Manager also reported on devel-
opments in domestic financial markets
and on System open market transactions
in government securities and federal
agency obligations during the period
September 26, 1995, through Novem-
ber 14, 1995. By unanimous vote, the
Committee ratified these transactions.

By unanimous vote, the Committee
authorized the renewal for an additional
one-year period of the System's recip-
rocal currency ("swap") arrangements
with foreign central banks and the Bank
for International Settlements that were

6. Did not attend portion of meeting covering
the monetary policy discussion.

due to mature on various dates in December 1995. The renewal encompassed all the System's swap arrangements except that with the Bank of Mexico, which is scheduled to mature on January 31, 1996, and will be considered at a later meeting. The amounts and maturity dates of the arrangements approved for renewal are shown in the table that follows:

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
Austrian National Bank	250	12	12/04/95
Bank of England	3,000		12/04/95
Bank of Japan	5,000		12/04/95
Bank of Norway	250		12/04/95
Bank of Sweden	300		12/04/95
Swiss National Bank	4,000		12/04/95
Bank for International Settlements:			
Swiss francs	600		12/04/95
Other authorized European currencies	1,250		12/04/95
National Bank of Belgium	1,000		12/18/95
Bank of Canada	2,000		12/28/95
National Bank of Denmark	250		12/28/95
Bank of France	2,000		12/28/95
German Federal Bank	6,000		12/28/95
Bank of Italy	3,000		12/28/95
Netherlands Bank	500		12/28/95

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information available at the time of the meeting was mixed, but on balance it suggested a more moderate rate of expansion of economic activity after a strong gain during the summer. Consumer spending had turned sluggish recently; but with order backlogs still large, business spending for durable equipment was continuing at a robust if somewhat less rapid rate, and the sizable rise in housing starts in the third quarter presaged higher residential construction outlays. Appreciable increases in employment and hours worked tended to confirm that the economy had continued to expand at a solid pace, although manufacturing activity had weakened a little. Consumer and producer prices had risen more slowly on average in recent months after having increased at elevated rates in the early part of the year, and growth in labor costs had slowed further.

Nonfarm payroll employment, though held down somewhat by the onset of a labor strike in the aircraft industry, increased in October at the average monthly pace of the third quarter; in addition, aggregate hours worked by private production workers rose appreciably further. Construction payrolls recorded another sizable advance. The rate of job growth in the services industry slowed a little further, reflecting a decline in employment in personnel supply services after two months of strong advances. Manufacturing employment declined again. The civilian unemployment rate edged down in October to 5.5 percent.

Industrial production fell somewhat in October after having risen appreciably in the third quarter; most of the loss reflected the strike in the aircraft industry, but motor vehicle production and mining output also recorded substantial declines. In contrast, production of information processing equipment con-

tinued to rise at a rapid pace. Total utilization of industrial capacity contracted in October, with declines widespread across industries.

Total nominal retail sales, which had expanded relatively briskly over the second and third quarters, fell in October. As part of a pattern of widespread weakness in October, purchases at furniture and appliance stores were down appreciably after large gains in earlier months, and sales at general merchandise and apparel outlets reversed most of their sizable September increases. Housing demand and construction activity firmed in the third quarter: Sales of both new and existing homes posted solid advances, and single-family housing starts rose considerably, though multifamily starts remained sluggish.

Business investment in both equipment and structures expanded less rapidly in the third quarter. Stepped-up shipments of nondefense capital goods in August and September more than offset a sharp drop in shipments in July, but the quarterly average gain was significantly smaller than the increases recorded in the previous two quarters. Although orders for nondefense capital goods also rose more slowly in the third quarter, the still-sizable order backlogs pointed to substantial expansion of spending on business equipment in the near term. Nonresidential construction increased appreciably further in the third quarter, reflecting a surge in office and institutional building activity.

Available data suggested a reduction in business inventory accumulation in August and September. In manufacturing, the pace of stockbuilding slowed in the third quarter from the brisk rate of the first half of the year, leaving the factory stock–shipments ratio unchanged in the third quarter and a little above historic lows. In the wholesale sector, inventories were drawn

down in August and September after sizable buildups in earlier months; with sales weak, the aggregate inventory–sales ratio for the sector edged up in the third quarter and was at the upper end of its range for recent years. Retail inventories expanded significantly in August (latest data available), but the stockbuilding was generally in line with sales and the ratio of inventories to sales remained near the middle of its range in recent years.

The nominal deficit on U.S. trade in goods and services narrowed markedly in August; for July and August combined, the deficit was significantly smaller than its average rate in the second quarter. The value of exports declined over the two-month period, with increases in exports of computers and agricultural products more than offset by decreases in exports of aircraft, gold, and service receipts. Imports fell more than exports; with the notable exception of computers and semiconductors, declines were recorded in most major import categories. Available data indicated that economic expansion remained subdued in the major foreign industrial countries. Growth continued to slow in the European economies other than Italy, and the Japanese economy showed little evidence of a sustained recovery.

Consumer prices rose at a slightly faster rate in October; with a smaller increase in food prices offsetting higher energy prices, the index for items other than food and energy also picked up a little. For the four months ending in October, prices for nonfood, non-energy items advanced at a rate well below that of earlier in the year. Producer prices of finished goods edged down in October, reflecting a further decline in the prices of finished energy goods. Excluding food and energy, producer prices were unchanged in October and increased at a

slower pace in the third quarter than in the first half of the year. Growth in total nominal hourly compensation of private industry workers slowed in the third quarter and, on a year-over-year basis, continued to trend down; the decrease in compensation growth over the past year surpassed most major occupations and industries.

At its meeting on September 26, 1995, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with growth of M2 and M3 over the balance of the year at a pace near that experienced in recent months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged close to $5\frac{3}{4}$ percent, apart from a temporary rise around the end of the third quarter. Other short-term market rates also changed little on balance; market participants continued to anticipate an easing of monetary policy at some point but apparently viewed the chances of near-term easing as small. Longer-term interest rates declined further over the intermeeting period, perhaps in response to a growing conviction that inflation pressures would remain subdued and that substantial reductions in fiscal deficits would be

achieved over a period of years. The lower longer-term interest rates, coupled with continuing reports of strong corporate earnings, helped lift major indexes of equity prices to new record levels during the period. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly over the intermeeting period.

Expansion of the broad monetary aggregates weakened in October. M2 was unchanged in October after having grown relatively rapidly in the third quarter and despite the persistence of low opportunity costs associated with holding M2 assets. For the year through October, M2 expanded at a rate in the upper half of the Committee's range for this aggregate in 1995. Growth of M3 apparently was held down somewhat by the reduced need for additional bank funding during a time of sluggish loan demand; for the year to date, M3 grew at a rate a little above its range. Total domestic nonfinancial debt had risen more slowly in recent months, reflecting reduced expansion of both private and federal borrowing. Nonetheless, for the year to date, this measure of debt remained around the midpoint of its monitoring range.

The staff forecast prepared for this meeting suggested that the growth of economic activity would slow from the strong third-quarter pace to a rate more in line with the increase in the economy's potential. The forecast assumed that the favorable interest rate and wealth effects of the extended rally in the debt and equity markets would provide support for a moderate advance in final sales. Consumer spending was expected to expand at a rate generally in line with the growth of incomes; the favorable effects of higher prices on financial assets held by households would be offset to some extent by the

difficulties of increasing numbers of households in servicing their growing debts. The greater affordability of housing stemming from the earlier decline in mortgage rates was projected to help sustain homebuilding activity at a relatively high level. In anticipation of reduced growth in sales and profits, business investment in new equipment and structures was projected to slow appreciably from the very rapid pace of the past few years. Strong export expansion would be associated with the improving outlook for the economies of major trading partners. Although substantial uncertainty still surrounded the fiscal outlook, the forecast continued to incorporate a considerable degree of fiscal restraint. In the staff's judgment, wage and price inflation likely would not deviate significantly from recent levels.

In the Committee's discussion, members commented that recent statistical and anecdotal information pointed on balance to an appreciable slowing in the economic expansion, which had displayed unexpected strength during the summer months. There was some mix of views among the members concerning how far the slowing might proceed, though they generally viewed moderate growth as the most likely course for the economy. A number of members believed that growth around potential was a probable outcome, with business activity sustained in part by the favorable developments this year in the bond and stock markets. Other members expressed concern about some signs of further ebbing in the strength of final demands, and they envisaged the possible need for a policy adjustment at some point to sustain continued moderate growth. With regard to inflation, members noted that despite generally high levels of resource use, including tight labor markets in many parts of the

country, inflation had been more subdued than many had expected over the past several months. A number of members commented that they saw a basis in this development for mild optimism about the outlook for inflation, but others expressed concern that, in the context of current forecasts for economic activity and relatively high levels of resource use, progress toward lower inflation was unlikely over the projection period and indeed there was a risk of some modest deterioration in price performance.

In the course of the Committee's discussion, members reported on uneven business conditions in different parts of the country and among industries. On balance, modest to moderate growth appeared to characterize most regions, with overall levels of activity ranging from relatively robust in some regions to comparatively depressed in others. The mixed conditions were especially notable in manufacturing where numerous producers faced lagging demands while others, particularly in high-tech industries, found it difficult to satisfy strong demands for their products. More generally, the industrial sector of the economy had tended to stagnate for some time, including a slight decline in manufacturing activity reported for October, but recent improvement in orders for steel was cited as a favorable if not decisive omen in the outlook for industrial production. In other sectors of the economy, members observed that tourism displayed considerable strength in many areas, while cattle operations and energy production were adversely affected by high production costs or low prices.

In their review of developments in key demand sectors of the economy, members observed that consumer spending appeared to be on a firm growth trend, though weakness in overall sales

of motor vehicles in recent months and a decline in total retail sales in October had introduced a cautionary note. It was suggested that the performance of retail sales during the holiday season would tend to set the tone for the longer-term trend in such sales, and in this respect available data and anecdotal reports covering the first part of November were somewhat promising. More generally, further growth in consumer spending, though probably at a somewhat slower pace than over the past year, appeared likely. Such growth would be supported by moderate expansion in incomes and by the favorable effects on household wealth and confidence of the substantial improvement in the value of financial assets this year and the ready availability of financing on relatively attractive terms. Consumer confidence currently seemed to be at a fairly high level, albeit not uniformly so across the country, and at least for the quarters immediately ahead, anticipated strength in homebuilding should induce spending for many household durables. On the negative side, some members emphasized that the growth in consumer debt was likely to exert an increasingly inhibiting effect on consumer spending. Moreover, the satisfaction of earlier pent-up demands might well limit sales of many consumer durables, notably motor vehicles, in coming quarters. In one view, the projected growth in personal incomes and the increases that had occurred this year in the value of household holdings of financial assets would provide relatively little stimulus to consumer spending because the distribution of such gains was heavily tilted toward consumers in higher income or older age groups.

Further sizable growth in business fixed investment, but at a pace well below that experienced in recent years, was expected to provide appreciable

impetus to the expansion over the next several quarters. Favorable factors in the outlook for business capital spending included a desire to upgrade technological capabilities for competitive reasons, strong business earnings and cash flows, and an ample availability of financing on relatively liberal terms. Declining office vacancy rates in a number of areas would help to support office construction, and several members also commented on the strength in commercial and other nonresidential building activity in various parts of the country.

Ongoing efforts by many business firms to bring inventories into better alignment with sales had resulted in declining inventory investment since earlier in the year. Some further inventory adjustments, notably in stocks of motor vehicles, were expected over coming months, though not at a pace that would have a marked retarding effect on economic activity. Over much of 1996, inventory investment was projected to be a more neutral factor in the economy, with accumulation proceeding at a pace in line with growth in final sales, but the risks of unexpected developments in this sector of the economy were always substantial.

The outlook for fiscal policy remained obscured by the uncertain outcome of the current debate between the Congress and the Administration. While substantial fiscal restraint aimed at eventually balancing the budget appeared to be the likely result, the timing of the implementation of various tax and expenditure initiatives and the resulting extent of the fiscal restraint over the forecast period could not be anticipated with any degree of precision. For the nearer term, the ongoing shutdown of much of the federal government presented a downside risk to the expansion whose effects would depend on the presently uncertain duration of the shutdown and the poten-

tial unsettlement in financial markets that might develop at some point. The members generally believed, however, that in light of the underlying strength of the economy, the retarding effects of likely federal budget developments would not be sufficient in themselves to arrest the expansion over the forecast period, at least if the federal government shutdown were of relatively short duration and a federal debt default were averted.

The nation's foreign trade deficit had worsened substantially during the past several years, but current forecasts did not point to further deterioration over the projection period. An anticipated firming in the economies of major U.S. trading partners was expected to bolster exports. Several members questioned, however, the extent to which forecasts of strengthening economic activity were likely to materialize in a number of these countries, and they suggested that the foreign sector might well remain a somewhat constraining factor in the performance of the domestic economy.

Members welcomed the generally favorable price and cost developments of recent months and the related indications that currently high levels of resource use did not appear to be associated with rising inflationary pressures. Many emphasized the persistence of subdued increases in labor costs, and a number provided supporting anecdotal indications of relatively small advances in labor compensation in many parts of the country despite tight labor markets. The anecdotal reports also continued to suggest that strong competition was holding down price inflation and that producers were benefiting from soft prices of industrial materials. While a number of members believed that these developments might augur a modest decline in inflation over the year ahead, given current forecasts of moderate

economic expansion, many viewed as more likely the prospect of little or no progress toward price stability over coming quarters, and some expressed concern about the potential for an upward drift in the rate of inflation. An underlying factor in the relatively favorable climate for inflation was the continued limited rise in the costs of worker benefits. In the view of some members, however, benefit costs were likely to be less well contained as time went on and further major gains in curbing such costs became more difficult to achieve. Moreover, worker willingness to accept relatively limited increases in wages and other compensation might well begin to erode as concerns about job security tended to diminish after an extended period of relatively low unemployment. On balance, recent experience had raised questions about the relationship between levels of resource use and inflation that warranted careful monitoring.

In the Committee's discussion of policy for the intermeeting period ahead, all but one member favored or could accept an unchanged policy stance. This policy position took account of current indications of a generally acceptable rate of economic growth and the absence of any clear signs regarding the future strength of the expansion in relation to the economy's potential or the future course of inflation. Several commented that current monetary policy might be viewed as somewhat restrictive, though the degree of restraint was difficult to calibrate and it did not appear as yet to be inhibiting declines in intermediate- and long-term interest rates, increases in stock prices, or the availability of financing from lending institutions.

Members expressed somewhat differing views regarding the stance of monetary policy that was likely to prove consistent with the Committee's objectives over time. In the view of some, private

spending was not likely to have sufficient momentum to overcome the effects of increased fiscal restraint if the current stance of monetary policy were maintained. In the circumstances, an easing at some point would be needed to foster sustained economic growth at an acceptable pace and would be consistent with progress toward the System's price stability objective. For most of these members, however, the stronger-than-expected performance of the economy in the third quarter had reduced the urgency of such a policy move and had created enough uncertainties to justify a careful appraisal of unfolding developments before a decision was made to ease policy. In the view of one member, the probability of a shortfall from an acceptable rate of economic expansion was sufficiently high to require an immediate easing of policy. Other members believed that an unchanged policy was desirable under current conditions and that the direction and timing of the next policy move were more open to question. Not only were recent data giving an uncertain picture of the underlying strength of aggregate demand, but current forecasts generally did not point to progress toward the System's long-run goal of price stability. In this view, therefore, the current stance of monetary policy, even if slightly restrictive, was likely to be consistent with satisfactory economic growth over time, and it would provide better assurance of consolidating gains against inflation and fostering some further moderation in price increases over coming years. With regard to potential fiscal policy developments, although an especially broad range of outcomes seemed possible, the members agreed that the Committee could not freeze its policy options while it awaited the outcome of a prolonged federal budget debate nor could it commit itself to a specific response to a

particular fiscal policy agreement. Fiscal policy and any associated market reactions would be among the many factors that would have to be taken into account in the formulation of monetary policy.

In the Committee's discussion of possible intermeeting adjustments to monetary policy, a majority of the members expressed a preference for retaining a symmetric directive. In their view, the potential need to adjust policy during the relatively short intermeeting period was remote, and some of these members also believed that the direction of the next adjustment to policy was uncertain. A few also noted that the adoption of a biased intermeeting instruction at this point might send an unintended message regarding the prevailing view within the Committee concerning the risks to the expansion. The remaining members said that they preferred a directive that was tilted toward an easing policy action. Such an instruction in the directive would be consistent with what they viewed as the most likely policy course over coming months. They agreed, however, that the current uncertainties surrounding the economic outlook were not likely to be resolved during the weeks immediately ahead, and since no policy action was likely to be required in this period they could accept a symmetric directive.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could vote for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Com-

mittee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

The information reviewed at this meeting suggests a moderation in the expansion of economic activity after a strong gain in the third quarter. Nonfarm payroll employment increased further in October and the civilian unemployment rate edged down to 5.5 percent. Industrial production fell somewhat in October after a moderate rise in the third quarter. Total nominal retail sales were little changed on balance over September and October. Single-family housing starts were up considerably in the third quarter. Orders for nondefense capital goods point to substantial expansion of spending on business equipment in the near term; nonresidential construction has risen appreciably further. The nominal deficit on U.S. trade in goods and services narrowed over July and August from its average rate in the second quarter. After increasing at elevated rates in the early part of the year, consumer and producer prices have risen more slowly on average in recent months.

Short-term market interest rates have changed little on balance since the Committee meeting on September 26 while long-term rates have fallen somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined slightly over the intermeeting period.

In October, M2 was unchanged and M3 growth moderated. For the year through October, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate a little above its range. Growth in total domestic nonfinancial debt has slowed somewhat in recent months but for the year to date remains around the midpoint of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the range it had established on January 31–February 1 for growth

of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, and Melzer, Ms. Minehan, Mr. Moskow, and Ms. Phillips and Yellen. Vote against this action: Mr. Lindsey.

Mr. Lindsey dissented because he believed that monetary policy should be eased. The evidence suggested to him that in the absence of an easing move the underlying rate of nominal GDP growth was likely to be lower than needed to maintain real GDP at or near its potential. The intermediate forecast was subject to a number of significant risks: household balance sheets seemed unlikely to sustain the current rate of durables expenditure for any extended period; government expenditures were

certain to be cut substantially; and with fiscal contractions underway in Europe and Canada and severe financial stresses present in Japan and Mexico, he did not see much likelihood of a substantial expansion of exports. In keeping with his views, the financial markets were signalling the likelihood that a weaker pace of nominal GDP growth would materialize. The yield curve was virtually flat, with government securities up through relatively long maturities trading at yields below the current average federal funds rate. Thus, markets would be unlikely to find some easing inappropriate and over the intermediate horizon would view the current level of short-term rates as unsustainable.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 19, 1995.

The meeting adjourned at 1:35 p.m.

Donald L. Kohn
Secretary

Meeting Held on December 19, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System, in Washington, D.C., on Tuesday, December 19, 1995, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broadbuss and Parry, Presidents of the Federal Reserve Banks of Richmond and San Francisco respectively

Mr. Guynn, President-elect, Federal Reserve Bank of Atlanta

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Ms. Browne and Messrs. Davis, Dewald, Lindsey, Mishkin, Promisel, Siegman, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Mr. Ramm,⁷ Section Chief, Division of Research and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, Goodfriend, Lang, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Dallas, and Cleveland respectively
Ms. Rosenbaum, Vice President, Federal Reserve Bank of Atlanta

7. Did not attend portion of meeting covering the monetary policy discussion.

Ms. Perelmuter, Assistant Vice
President, Federal Reserve Bank
of New York
Mr. Weber, Senior Research Officer,
Federal Reserve Bank of
Minneapolis
Mr. Evans, Senior Economist,
Federal Reserve Bank of Chicago

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 15, 1995, were approved.

The Report of Examination of the System Open Market Account, conducted by the Board's Division of Reserve Bank Operations and Payment Systems as of the close of business on September 29, 1995, was accepted.

The Manager of the System Open Market Account reported on developments in foreign exchange markets during the period November 15, 1995, through December 18, 1995. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period November 15, 1995, through December 18, 1995. By unanimous vote, the Committee ratified these transactions.

By unanimous vote, the Committee authorized the renewal until December 13, 1996, of the System's regular reciprocal currency ("swap") arrangement of \$3 billion with the Bank of Mexico and the System's participation in the North American Framework Agreement with the monetary authorities of Canada and Mexico. Both were due to terminate on January 31, 1996. The additional temporary \$3 billion swap arrangement with the Bank of Mexico, approved by the Committee on

February 1, 1995, would lapse on January 31, 1996, in line with its original terms.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information available at this meeting suggested that the expansion of economic activity had slowed substantially after a strong gain in such activity during the third quarter. Data on employment and aggregate hours worked since late summer were consistent with moderate further increases in overall economic activity. Industrial production had changed little on balance after a sizable rise in the third quarter. On the spending side, robust advances in business fixed investment continued to provide considerable impetus to the economy. The available information on consumer expenditures pointed to somewhat reduced gains in recent months, and indicators of housing demand suggested on balance that activity in housing markets had tended to stabilize after several months of considerable strengthening. Consumer prices had risen relatively slowly in recent months, while increases in labor compensation had remained comparatively subdued.

Nonfarm payroll employment continued to grow at a pace roughly in line with the expansion of the labor force in recent months, with gains concentrated in the private service-producing sectors. The published information indicated some further declines in factory and government jobs in October and

November. Although aggregate hours of private production workers fell in November, they remained appreciably above their average level in the third quarter. The unemployment rate edged up to 5.6 percent in November, equaling its average for the third quarter.

Industrial production was little changed on balance over October and November after a sizable increase in the third quarter. A decline in October was largely accounted for by a strike at a major aircraft manufacturer; that strike, very recently settled, had also exerted a slightly depressing effect on production in November. Production of motor vehicles and parts also fell, on net, in October and November. Further growth outside the aircraft and motor vehicle industries was paced by continuing strength in the production of business equipment. Outside manufacturing, the output of utilities was boosted in November by demand associated with unusually cold weather.

Business fixed investment was continuing to grow at a rapid pace, with much of the strength stemming from the persisting and vigorous expansion in spending for office and computing equipment. However, the recent gains in total business investment had moderated from the extraordinary pace evident in 1994 and early 1995, and they also were less widespread among major categories of business equipment than they had been earlier. New orders for nondefense capital goods other than computers and aircraft had leveled out, although shipments were being maintained at high levels by still-large backlogs of unfilled orders. Producers of aircraft had received very sizable new orders recently, but shipments of completed aircraft had been held back in recent months by the strike at a major firm. Outlays for non-residential construction were continuing to advance briskly, with construction of

commercial structures posting sizable increases recently. Overall drilling and mining activity also had continued to move higher, led by increased exploration for natural gas.

Total nominal retail sales rose considerably in November, more than offsetting a drop in October; over the two months, retail sales advanced at a slower pace than the average rate in the second and third quarters. Much of the November increase reflected strong gains in sales of consumer durables, including improved sales of motor vehicles. In the nondurables sector, a sizable rise in November about reversed a decline in October. Recent surveys of consumer sentiment pointed to generally positive attitudes.

After having recorded robust advances during the third quarter, most indicators of housing activity suggested little further change more recently. However, considerable strength in mortgage applications associated with lower mortgage rates, together with survey indications of an upturn in house-buying intentions, pointed to strengthening housing construction over coming months. Housing starts were down in October, the latest month for which these data were available, after a large increase in the third quarter.

Data for October indicated a sizable accumulation of business inventories. In manufacturing, stocks grew at a rate only moderately below the brisk pace in the third quarter, and the rise continued to be concentrated in the capital goods industries. The aggregate ratio of inventories to sales in manufacturing was somewhat above the lows in late 1994 and early 1995. In the wholesale sector, a buildup in stocks of capital equipment accounted for the bulk of the accumulation in October, and the inventory-to-sales ratio in this sector remained on an uptrend. A sharp rise in retail inven-

tories in October was led by a large increase in stocks at auto dealers and at general merchandise and apparel outlets. The inventory-to-sales ratio for the retail sector as a whole was at its high for the year, but signs of overstocking, apart from motor vehicles, were limited.

After having strengthened appreciably in the third quarter, federal government purchases were now lagging and exerting some retarding effect on overall economic activity. The decline in federal purchases in part represented the transitory effects of government shut-downs and the restraining effects of spending cuts imposed by continuing resolutions and by curtailed appropriations in bills that already had been enacted into law. At the state and local government levels, however, available data pointed to continued, relatively strong growth in purchases.

The nominal deficit on U.S. trade in goods and services changed little in September (latest data available). Measured on a quarterly average basis, however, the deficit declined substantially in the third quarter, with the reduction about equally divided between a rise in the value of exports and a drop in the value of imports. Increases in exports were widespread among the major categories of trade, while reductions in imports were concentrated in categories in which there had been large gains in the second quarter. Available data pointed to subdued growth in most of the major foreign industrial countries in the second half of 1995.

Consumer prices had risen more slowly on balance in recent months than they had during the first half of the year. In November, the total index for consumer prices was unchanged, and consumer prices excluding food and energy were up only slightly. In contrast, producer prices of finished goods registered a relatively large increase in November,

and the component of this index excluding food and energy posted its largest rise since January. At the same time, prices of intermediate materials declined a bit further in November. According to recent survey results, consumers now expected less inflation over the year ahead and also over the next five to ten years. The available data on wages and worker benefits continued on balance to display a relatively subdued trend of increases in labor compensation.

At its meeting on November 15, 1995, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged a bit above the expected rate of $5\frac{3}{4}$ percent over the period. The bunching of settlements of several Treasury issues that had resulted from debt ceiling disruptions and the mid-December corporate tax date were among the factors exerting pressure on the funds rate. Most other short-term interest rates fell slightly, and longer-term interest rates extended earlier declines during the intermeeting period. Market expectations of some easing of

monetary policy appeared to be reinforced by market interpretations of the incoming information as further evidence that overall demand would be restrained and that the risks of a pickup in inflationary pressures had diminished. Over the intermeeting interval, major indexes of stock prices continued to move higher in concert with the rise in bond prices.

The sluggish performance of the broad monetary aggregates since August continued in November. Despite the persistence of low opportunity costs associated with holding M2 assets, M2 growth was relatively modest in November after a slight contraction in October. M3 growth slowed further in November, partly as a result of a shift of funding by borrowers toward capital market instruments to take advantage of lower long-term market rates. Nonetheless, because of robust expansion earlier in the year, M2 remained in the upper half of its 1995 range through November and M3 expanded at a rate at the upper end of its range. Growth of total domestic non-financial debt had slowed somewhat in recent months, reflecting reduced expansion of both private and federal borrowing, and for 1995 to date, this debt measure had grown at a rate around the midpoint of its monitoring range.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose slightly further on balance over the intermeeting period. Declining interest rates in several major foreign industrial countries, evidently induced by disappointing economic growth in those countries, appeared to have a firming effect on the dollar in relation to European currencies. The dollar changed little against the Japanese yen over the period after a sharp advance earlier. The Mexican peso appreciated a bit in relation to the dollar over the period.

The staff forecast prepared for this meeting suggested that the growth of economic activity would slow substantially from the very strong pace now indicated for the third quarter. Although this forecast did not differ significantly from that prepared for the November meeting, less growth than expected earlier seemed likely in the current quarter. Over the forecast horizon, however, the economy was still projected to expand at a pace that would keep activity close to the economy's potential. The forecast anticipated that the expansion in consumer spending would slow a bit in response to diminished gains in disposable income associated with less rapid advances in spending in other sectors of the economy. The rise that had occurred in the value of financial assets held by households would be a positive factor helping to support consumer spending but one that would be offset to a degree by the difficulties of an increasing number of households in servicing their growing debts. The greater affordability of housing stemming from the earlier decline in mortgage rates was projected to help sustain homebuilding activity at a relatively high level. In the context of reduced growth in sales and profits, business investment in new equipment and structures was projected to increase more moderately after several years of rapid advance. Although indications of excess inventories were limited, slower growth in sales and ongoing efforts to reduce inventory costs were projected to lead to smaller increases in stocks over the projection period. Exports were expected to be bolstered to some extent by the projected improvement in the economies of major trading partners. Although a great deal of uncertainty still surrounded the fiscal outlook, the forecast continued to incorporate an appreciable degree of fiscal restraint. Given the projected outlook, rates of utilization

of labor and capital resources would remain relatively high, and the underlying trend of price inflation was seen as unlikely to change significantly over the projection period.

In the Committee's discussion of current and prospective developments, members noted that the information that had become available since the November meeting tended to confirm earlier indications that the economic expansion had slowed appreciably from the brisk pace of the summer months. The members generally agreed that the most likely course for the economy remained one of moderate growth. Expansion at or near potential was seen as the most probable outcome, associated at least in part with the favorable effects on business and consumer spending of lower interest rates, higher equity prices, and an ample availability of credit. However, a number of members expressed concern that the strength of final demands would not be sufficient to support growth near the economy's potential, absent a policy adjustment. One factor that might retard growth was a higher level of real short-term interest rates owing to the favorable performance of inflation. Members noted that consumer price increases had remained relatively subdued and below expectations in recent months, despite the generally high levels of utilization of both labor and capital resources that had prevailed through much of the year. Several commented that the effects of new technologies, gains in productivity, global competitive pressures on businesses, and restraint in wage setting might imply that inflation would edge down further. Others expressed concern that the prospects for further reductions in inflation seemed quite limited in the context of projected high levels of resource use, including tight labor markets in many parts of the country.

In the Committee's discussion of regional developments, members reported that anecdotal and other information pertaining to regional activity suggested that the moderation in nationwide economic growth was evident across most of the nation, with the rate of expansion ranging from slow to moderate in different areas of the country. Overall levels of business activity continued to vary widely, from relatively weak in some areas to comparatively robust in others. Conditions also were uneven across industries, particularly in manufacturing, where flagging auto sales and some further inventory accumulation contrasted sharply with brisk demand for a range of producers durable goods, notably office and computing equipment, and building products. Despite indications that job growth had been relatively limited, labor markets remained tight in many parts of the country and there were more, albeit still limited, reports of rising wage pressures; in some areas, however, labor market conditions appeared to have eased somewhat recently.

In their discussion of developments in key sectors of the economy, members commented that the data and the anecdotal information on consumer spending had been mixed. For the holiday season, reports indicated that retail sales had been disappointing thus far, though sales appeared to be holding up relatively well in some sections of the country and for higher-priced luxury items more generally. Consumers had remained very cautious despite considerable promotional sales activity, perhaps anticipating even more aggressive markdowns of prices as the shopping season neared its end. Members noted that the reluctance of consumers also might be reflecting a sense of continued job insecurity in an environment of ongoing business restructuring and downsizing, higher

debt service burdens and rising delinquency rates, and the satisfaction of pent-up demand for durable goods. While these factors might be exerting an inhibiting influence on consumers, the members generally viewed moderate growth in consumer spending as a reasonable expectation in the context of further projected expansion in disposable incomes. The increase in household wealth associated with the strong performance of the bond and stock markets might tend to boost consumer spending relative to disposable incomes, although one member suggested that the highly concentrated nature of wealth holdings might limit any positive effect on aggregate consumption. With regard to housing, members took note of the recent declines in single-family housing starts and sales after a strong third quarter. They remarked, however, that some of their contacts were anticipating that the declines in mortgage interest rates over recent months to their current relatively low levels would foster a wave of mortgage refinancing and a pickup in housing demand in the spring.

Business fixed investment was expected to grow at a pace appreciably below that observed in recent years but nonetheless to continue supplying considerable impetus to the expansion. Strong profits and cash flows, along with the ample availability of financing on attractive terms, were favorable factors in the outlook; on the other hand, a weakening trend in final demand, notably in consumer outlays, likely would have a negative effect on business capital spending. Several members reported that commercial and other nonresidential construction activity remained brisk in various regions around the nation. A number of members commented on business inventory developments. Overall inventories of motor vehicles were on the high side, and inventory accumu-

lation more generally appeared to be running somewhat ahead of sales. There were no indications that serious overhangs were emerging, but there were risks that efforts to hold down stocks would damp production over the near term.

The outlook for fiscal policy continued to be clouded by the uncertainty surrounding the outcome of the debate between the Congress and the Administration. The members anticipated that the result of the debate would be considerable fiscal restraint, but the timing of tax and spending initiatives aimed at an eventual balancing of the budget and the extent of the fiscal contraction over time could not be forecast with any precision. In the interim, much of the federal government was closed, and while federal workers were expected to get paid eventually, their spending and that of federal contractors might be damped until the situation was resolved. The members believed, however, that in light of the plans being put forward, the fiscal drag imposed by likely federal budget developments would not be unusually large over the next few years.

In reviewing the outlook for inflation, members referred to the generally favorable price and cost experience of recent months. Several pointed to subdued increases in labor compensation and to anecdotal indications that upward pressures on wages and benefits remained scattered despite tightness in many labor markets. In this environment, and with the economy expected to expand at a comparatively moderate pace over the forecast period, many members anticipated that inflation would remain relatively stable despite continuing high levels of resource utilization, and some believed that it might record a somewhat improved performance. One argument advanced in support of a possibly better performance was that the recent

experience, which had been more favorable than expected given capacity utilization levels, was perhaps suggestive of the effects of rapid technological improvements on productivity, the enhanced efficiencies from greater economic specialization around the world, and the influence of heightened job insecurity on wages and prices. Another was the possible effect on future wage demands of the lower inflation expectations that now prevailed. Although no member saw greater inflation as having a high probability, several did refer to risks in that direction, including the possibility of greater pressures on resources stemming from faster than currently anticipated economic growth.

In the Committee's discussion of policy for the intermeeting period ahead, all the members either favored or could accept a slight easing in the degree of pressure on reserve positions. One argument cited in favor of some easing was that the policy stance, as indexed by the prevailing real federal funds rate, was becoming somewhat restrictive as inflation and inflationary expectations moderated, leaving real short-term rates higher than anticipated. In addition, with markets expecting a reduction in the federal funds rate in coming months, an unchanged policy was likely to lead to a backup in intermediate- and long-term rates. Although there was no sign that a cumulative deterioration in economic performance was about to get under way, the downside risks to the expansion appeared to have increased and a modest easing would better position policy to guard against the possibility that over the longer term the expansion would begin to fall short of the economy's potential, especially with fiscal policy likely to be at least moderately restrictive. In any case, the recent slowing of the economic expansion, combined with the wage and price restraint

evident at current levels of resource utilization and continuing business efforts to expand capacity, suggested that there was little risk of a pickup in inflation. Indeed, the favorable inflation experience over the last half year raised the possibility of continued modest price improvement.

A number of members, though willing to accept a slight easing, preferred an unchanged policy stance. While inflation had slowed from the elevated pace observed in the early part of the year, there was little hard evidence to indicate that it would decline any further over the forecast horizon or that there had been a significant increase in the sustainable growth rate of the economy. A few members also expressed concern about the possible repercussions in financial markets of an easing action that would follow an already strong rally in bond and stock prices. In the circumstances, these members questioned whether a somewhat easier policy stance would prove consistent with the Committee's objective of fostering further progress toward price stability. Moreover, although the available evidence on the economy's current performance remained mixed, the moderation in economic growth after the third-quarter surge did not seem at this time to signal a growing shortfall of the economy from its potential. Instead, the economy was likely in this view to continue to grow at a generally acceptable rate at or near capacity, and a few members saw some potential for somewhat faster growth at a pace that over time could intensify inflationary pressures. Accordingly, they preferred to wait for further evidence on inflation trends and the performance of the economy, but they indicated that in light of the uncertainties that were involved and the small amount of easing that was proposed they would not dissent from the majority position.

With regard to possible adjustments to policy during the intermeeting period, all the members endorsed a proposal to retain an intermeeting instruction in the directive that did not incorporate any presumption about the direction of a possible intermeeting change. While such a change in policy could not be ruled out, the potential need for a further intermeeting policy adjustment appeared remote at this juncture. The risks to the outlook seemed generally in balance, and the direction of the next policy move was not clear in the view of some members.

At the conclusion of the Committee's discussion, all the members indicated that they favored or could support a directive that called for some slight easing in the degree of pressure on reserve conditions during the intermeeting period but that contained no presumption about the likely direction of any intermeeting policy change. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser monetary restraint would be acceptable during the intermeeting period. A staff analysis indicated that the reserve conditions contemplated at this meeting would be consistent with moderate growth of M2 and M3 over coming months.

The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests a substantial slowing in the expansion of economic activity after a strong gain

in the third quarter. Nonfarm payroll employment increased further in November, but the civilian unemployment rate edged up to 5.6 percent. Industrial production was little changed on average over October and November after a moderate rise in the third quarter. Total nominal retail sales rose somewhat on balance over October and November. Housing starts were down in October after a large increase in the third quarter. However, orders for nondefense capital goods point to substantial expansion of spending on business equipment in the near term, and nonresidential construction has risen appreciably further. Wage trends have been stable and consumer prices have risen relatively slowly on average in recent months.

Most market interest rates have declined slightly since the Committee meeting on November 15. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen slightly on balance over the intermeeting period.

The substantial moderation in the growth of M2 and M3 since midsummer continued in November; however, for the year through November, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate at the upper end of its range. Growth in total domestic nonfinancial debt has slowed somewhat in recent months but for the year to date remains around the midpoint of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the range it had established on January 31–February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the

monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Hoenig, Kelley, Lindsey, and Melzer, Ms. Minehan, Mr. Moskow, and Mses. Phillips and Yellen.
Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, January 30–31, 1996.

The meeting adjourned at 1:05 p.m.

Donald L. Kohn
Secretary

Consumer and Community Affairs

In 1995 the Division of Consumer and Community Affairs continued to address concerns about community development and reinvestment, access to credit by minorities and low-income households, possible discrimination in mortgage lending, and the need to match its consumer regulations to industry developments.

The Board joined in issuing revised interagency regulations under the Community Reinvestment Act (CRA) after rulemaking that included the publication of two proposals. The new rules emphasize performance in lending, service, and investment; they will help promote consistency in assessments and reduce compliance burdens for many banks. In the area of bank and bank holding company applications, the Board acted on a large number of cases that involved CRA protests or adverse CRA ratings, or both, or involved fair lending and noncompliance with consumer regulations. Several of the applications involved proposed "mega mergers" that engendered great interest among members of the public, who voiced both strong support and opposition regarding the mergers. The Board approved them after extensive analyses, finding that convenience and needs factors were consistent with approval.

In the fair lending area, the Board adopted streamlined procedures for referring discrimination complaints to the Department of Justice; forwarded the results of a major investigation into a mortgage lender's "overages" practices; and successfully concluded a joint enforcement action that involved credit discrimination against Hispanic borrowers. The Board referred other cases,

which raised claims of alleged mortgage discrimination, to the Department of Housing and Urban Development (HUD) for investigation. The Board improved the System's examination process for fair lending, modifying statistical techniques that are used to test large institutions for compliance; and took steps with other agencies to achieve more uniform enforcement and provide greater clarity of legal standards for the industry. Acting on behalf of the Federal Financial Institutions Examination Council and HUD, the Board met statutory deadlines for the early release of Home Mortgage Disclosure Act statements for individual lenders and aggregate reports for metropolitan areas. From the data, the Board noted a marked increase in lending to minority and low-income homebuyers, although denial rates continued to show disparities among racial and ethnic groups.

These matters are discussed below, along with other actions by the Board in the areas of community affairs and consumer protection.

CRA Reform

In April the Board amended its Regulation BB (Community Reinvestment) in a joint issuance with the three other financial supervisory agencies that have CRA responsibilities (the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision). The issuance marked an important step toward a new agency approach for assessing the CRA performance of financial institutions and brought to closure a rulemaking process begun in 1993

at the direction of President Clinton. The President had asked the agencies to reform the implementation of the act by developing new regulations, supervisory procedures, and standards for assessing a financial institution's CRA performance. The goal was to orient assessment in CRA examinations more on results than process, produce examinations that are more predictable and consistent, and make the law generally more effective while reducing its burden on the industry.

The President had directed the agencies to consult with community groups and the banking and thrift industries; the new regulation takes account of an extensive outpouring of public views at hearings and in comment letters as well as the agencies' own experience with the original assessment system. The regulation provides more direct guidance to banks and thrift institutions on the nature and extent of their CRA responsibilities and the means by which those obligations will be assessed and enforced. It creates a more quantitative system for assessing CRA performance that includes measurements for lending, service, and investment; requires institutions with assets of more than \$250 million to collect additional data for small-business and small-farm loans; and allows alternative bases of evaluation to minimize the regulatory burden for certain institutions. The rules establish a streamlined examination for small lenders and allow any covered institution to operate under, and have performance measured against, its own strategic plan.

In the fall, the agencies issued new examination procedures, and by year-end they had held five week-long staff training sessions in Boston, Atlanta, Chicago, Dallas, and San Francisco. More than 1,100 examiners from the OCC, the OTS, the FDIC, and the Federal Reserve took part. In December the

Board settled the procedures for the wholesale and limited-purpose bank designations and the strategic plan approvals necessary for banks to qualify for special examinations.

Some measures taken by the Federal Reserve will assist both state member banks and System examiners to implement the new CRA rules. Data-entry software made available to institutions will make it easier for them to collect information about small-farm and small-business lending, required for banks with more than \$250 million in assets and those affiliated with bank holding companies with \$1 billion or more in assets. The software has an export capability that allows institutions to download and submit data on diskette for processing by the Federal Reserve. A computer-analysis system will enable examiners to produce the performance-based analyses called for by the new rules and assist them in preparing summaries of demographic, economic, and lending information that they will use in examining small banks. Beginning in 1997, the system will incorporate data for large-bank examinations.

Fair Lending

Under the Equal Credit Opportunity Act, as amended in 1991, the Board is required to refer violations that constitute a "pattern or practice" of discrimination to the U.S. Department of Justice. The five referrals this year represent a substantial increase over 1994, when the Board referred one case. Justice officials returned four of the five 1995 cases to the Board for administrative handling, finding that the Board's enforcement action alone was adequate. The remaining case raised issues of potential discrimination in mortgage lending and was under active investigation at year-end.

In 1995 the Board addressed a lender practice that involves the application of "overages." The practice represents a form of tiered loan pricing in which individual loan officers exercise discretion, for any given loan transaction, in seeking interest rates or points above the institution's established minimums. Often, the discretionary setting of rates is a form of incentive for loan officers, who may receive a significant share of any overages obtained, as compensation for increasing the lender's return on the loan. In May 1994 the Board had advised state member banks that while overages may not be inherently discriminatory on a prohibited basis, bank management should be aware that such a program could, in some circumstances, result in illegal lending discrimination because of either disparate treatment or disparate impact.

The Board dealt with two cases that involved discriminatory pricing. One case, involving a state member bank, had been referred to the Department of Justice in 1994; in October 1995, the Board acted in concert with Justice against the bank for what both agencies regarded as a pattern or practice of charging higher interest rates to Hispanic borrowers for consumer installment and single-payment loans. The Board issued a cease-and-desist order to bar the practice and required the bank to adopt a series of corrective measures; concurrently, the bank and Justice entered into a stipulated judgment that enjoined future discrimination in rates or other loan terms and conditions; the judgment also required the bank to establish a \$500,000 fund to compensate victims of the alleged discrimination.

In the second case, the Board and a Reserve Bank conducted an extensive review of possible discrimination in mortgage loan transactions by a bank holding company subsidiary. The matter

was referred to the Department of Justice, where it was under review at year-end.

Assessing Compliance with Fair Lending Laws

The Board completed its first full year of operating a specialized fair-lending school for Federal Reserve examiners. The two-week school covers an extensive range of conceptual topics and practical, hands-on classwork; a total of 109 examiners attended the three sessions offered during 1995.

In evaluating compliance with fair lending laws, bank examiners assess decisions in the context of the lending institution's underwriting standards. They look at a sample of approved and denied applications and check whether the institution, in applying its lending criteria, has implemented standards consistently and fairly and whether any differential treatment warrants further investigation.

Examiners also use data collected and reported by banks and others under the Home Mortgage Disclosure Act (HMDA). Although the HMDA data do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applications, access to the lenders' files on loan applications and to related information enables examiners to overcome many of the data's limitations.

Since 1993 the banking agencies have used a computer-based system to obtain customized HMDA reports. Developed in consultation among the agencies, the system gives examiners a more complete picture of an institution's mortgage lending record than was readily available in the past. In 1994 the Federal Reserve began using a statistical analysis system to aid in the fair-lending examination of large-volume mortgage

lenders. The system helps examiners determine the significance of race in a bank's lending decisions through a regression analysis of the HMDA data recorded by the institution on its loan-application register. Examiners supplement the results of that analysis with other information drawn from actual loan files to identify specific cases that may need further review and possible discussions with bank management. To aid examiners in the field, the Board has developed a sampling system to run on a laptop computer.

The Board also continues to improve its automation capabilities for analyzing HMDA data, making enhancements in the application analysis and statistical components that Reserve Banks use in fair-lending examinations. Staff members from FDIC regional offices also have direct access to the HMDA analysis system.

HMDA Data and Lending Patterns

The Home Mortgage Disclosure Act requires covered mortgage lenders in metropolitan areas to disclose data regarding home purchase and home improvement loans, including refinancings. Depository institutions and mortgage companies generally are covered if they are located in metropolitan areas and have assets of more than \$10 million. Since January 1993, independent mortgage companies with lower assets are also covered if they originated 100 or more home purchase loans in the preceding calendar year. One consequence of the expanded coverage has been a significant increase in the number of independent mortgage companies reporting data. In 1993, about 225 independent mortgage companies reported data (covering 1992 loans); in 1995, more than 900 reported.

Under HMDA, covered lenders submit geographic information about the property related to a loan or a loan application. They report on the disposition of applications and, in most cases, about the race or national origin, income, and sex of applicants and borrowers. The Board processes the data and prepares disclosure statements on behalf of HUD and member agencies of the Federal Financial Institutions Examination Council (FFIEC).¹

In 1995 the FFIEC prepared nearly 39,000 disclosure statements for the 9,858 lenders that reported HMDA data for calendar year 1994. (Overall, the 1994 data include a total of 12.2 million reported loans and applications, a 21 percent decrease from 1993 that is largely attributable to a sharp decline in refinancing activity.)² In July, individual institutions made these disclosure statements public, and in August, aggregate reports that contain data for all lenders in a given metropolitan statistical area (MSA) became available at a central depository in each of the nation's 329 MSAs. To enhance public access to the HMDA data, the FFIEC also makes the information available on paper, microfiche, magnetic reel and cartridge, PC diskette, and CD-ROM.

Lending institutions tend to specialize in different types of home loans. Depository institutions are the predominant source of home improvement and multi-family loans. Mortgage companies accounted for about 50 percent of the home purchase loans reported in 1994 and about 80 percent of the government-backed loans.

1. The member agencies are the Board, the FDIC, the National Credit Union Administration, the OCC, and the OTS.

2. A summary of the 1994 HMDA data appears in a series of special tables included in the *Federal Reserve Bulletin*, vol. 81 (September 1995), pp. A68-A75.

Mortgage originators—as well as institutions in the secondary market for mortgages, such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—have in recent years initiated a variety of affordable home loan programs intended to benefit lower-income and minority households and neighborhoods. A year-to-year comparison of the HMDA data suggests that these programs may be making a difference. From 1992 to 1993 the number of conventional home purchase loans extended to lower-income borrowers increased 38 percent compared with an 8 percent increase for higher-income homebuyers. The trend continued into 1994. The 1994 HMDA data show that the number of loans to lower-income borrowers increased about 27 percent while the number extended to higher-income borrowers increased about 13 percent.³

Lending to minority homebuyers has also increased markedly in recent years. Among racial or ethnic groups from 1993 to 1994, the number of loans to black applicants increased 55 percent, to Hispanic applicants 42 percent, and to Asian applicants 19 percent. The increase for white applicants was 16 percent over the same period.

The 1994 data continue to show rates of credit denial that are higher for black and Hispanic loan applicants than for Asian and white applicants even when applicants are in the same income brackets. In 1994 the denial rates for conventional home purchase loans overall were 33 percent for black applicants, 25 percent for Hispanic applicants, 12 percent for Asian applicants, and 16 percent for

white applicants. These rates were not much different from 1993. For neighborhoods, the data also show that the rate of loan denial generally increased with an increase in the proportion of minority residents.

The data collected under HMDA do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applications. Consequently, the data alone do not provide a sufficient basis for determining whether a lender is discriminating unlawfully. But because the data can be supplemented by other information available to the agencies, they are an important tool for enforcement of fair lending laws.

The important uses of the HMDA data make accuracy a critical issue. The FFIEC's processing software is programmed to identify errors in the data submitted by lenders for correction before disclosure statements and reports for specific MSAs are prepared. During the years that lenders have submitted their HMDA data in register format, the quality has improved considerably. The proportion of 1994 loan records containing detected errors was less than 0.5 percent, down from about 4.4 percent in 1991 (the first year for which data were collected on a loan-by-loan basis).

Other Uses of HMDA Data

Since 1990 the HMDA data reported by lenders have included information about the race, sex, and income of borrowers and loan applicants. For loans sold, lenders also identify secondary-market purchasers by type of entity. These expanded data provide opportunities to profile the characteristics of the borrowers whose loans are purchased by secondary-market entities and of the

3. Computations are adjusted to exclude the effects, beginning with the 1993 data, of HMDA's expanded coverage of independent mortgage companies.

neighborhoods in which those borrowers reside.⁴

In carrying out a statutory responsibility to oversee housing activities by government-sponsored entities, HUD uses the expanded HMDA data to help assess the efforts of Fannie Mae and Freddie Mac to attain HUD goals for supporting mortgages for low- and moderate-income families and for properties in central cities. HUD also makes extensive use of the HMDA data as one component of its fair lending reviews. The data assist in the handling of loan applicants' and borrowers' allegations of lending discrimination filed with HUD, the Department of Justice, or with some state or local agencies, and in the agencies' targeting of lenders for investigation.

Private Mortgage Insurance

On behalf of the private mortgage insurance (PMI) industry, the FFIEC also compiles HMDA-like data pertaining to PMI applications. PMI typically is required by lenders when they extend conventional mortgages with small down payments.

Working through their national trade association, the Mortgage Insurance Companies of America, the eight active PMI companies voluntarily submit their data to the FFIEC, which prepares company-specific disclosure statements for each of the firms and aggregate reports for each MSA. These reports are available for public review at the central depositories where HMDA data are available. The information is also available from the FFIEC in other formats,

including data tape, CD-ROM, and PC diskette.⁵

Community Development

The implementation of new CRA rules—with their increased emphasis on community development lending, service, and investment—helped shape the activities of the Federal Reserve's Community Affairs program during 1995.

The community affairs offices provided a variety of training workshops—often in cooperation with consumer compliance examiners—designed to help bankers, community groups, and others understand and respond effectively to the revised CRA regulation. The Federal Reserve Banks of Richmond and San Francisco sponsored workshops throughout their Districts to explain the new rules. The Reserve Banks at Kansas City, Chicago, and Atlanta held educational workshops or informational forums, and the remaining Reserve Banks developed plans to hold similar programs early in 1996.

Because the new CRA regulation emphasizes community development lending and investment, the Reserve Banks' educational programs and informational materials continued to focus on these areas:

- The Atlanta, Richmond, Dallas, and St. Louis Reserve Banks co-sponsored a major conference on rural economic development
- The Richmond, Dallas, and Boston Reserve Banks sponsored community development training workshops
- The St. Louis, Philadelphia, and Chicago Reserve Banks conducted edu-

4. See the discussion of secondary-market activity in Glenn B. Canner and Wayne Passmore, "Credit Risk and the Provision of Mortgages to Lower-Income and Minority Homebuyers," *Federal Reserve Bulletin*, vol. 81 (November 1995), pp. 989–1016.

5. For an analysis of the 1994 private mortgage insurance data, see the appendix to Canner and Passmore, "Credit Risk and the Provision of Mortgages," pp. 1007–16.

cational programs about opportunities for bank involvement in financing women-owned and minority-owned small businesses, including "micro" businesses

- The Kansas City Reserve Bank conducted training programs in housing finance techniques that help meet the needs of low- and moderate-income families.

Several Reserve Banks presented targeted training programs to meet special needs of bankers in their Districts. The Richmond Reserve Bank sponsored a forum on the operation of multibank community development corporations; and the Kansas City, Chicago, and Dallas Reserve Banks conducted educational sessions on fair lending. Overall during 1995, community affairs programs sponsored or co-sponsored more than 200 conferences, seminars, and informational meetings on community development, fair lending, and related community reinvestment topics. As part of their educational activities, the community affairs staff members at the Board and the Reserve Banks also made 400 presentations at conferences, seminars, and meetings sponsored by banking, governmental, business, and community organizations.

The Federal Reserve's community affairs program undertook several special initiatives to help banks develop effective programs to meet community credit needs. The Federal Reserve Bank of Atlanta, working with the Board, developed software for personal computers called "Partners: A Public Private Partnership Model for Home Mortgage Lending." The software helps bankers determine borrowers' loan eligibility and provides ten potential loan-qualifying techniques—from borrower self-help to loan subsidies and other combinations of public and private

funds—that bankers can consider in serving low- and moderate-income homebuyers. By year-end, more than 30,000 copies of the software had been distributed nationwide by the Board and the Reserve Banks. The software also is available for downloading from the Internet.

The Federal Reserve produced new and updated publications in 1995. The Board published *Community Development Investments: A Guide for State Member Banks and Bank Holding Companies*, an overview of the Federal Reserve's policies and guidelines on the formation of community development corporations (CDCs) and other uses of equity investments for community development purposes. The guide replaces *Community Development Investments*, first published in 1991. The new publication covers changes to the Federal Reserve Act that authorize community development investments for state member banks and a new Board interpretation of Regulation Y for community development investments by bank holding companies. The Board updated a companion publication, *Directory: Bank Holding Company Community Development Investments*, which describes existing CDCs and other investments made by bank holding companies.

The Federal Reserve Bank of Dallas published *Breaking Ground: A Beginner's Guide for Nonprofit Developers*, which provides basic information for prospective nonprofit community development groups about the planning, financing, and development of affordable housing.

The Federal Reserve Bank of Philadelphia published *Small Business = Big Possibilities*, which profiles the public-private partnerships of various financial institutions throughout the country that help finance small businesses. Each

profile describes a bank's involvement, gives the total lending activity under the program, includes comments on the profitability of the relationship for the bank, and makes recommendations for other banks that seek to develop a similar partnership program.

The Federal Reserve Bank of Chicago published *Access to Credit: A Guide for Lenders and Women Owners of Small Businesses*, a collaborative effort with the Women's Business Development Center of Chicago. The guide presents the views of women business owners and of lenders on the loan application process for small businesses and gives recommendations that can help foster successful lending relationships with small businesses.

Community affairs newsletters further expanded the Reserve Banks' reach in helping to inform financial institutions about community development and reinvestment issues and program opportunities. The Federal Reserve Bank of Richmond began publishing *Marketwise*, a newsletter that covers a broad range of community development and reinvestment topics. The Chicago Bank began issuing *Economic Development News and Views*, a newsletter that focuses on development issues for small and minority businesses and opportunities for banks.

Each of the twelve Reserve Banks now publishes one or more newsletters covering various aspects of bank involvement in affordable housing and community and economic development. These newsletters reach a combined circulation of more than 55,000 bankers, community representatives, government officials, bank regulators, and others.

The Reserve Banks' community affairs programs continued their outreach to help identify community development and reinvestment needs and obtain guidance concerning the kinds of

educational and information products that should be developed. Several Reserve Banks prepared profiles of targeted communities to assist bankers, community representatives, and others interested in community credit needs:

- The Federal Reserve Bank of Richmond published community profiles for the Prince George's County and Cumberland areas in Maryland, the Raleigh-Durham area in North Carolina, and the Norfolk-Virginia Beach-Newport News area of Virginia
- The Federal Reserve Bank of Philadelphia published a profile for the Wilkes-Barre-Hazleton-Scranton area of Pennsylvania
- The St. Louis Reserve Bank issued profiles for the metropolitan areas of Little Rock, Arkansas; Jackson, Tennessee; and Columbia, Missouri. For the Lower Mississippi Delta region, the Reserve Bank issued a profile and also produced a video highlighting economic development projects in which banks in the region were participating
- The San Francisco Reserve Bank published community profiles for Fresno and Oakland
- The Federal Reserve Bank of Kansas City developed demographic analyses for the metropolitan areas of Kansas City, Oklahoma City, Omaha, and Denver
- The Federal Reserve Bank of New York published a report that outlined the credit needs of Washington Heights, a Manhattan neighborhood, and convened a forum with bankers and community groups to discuss community investment options for the area.

Overall during 1995, the System's community affairs offices held more than 1,400 outreach meetings with bankers, community groups, business representatives, and others.

Community affairs programs continue to meet a growing demand for technical assistance and advice on community development and reinvestment matters. Technical assistance is aimed at helping financial institutions and communities develop program responses to recognized needs and, in many cases, to assist individual institutions in strengthening their CRA programs.

The Federal Reserve Bank of San Francisco worked to foster the creation and growth of multibank loan consortia focusing on community reinvestment. The Reserve Bank continued its efforts to help establish a statewide loan consortium for small businesses, the California Economic Development Loan Initiative. That effort culminated in the formation of a \$50 million statewide loan pool involving about forty banks and other corporations. The Reserve Bank also provided organizational support for the formation of the Association of Reinvestment Consortia for Housing (ARCH) and helped launch the group's newsletter, *Consortia News*. The Federal Reserve Bank of Atlanta assisted a number of state member banks with issues related to community development corporations and investments in tax-advantaged low-income housing projects. Overall during 1995, community affairs programs responded to almost 600 requests for technical assistance on community development and reinvestment matters.

In 1995 the Federal Reserve's Community Affairs program continued to support the System's supervisory responsibilities for the CRA and for fair lending laws. Board staff members taught sessions for consumer compliance examiners on how to conduct community contacts and on bank involvement in community development finance; and they presented seven half-day training sessions to help senior com-

mercial examiners understand various aspects of affordable housing and the financing of community development projects. Board and Reserve Bank staff members also helped conduct fair lending schools, joined in interagency efforts to reform implementation of the CRA, and provided other briefings and educational sessions for bank examiners.

Other Regulatory Matters

The Board took the following other actions with regard to rulemaking and other responsibilities for the implementation of consumer protection laws.

Regulation B (Equal Credit Opportunity)

In April the Board published for comment a proposal to amend Regulation B to eliminate a general prohibition on collecting data that relate to an applicant's race, color, sex, religion, or national origin. If adopted, the rule would allow, but not require, creditors to collect these data for any credit product. The prohibition against taking such data into account in credit decisions would remain unchanged. At year-end the Board expected to take final action on the proposal early in 1996.

Regulation E (Electronic Fund Transfers)

In April the Board made final an amendment to Regulation E that had been adopted on an interim basis in November 1994. The rule gives financial institutions more flexibility in identifying consumer accounts on receipts at automated teller machines (ATMs). It eliminates the requirement that the receipts uniquely identify the consumer, the con-

sumer's account, or the ATM card. This change helps to protect consumers and financial institutions against fraudulent fund withdrawals.

Regulation M (Consumer Leasing)

In September the Board published proposed revisions to Regulation M following a review under the Board's Regulatory Planning and Review program. The primary focus of the review is on automobile leasing, and the proposed changes include a new disclosure of the early termination charge; disclosure of the gross cost of a lease, the residual value, and an estimated lease charge; a requirement that certain lease disclosures be segregated from other information; and, to implement a statutory change enacted in 1994, revised provisions for radio and television advertising.

At year-end, the Board was completing plans for focus group sessions in Washington, D.C., and Los Angeles to obtain the views of consumers on the proposed disclosures. The Board believes the focus groups will assist in identifying information needed by consumers to make informed decisions about lease transactions. The comment period on the Board's proposal, scheduled to end in December, was extended to mid-February to accommodate the completion of the focus group interviews.

Regulation Z (Truth in Lending)

In March the Board amended Regulation Z to implement changes made to the Truth in Lending Act by the Riegle Community Development and Regulatory Improvement Act of 1994. The

amendments impose both new disclosures and substantive limitations on home mortgage loans bearing rates above a certain percentage or fees above a certain amount. New disclosures also apply to reverse mortgage transactions, which provide periodic advances to the borrower and rely principally on the home's value for repayment. The disclosures will assist consumers (elderly homeowners, for the most part) in comparing costs when shopping for reverse mortgages.

The Riegle legislation of 1994 directed the Board to submit special reports to the Congress about possible amendments to the Truth in Lending Act. In March the Board submitted a report on consumers' ability to waive the right of rescission when they refinance or consolidate home-secured loans with new creditors. The Board concluded that many consumers would benefit from greater flexibility and supported amending the Truth in Lending Act so that consumers can waive the right of rescission more freely if the transaction involves no additional debt.

The 1994 legislation also asked the Board to report on how existing rules governing credit advertising could be modified to increase consumer benefit and decrease creditor costs and whether the rules for radio advertisements could be modified without diminishing consumer protection. In June the Board published a notice requesting public comment on these issues; in September it submitted a report to the Congress recommending statutory amendments that could decrease creditor cost without decreasing consumer benefit. One recommended change would allow creditors to give abbreviated credit disclosures in radio and television advertisements together with a toll-free number that consumers could call for further information about credit costs.

Regulation DD (Truth in Savings)

In January the Board requested comment on possible changes in the formula for calculating an annual percentage yield (APY). The Board adopted an interim rule for certain noncompounding multiyear certificates of deposit; the rule permits institutions to disclose an APY equal to the contract interest rate. The Board deferred final action on the January proposal, taking account of pending legislation that would make significant reductions in the requirements of the Truth in Savings Act.

Interpretations

In 1995 the Board continued to offer legal interpretations and guidance through its official staff commentaries, which are a substitute for individual staff interpretations.

In April the Board revised the official staff commentary to Regulation Z (Truth in Lending). The update gives guidance on the treatment of various fees and taxes associated with real estate loans and a creditor's responsibilities when investigating a claim of the unauthorized use of a consumer's credit card. In December the Board proposed revisions for the 1996 update; they provide guidance on amendments to Regulation Z affecting reverse mortgages and certain mortgages bearing rates above a certain percentage or fees above a certain amount. The proposed revisions also address issues such as a credit card issuer's responsibilities when a cardholder asserts a claim or defense relating to a merchant dispute.

In July the Board published a proposed staff commentary to Regulation C (Home Mortgage Disclosure); in December it published a final version. The commentary provides guidance on

such matters as the treatment of loan prequalifications, participations, refinancings, home equity lines of credit, mergers, and loan applications received through brokers. The Board expects the commentary to reduce the burden of compliance by clarifying difficult issues, providing flexibility, and consolidating the guidance previously contained in various sources.

In December the Board proposed an update to the official staff commentary to Regulation DD (Truth in Savings). It addressed issues such as the timing by which credited interest becomes part of principal and how leap years affect the calculation of the APY.

In June the Board published an update to the commentary to Regulation B (Equal Credit Opportunity). The update addressed disparate treatment, special-purpose credit programs, credit scoring systems, and discrimination based on marital status. In December the Board published proposed revisions for the 1996 update; they included guidance on such issues as the use of age in credit scoring systems, spousal signature rules, and the signature rules for business credit.

Economic Effects of the Electronic Fund Transfer Act

In keeping with statutory requirements, the Board monitors the effect of the Electronic Fund Transfer Act on compliance costs and consumer benefits related to EFT services. Proposed revisions to Regulation E (Electronic Fund Transfers) under the Board's Regulatory Planning and Review program were scheduled as of year-end for Board consideration in early 1996.

The proposed revisions to Regulation E are limited because the current regulation already follows closely the detailed requirements of the statute. Most

revisions would clarify and simplify the text of the regulation, reorganize and consolidate related material, and delete obsolete provisions. The commentary to Regulation E would be revised to follow the format of the commentaries of other regulations. These changes would reduce burden somewhat since they would make it easier for financial institutions to understand and use the regulation and commentary. The few substantive changes would not likely have much effect on regulatory burden. As a whole, the proposed revisions would reduce ongoing burden without reducing consumer benefits. There would be some transaction cost of learning and implementing the revised regulation.

Aside from regulatory changes that potentially benefit consumers or reduce compliance burdens, the economic effects of the Electronic Fund Transfer Act generally increased because of continued growth in the use of EFT services. During the 1990s the proportion of U.S. households using EFT services has grown at an annual rate of about 2.5 percent. About 85 percent of households with deposit accounts at financial institutions now have one or more EFT features on those accounts.

Automated teller machines are the most widely used EFT service. Nearly two-thirds of all households with deposit accounts currently have ATM cards, and most of the nation's depository institutions offer customers access to their accounts through ATMs. Access has been enhanced by the operation of shared networks. Almost all ATMs in operation today participate in one or more shared networks. The monthly average number of ATM transactions increased about 16.3 percent, from 694.5 million in 1994 to 807.4 million in 1995. During the same period, the number of ATMs available to consumers rose 12.6 percent, to 122,700.

Direct deposit is another widely used EFT service. More than half of all U.S. households with deposit accounts receive some funds through direct deposit. Direct deposit is particularly widespread in the public sector: More than half of social security payments and two-thirds of federal salary and retirement payments are made electronically. The use of direct deposit is less common in the private sector, but it has grown substantially in recent years. Considering both public and private payments, the proportion of households receiving direct deposits grew about 5.4 percent per year during the 1990s.

Point-of-sale (POS) systems account for a small share of EFT activity, but their use continued to grow rapidly in 1995. The number of transactions on POS systems rose 36.9 percent, from 47.2 million per month to 64.6 million per month; the number of POS terminals rose 53.6 percent, to 528,700.

The incremental costs associated with the EFT act are difficult to quantify because it cannot be determined how industry practices would have evolved in the absence of statutory requirements. The benefits of the law are also difficult to measure because they cannot be isolated from consumer protections that would have been provided even in the absence of regulation. The available data provide no evidence of serious consumer problems with electronic transactions. In 1995 about 90 percent of depository institutions examined by federal agencies were in full compliance with Regulation E. Statistics indicate that among institutions examined, those not in full compliance generally had fewer than five violations. The violations primarily involved failure to provide all required disclosures to consumers.

The Board's database of consumer complaints and inquiries is another

source of information on potential problems. In 1995, 38 complaints, of about 1,200 investigated by the Federal Reserve, involved state member banks' handling of electronic transactions. Two of the EFT complaints involved a possible violation of the act or regulation.

Compliance Examinations

The Federal Reserve System has maintained a program of specialized examinations for compliance with consumer protection laws since 1977. During the 1995 reporting period (from July 1, 1994, to June 30, 1995), the Federal Reserve examined 593 state member banks and 238 foreign banking organizations for compliance with consumer laws governing financial services.⁶

The compliance examinations are conducted by a consumer affairs unit within each of the twelve Federal Reserve Banks. The Compliance Section of the Board's Division of Consumer and Community Affairs reviews and coordinates compliance activities, providing Reserve Banks with the information and assistance they need, and ensuring that the Reserve Banks take a uniform approach to compliance examinations. New examiners in the Federal Reserve System attend the Board's three-week basic consumer compliance school; examiners with eighteen to twenty-four months of field experience attend the Board's week-long advanced compliance school, two-week fair lend-

ing school, and a class in CRA examination techniques.⁷

During the reporting period, the Federal Reserve System conducted three basic consumer compliance schools for a total of 96 students, three advanced consumer compliance schools for 51 students, and three fair lending schools for 113 students.

Examiner training is supplemented by the Reserve Banks through departmental meetings and special training sessions. In addition, the Board's resident examiner program provides Federal Reserve examiners with the opportunity to get a System perspective through working at the Board for several weeks; they observe how the division operates, how policies are developed, and how the Board coordinates its activities with those of other agencies that supervise financial institutions.

The FFIEC is the interagency coordinating body charged with developing uniform examination principles, standards, and report forms. In 1995 the member agencies of the FFIEC collaborated to revise examination procedures to reflect changes in consumer laws and regulations. They adopted changes to examination procedures related to amendments to Regulation E (Electronic Fund Transfers) and developed new examination procedures for the revised regulations that implement the CRA.

Agency Reports on Compliance with Consumer Regulations

Data from the Board, other member agencies of the FFIEC, and other federal supervisory agencies cover the compliance of institutions with the Equal Credit Opportunity Act, the Electronic

6. The Federal Reserve examines state-chartered agencies and state-chartered uninsured branches of foreign banks, which are commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) of the Federal Reserve Act (Edge Act and agreement corporations). Typically, in comparison with state member banks, these institutions conduct relatively few activities that are covered by consumer protection laws.

7. The Board did not offer the advanced CRA examination techniques class during 1995. Instead, FRB examiners attended interagency training for the revised CRA.

Fund Transfer Act, the Consumer Leasing Act, the Truth in Lending Act, the Community Reinvestment Act, the Expedited Funds Availability Act, and the prohibitions in Regulation AA on unfair and deceptive practices. The degree of compliance with these laws and regulations varied widely in 1995 but overall was little changed from 1994. The following section summarizes compliance data for the reporting period July 1, 1994, to June 30, 1995.⁸

Equal Credit Opportunity Act (Regulation B)

The level of full compliance with the Equal Credit Opportunity Act (ECOA) in 1995, 62 percent, was about the same as 1994's 61 percent. The agencies reported that 74 percent of the institutions examined in 1995 that were not in full compliance with Regulation B had between one and five violations (the lowest-frequency category), compared with 72 percent in 1994. The most frequent violations involved the failure to take the following actions:

- Provide a written notice of adverse action that contains a statement of the action taken, the name and address of the creditor, an ECOA notice, and the name and address of the federal agency that enforces compliance
- Notify the applicant of the action taken within the time-frames specified in the regulation
- Request information for monitoring purposes about race or national origin,

sex, marital status, and age on credit applications primarily for the purchase or refinancing of a principal residence

- Give a statement of reasons for adverse action that is specific and indicates the principal reasons for the credit denial or other adverse action.

The Board issued three written agreements, one cease-and-desist order, and one civil money penalty involving violations of Regulation B. The OTS issued eight formal enforcement actions involving Regulation B. The FDIC issued thirteen formal enforcement actions involving consumer compliance regulations without distinguishing which of those actions involved Regulation B.

The other agencies that enforce the ECOA—the Farm Credit Administration (FCA); the Department of Transportation; the Small Business Administration; the Grain Inspection, Packers and Stockyards Administration of the Department of Agriculture; and the Securities and Exchange Commission—reported substantial compliance among the entities they supervise. The FCA's examination and enforcement activities did reveal violations of the ECOA that resulted in one formal enforcement action. The FCA reported that the most frequent violation it found involved the failure to provide applicants with timely notification of action taken on loan applications. The Federal Trade Commission (FTC) reported a continuation of its work with other government agencies and with creditor and consumer organizations to increase awareness of, and compliance with, the ECOA.

Electronic Fund Transfer Act (Regulation E)

The five financial regulatory agencies reported that approximately 90 percent of examined institutions were in compli-

8. The federal agencies that supervise financial institutions do not use the same method to compile compliance data. Consequently, the data in this report, which are presented in terms of percentages of all financial institutions, represent general conclusions. When overall levels of compliance are discussed in terms of percentages of all financial institutions, the percentage shown is the mean.

ance with Regulation E, the same level of compliance reported for 1994. During 1995, financial institutions most frequently failed to comply with the following provisions of Regulation E:

- Provide a notice of the procedures for resolving alleged errors at least once each calendar year
- After receiving notice of an error, investigate the alleged error in a prompt manner, determine whether an error actually occurred, and transmit the results of the investigation and determination to the consumer within ten business days
- Provide a written statement outlining the terms and conditions of the electronic fund transfer service at the time a consumer contracted for an EFT service or before the first transfer was made
- Provide customers with a statement of all required information at least quarterly, or monthly if EFT activity occurred.

The Board issued one written agreement involving violations of Regulation E, and the OTS issued one formal enforcement action. The FTC reported that litigation continues regarding a telemarketing company that allegedly failed to obtain written authorization from consumers for preauthorized transfers. The SEC continues to examine for broker-dealer compliance with the EFT Act, but found no violations during 1995. The FDIC reported thirteen formal enforcement actions to deal with violations of Regulation E and other consumer compliance regulations without specifying how many of the thirteen involved electronic fund transfers.

Consumer Leasing (Regulation M)

The FFIEC agencies reported substantial compliance with Regulation M,

which implements the Consumer Leasing Act. As in the 1994 reporting period, more than 99 percent of examined institutions were found to be in full compliance with the regulation. The violations noted by the agencies involved the failure to adhere to specific disclosure requirements.

The Farm Credit Administration also considers the institutions it supervises to be in substantial compliance with the Consumer Leasing Act. It found no violations of the act through its examination and enforcement activities.

The FTC issued one final consent order involving violations of the Consumer Leasing Act by three automobile dealerships whose advertisements failed to make full disclosure of payment terms.

Truth in Lending Act (Regulation Z)

The FFIEC agencies reported that nearly 50 percent of examined institutions were in full compliance with Regulation Z, a slight improvement over the 48 percent reported for 1994. The Board, the NCUA, the FDIC, and the OCC showed increases in compliance, while the OTS reported a decrease. Agencies indicated that, of the examined institutions not in full compliance, 58 percent were in the lowest-frequency category (between one and five violations), compared with 56 percent in 1994.

The violations of Regulation Z most often observed were the failure to accurately disclose the finance charge or disclose the payment schedule; to disclose that the creditor has a security interest in the property being purchased or in other identified property; to provide a good faith estimate within three business days; and to provide two copies of the notice of the right of rescission to borrowers.

The Board issued one written agreement, one cease-and-desist order, and one civil money penalty involving violations of Regulation Z, and the OTS issued fifteen formal enforcement actions. The FDIC reported thirteen formal enforcement actions involving consumer compliance regulations without distinguishing which of those actions involved Regulation Z.

Under the Interagency Enforcement Policy on Regulation Z, 388 institutions supervised by the Board, the FDIC, the OCC, and the OTS were required to refund \$2.8 million on 17,110 accounts in 1995 for improper disclosures. In 1994, largely because of a single credit card issuer, \$6.8 million was refunded on 137,504 accounts.

The FTC issued three final consent orders that alleged violations of the Truth in Lending Act. The cases involved three automobile dealerships, three building firms, and a franchisor of video dating services and twenty-three of its franchisees. The FTC expects the respondents in the video case to make refunds in excess of \$200,000.

The FTC also continued its consumer and business education efforts. To this end, the FTC completed a brochure about the new mortgage protections contained in the Truth in Lending Act and Regulation Z that pertain to home equity loans with rates above a certain percentage or fees above a certain amount.

Community Reinvestment Act (Regulation BB)

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. The Federal Reserve System maintains a three-

faceted program for enforcing and fostering better bank performance under the CRA:

- Examinations of institutions to assess compliance
- Dissemination of information on community development techniques to bankers and the public through community affairs offices at the Reserve Banks
- CRA analyses in processing applications from banks and bank holding companies.

Under the provisions of the CRA, Federal Reserve examiners review the performance of state member banks in helping to meet the credit needs of their communities. When appropriate, examiners suggest ways to improve CRA performance. During the 1995 reporting period, the Federal Reserve conducted 582 CRA examinations: 3 banks were rated as being in "substantial noncompliance" with the CRA, 12 as "needs to improve" in meeting community credit needs, 435 as "satisfactory," and 132 as "outstanding."⁹

Expedited Funds Availability Act (Regulation CC)

The FFIEC agencies reported that 76 percent of examined institutions were in full compliance with the Expedited Funds Availability Act in 1995, about the same level as in 1994. Of the institutions not in full compliance, 78 percent were in the lowest-frequency category (between one and five violations). Among all institutions examined, the following five rules were the provisions of Regulation CC most often violated:

9. Foreign banking organizations and Edge Act and agreement corporations accounted for 238 of the institutions examined for compliance with consumer laws; they are not subject to the CRA.

- Follow special procedures for large deposits
- Adequately train employees and provide procedures to ensure compliance
- Provide the required second-day availability for specified items
- Provide adequate written notice when the bank extends the time that funds will be unavailable based on a permitted exception, including the reason for not providing normal availability
- Provide immediate availability on \$100 of deposits not subject to next-day availability.

The Board issued one cease-and-desist order and one civil money penalty, and the OTS issued two formal enforcement actions. The FDIC reported thirteen formal enforcement actions involving consumer compliance regulations without identifying the legislation or regulations involved.

Unfair and Deceptive Acts or Practices (Regulation AA)

The three financial regulatory agencies with responsibility for enforcing Regulation AA's Credit Practices Rule reported that more than 98 percent of examined banks were in full compliance with the regulation. The most frequent violation involved the failure to provide a clear and conspicuous disclosure on cosigner liability. The Board issued one cease-and-desist order and one civil money penalty.

Applications

During 1995 the Federal Reserve System acted on seventy-five bank and bank holding company cases that involved

CRA protests or adverse CRA ratings.¹⁰ The System reviewed another twenty-three cases that involved fair lending and other issues related to compliance with consumer regulations.¹¹

Among the seventy-five cases involving CRA concerns, seventeen involved adverse CRA ratings, fifty-three were protested on CRA grounds, and five involved both adverse CRA ratings and protests.

Several applications related to major bank mergers; all had been protested on CRA grounds. The Board approved the mergers, finding in each case that convenience and needs factors were consistent with approval.

In October the Board approved the application of First Union Corporation (Charlotte, North Carolina) to acquire First Fidelity Bancorporation (Lawrenceville, New Jersey). With the acquisition, First Union became the sixth largest banking organization in the nation.

In November the Board approved the application of NBD Bancorp (Detroit) to acquire First Chicago Corporation (Chicago), an acquisition that made NBD the seventh largest banking organization in the nation.

In August the Federal Reserve held public meetings in Boston, Hartford, and Albany on an application by the Fleet Financial Group (Providence, Rhode Island) to acquire Shawmut National Corporation (Hartford and Boston) amid protests against the acquisition. In November the Board approved the application. With the acquisition of Shawmut, Fleet became the dominant banking organization in New England

10. These cases involved applications and requests for waiver of an application requirement.

11. Six cases involving CRA issues and five involving other compliance issues were withdrawn during 1995. Twenty-three cases were pending as of year-end 1995.

and among the top ten in the country. The Board expressed concerns about a loan-pricing policy involving "over-ages" at one of Fleet's nonbanking subsidiaries because of its effect on minority borrowers.

Also in November the Federal Reserve held public meetings in New York City on an application by Chemical Banking Corporation to acquire Chase Manhattan Corporation (both of New York), for the largest U.S. bank merger to date. The meetings were conducted jointly with the New York State Banking Department. At year-end the Board had not yet acted on the application.¹²

In December the Board approved the application of NationsBank Corporation (Charlotte, North Carolina), the fourth largest banking organization in the country, to acquire Bank South Corporation (Atlanta).

During 1995 the Board denied two applications on CRA or compliance grounds. In March the Board denied the

application of Johnson International, Inc. (Racine, Wisconsin), to acquire Seaboard Savings Bank, F.S.B. (Stuart, Florida). Johnson's lead bank had received three consecutive "unsatisfactory" compliance ratings, the first in 1989 and the most recent in September 1994. This application was the first to be denied by the Board solely because of a bank's compliance deficiencies.

In July the Board denied the application of Totalbank Corporation of Florida (Miami) to acquire Florida International Bank (Perrine, Florida). The Board based the denial on the "less than satisfactory" CRA ratings received by Totalbank's two subsidiary banks from the FDIC and OCC respectively.

Consumer Complaints

The Federal Reserve investigates complaints against state member banks, and forwards to the appropriate enforcement agencies complaints that involve other creditors and businesses (see table). The Federal Reserve also monitors and analyzes complaints about unregulated practices.

12. The Board approved the application on January 5, 1996.

Consumer Complaints to the Federal Reserve System Regarding State Member Banks and Other Institutions, by Subject, 1995

Subject	State member banks	Other institutions ¹	Total
Regulation B (Equal Credit Opportunity)	70	38	108
Regulation E (Electronic Fund Transfers)	39	38	77
Regulation Q (Interest on Deposits)	1	2	3
Regulation Z (Truth in Lending)	207	218	425
Regulation BB (Community Reinvestment)	0	2	2
Regulation CC (Expedited Funds Availability)	16	33	49
Regulation DD (Truth in Savings)	27	44	71
Fair Credit Reporting Act	43	50	93
Fair Debt Collection Practices Act	11	10	21
Fair Housing Act	2	4	6
Flood insurance	0	1	1
Holder in due course	1	1	2
Real Estate Settlement Procedures Act	6	11	17
Unregulated practices	815	939	1,754
Total	1,238	1,391	2,629

1. Complaints against these institutions were referred to the appropriate enforcement agencies.

Complaints about State Member Banks

In 1995 the Federal Reserve received 2,629 complaints: 2,193 by mail, 421 by telephone, and 15 in person. The Federal Reserve investigated the 1,238 complaints that were against state member banks. About 60 percent involved loan functions (see table). Of these, 6 percent alleged discrimination on a prohibited basis, and 54 percent concerned credit denial on nonprohibited bases (such as length of residency) and other unregu-

lated lending practices (such as release or use of credit information). Another 25 percent of the 1,238 complaints involved disputes about interest on deposits and general deposit account practices. The remaining 15 percent concerned disputes about electronic fund transfers, trust services, and other miscellaneous bank practices.

The System also received 2,463 inquiries about consumer credit and banking policies and practices. In responding to these inquiries, the Board and Federal Reserve Banks gave specific explana-

Consumer Complaints to the Federal Reserve System, by Function and Resolution, 1995

Type of complaint and resolution	Total	Loans		Deposits	Electronic fund transfers	Trust services	Other
		Discrimination	Other				
Complaints about state member banks, by resolution							
Insufficient information ¹	31	1	8	12	2	0	8
Information furnished to complainant ²	67	2	42	15	1	1	6
Bank legally correct							
No reimbursement or accommodation	601	43	295	175	22	15	51
Reimbursement or accommodation—goodwill ³	202	1	153	32	5	1	8
Bank error	161	5	100	32	4	2	18
Factual dispute ⁴	30	1	14	9	2	0	4
Possible bank violation ⁵	21	3	10	6	2	0	0
Matter in litigation ⁶	9	2	1	6	0	0	0
Customer error	20	1	14	4	0	0	1
Pending, December 31	98	13	43	15	1	1	25
Total complaints, state member banks							
Number	1,238	72	680	306	39	16	217
Percent	100	6	54	25	3	2	10
Complaints referred to other agencies	1,391	52	695	373	38	16	217
Total	2,629	124	1,375	679	77	36	338

1. The staff was 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. The bank appeared to be legally correct but chose to make an accommodation.

4. Involves a factual dispute not resolvable by the Federal Reserve System or a contractual dispute 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. After the Federal Reserve determined that a state member bank had possibly violated a law or regulation, the bank took corrective measures voluntarily or as indicated by the Federal Reserve.

6. Parties are seeking resolution through the courts.

tions of laws, regulations, and banking practices and provided relevant printed materials on consumer issues.

Unregulated Practices

Under section 18(f) of the Federal Trade Commission Act, the Board continued to monitor complaints about banking practices that are not subject to existing regulations and to focus on those complaints that may be unfair or deceptive. Three categories accounted for 11 percent of the 1,754 complaints received in 1995: problems involving credit card accounts (61), interest rates and terms of credit cards (78), and miscellaneous unregulated practices (59). Each of these categories accounts for a small number (about 4 percent or less) of all consumer complaints received by the System.

Many complaints about credit card accounts involved a variety of customer service problems, including financial institutions' failing to close accounts as requested; sending periodic statements to the wrong address; and limiting the number of telephone inquiries made to their service departments. Complaints about issuers of credit cards covered interest rate increases, allegations that banks are charging a higher-than-agreed interest rate on transferred account balances, and allegations that financial institutions did not keep their word on holding interest rates constant. Complaints in the miscellaneous category covered a wide range of issues including the purchase of certificates of deposit, check cashing, and the release of liens.

Complaints Referred to HUD

The Federal Reserve continued to refer to the Department of Housing and Urban Development complaints that allege violations of the Fair Housing Act, as required by a memorandum of

understanding between HUD and the federal bank regulatory agencies. In 1995 the Federal Reserve referred twelve complaints about state member banks to HUD. Investigations completed for ten of the twelve complaints revealed no evidence of discrimination; the remaining two complaints were pending at year-end.

Complaint Program Initiatives

To gain a better understanding of the type and scope of complaint activity at the federal level, the Board has undertaken an exchange of complaint data among the federal financial regulatory agencies. During 1995 the Board joined with the FDIC in analyzing the two agencies' respective systems for categorizing complaints and researched ways to facilitate data exchange and analysis; data exchange was expected to begin by the second quarter of 1996. Work with other agencies will follow.

In 1995 the Consumer Complaints Section joined with the division's Information Systems unit to develop the Consumer Complaint Executive Information System, a comprehensive system that will consolidate all of the complaint program's current analysis tools. The system, expected to be fully operational by mid-1996, will facilitate analysis of the types of discrimination complaints received by the Federal Reserve System; generate individualized response letters automatically; analyze data to determine complaint patterns and trends; and provide geographic and demographic analysis of data, along with other management tools.

In recent years the Federal Reserve has received an increasing number of consumer complaints about credit card mail solicitations from financial institutions that consumers allege are misleading because they do not clearly

set out the interest rates being charged and the credit limits offered. The Board has undertaken a study of the complaints received by the System as well as by the other federal financial regulatory agencies, state attorneys general, and state banking departments.

To complement the data gathering, the Board included questions on the Survey of Consumer Attitudes, conducted by the University of Michigan's Survey Research Center, for two successive months. These survey data will help define consumers' understanding of the credit terms used in mail solicitations and identify problems they have experienced. Analysis of the survey data and information from the state and federal agencies is scheduled for completion by mid-1996.

During 1995, individual staff members from the Reserve Banks' consumer complaint sections continued to work at the Board for several weeks at a time to gain familiarity with operations in Washington. Seven Reserve Banks participated in the program.

Consumer Policies

In 1995 the division formally established a Consumer Policies program to explore alternatives to regulation for providing consumer protection in retail financial services. The program focuses on bringing research information to bear more directly on the policymaking process and is staffed by an economist with an academic background in methods of information dissemination and in the study of consumer behavior. In its development of strategies, the program will target both lenders and consumers. During 1995 the program helped launch a focus-group project on consumer leasing disclosures (as discussed above, in the section on proposed revisions to Regulation M).

The program's most significant initiative to date is a nationwide campaign to educate consumers about uninsured products, especially mutual funds and annuities, sold by financial institutions. The project, carried out in cooperation with the Federal Reserve Banks of Minneapolis, Boston, Dallas, and Cleveland, and with assistance from the American Association of Retired Persons, seeks to communicate the core message that not all retail products offered by banks are insured. It offers a video and other resource materials to facilitate seminar presentations to consumers and training sessions for bankers on guidelines issued by the federal banking agencies. During 1995, sixty-four consumer seminars and forty-seven banker training programs reached almost 4,800 consumers and nearly 1,400 bankers. A series of town meetings sponsored by the Securities and Exchange Commission reached another 2,150 consumers. More than 7,200 copies of the video and more than 700 copies of the consumer seminar package have been distributed. The materials are available from the Board or electronically on the World Wide Web sites of the Minneapolis and Philadelphia Reserve Banks.

Consumer Advisory Council

The Consumer Advisory Council met in March, June, and November to advise the Board on matters concerning consumer credit protection laws and on other issues dealing with financial services to consumers. The council's thirty members come from consumer and community organizations, financial institutions, academia, and state and local government. Council meetings are open to the public.

The council considered many topics during 1995. These included regulatory

and legislative reform of the CRA; other statutory amendments in omnibus burden-reduction bills; the potential impact of technology on consumer banking; use of mandatory arbitration clauses in banks' agreements with consumers; fair lending matters; the sale of uninsured investment products by insured depository institutions; the waiver of consumers' right of rescission for certain loans; Truth in Savings proposals on the calculation of the annual percentage yields on deposit accounts; and the need for reconciling the requirements that govern real estate mortgage transactions under the Truth in Lending and Real Estate Settlement Procedures Acts.

At each of the three meetings, committees and the full council discussed various components of the Senate and House bills to reduce regulatory burden. The views of industry concerning regulatory burden often diverged from those of consumer and community groups. By contrast, in November, members of the council's Consumer Credit Committee offered, and the council unanimously adopted, a resolution suggesting that the Congress drop a proposed amendment to the Truth in Lending Act that would exclude first-mortgage loans from provisions of the Home Ownership Equity Protection Act of 1994. The 1994 law requires special disclosures when lenders offer loans that bear interest rates above a certain percentage or fees above \$400, and sets substantive prohibitions against, among other things, balloon payments and negative amortization.

In adopting the resolution, council members expressed concern that, if enacted, the proposed legislation would allow lenders to circumvent consumer protections by replacing a homeowner's existing mortgage with a higher-cost loan that retained first-lien status. Council members noted that many of the

abuses that gave rise to the 1994 law had involved first mortgages and not just subordinate-lien transactions. Representatives of both industry and consumer interests agreed that the proposed legislative amendment creates a serious loophole in the Truth in Lending law. The Board forwarded the council resolution to the chairmen of the House and Senate banking committees in November.

In regard to CRA reform, council members discussed the fair assessment of credit needs by financial institutions; the need for consistency among agencies and examiners in rating institutions' CRA performance; and the extent to which the revised CRA regulation will reduce regulatory burden and a perceived over-emphasis on documentation.

Technology and consumer banking was a major topic in November. Members considered the potentially wider use of electronic cash, pilot projects for stored-value cards, and the lower operating costs for institutions and greater flexibility for consumers that may flow from these electronic services. They also saw some potential drawbacks, such as unequal access to the banking system and the risk of loss from computer breakdowns or security breaches.

At all three meetings, the council addressed matters regarding the Board's proposed amendments to Regulation M, primarily as it affects the consumer leasing of automobiles. Discussion centered on the format of disclosures, means of highlighting the most important items, and the best ways to convey information about early-termination charges and about the choice between purchasing and leasing an automobile.

Roundtable discussions, known as the Members Forum and held at each council meeting, gave council members the opportunity through the year to offer the

Board their views on their industries or localities.

Testimony and Legislative Recommendations

The Board twice testified before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Banking and Financial Services: in March regarding CRA reform and in May regarding proposed legislation on regulatory relief. In May the Board also testified before the Subcommittee on Financial Institutions and Regulatory Relief of the Senate Committee on Banking, Housing, and Urban Affairs on a wide range of regulatory relief issues. In October the Board testified before the Subcommittee on Domestic and International Monetary Policy of the House Committee on Banking and Financial Services on emerging electronic payment technologies.

The Board's testimony on burden reduction supported efforts to reduce the cost of complying with federal laws.

The Board generally did not favor proposals to substantially amend the CRA, believing that the interagency regulations adopted by the federal banking agencies in April 1995 ought to be allowed to take effect. The Board also did not support a proposed transfer to the Board of rulewriting authority for the Real Estate Settlement Procedures Act, and it raised specific objections to the possibility of having to administer rules regarding prohibitions on kickbacks. The rulewriting authority currently rests with HUD.

In regard to emerging technologies for electronic payment systems such as stored-value products, the Board described some areas of concern, including the potential impact on monetary policy issues. The Board expressed a

desire not to hinder the development of these products by the application of the Electronic Fund Transfer Act, but it also suggested that the Congress should defer the wholesale exemption of stored-valued products from the act until some basic analysis is conducted.

Recommendations of Other Agencies

Each year the Board asks for recommendations that the federal supervisory agencies may have for amending the financial services laws or the implementing regulations.

In 1995 the OCC suggested that the Congress consider alternatives to make consumer disclosures less burdensome for depository institutions and more beneficial to consumers than under current laws. The OCC recommended also that the Congress modify the ECOA provisions that require a referral to the Department of Justice when an agency finds a pattern or practice involving violations of the nondiscrimination rules. The OCC suggested either limiting the mandate to refer cases—for example, to violations that involve particular prohibited bases—or alternatively, providing for waiver of referral if a violation detected by the agency stemmed from an institution's self-assessment.

The FDIC reiterated support for proposed amendments to the ECOA, EFT, Consumer Leasing, and Truth in Lending Acts pending in the Congress. The agency also noted its support, mentioned in congressional testimony, for amendments to the Board's Regulation B that would permit creditors to request information on race, color, national origin, sex, and religion from credit applicants. Such information, the FDIC believes, would enable institutions to review overall lending patterns to ensure that

customers are being treated in a fair, nondiscriminatory manner. The FDIC also expressed support for the Board's efforts to update and simplify the rules governing consumer lease transactions to reflect the marketplace more appropriately.

The FTC endorsed both the regulatory review of lease disclosures now under way and an upcoming review of credit requirements under Regulation Z. The agency notes that consumer financing practices have changed considerably since 1981, when the Board last revised Regulation Z in its entirety following the enactment of the Truth in Lending Simplification and Reform Act of 1980. ■

Litigation

In 1995 the Board of Governors was a party in fifteen lawsuits filed that year and was a party in seven other cases pending from previous years, for a total of twenty-two cases. In 1994 the Board had also been a party in a total of twenty-two lawsuits. Six of the fifteen lawsuits filed in 1995 raised questions under the Bank Holding Company Act. A total of twelve cases were pending at year-end 1995.

Bank Holding Company Act— Review of Board Actions

Lee v. Board of Governors, No. 94-4134 (2d Circuit, filed August 22, 1995), is a petition for review of two Board orders, dated July 24, 1995, approving certain steps of a corporate reorganization of U.S. Trust Corporation, New York, New York, and the acquisition of U.S. Trust by Chase Manhattan Corporation, New York, New York (81 *Federal Reserve Bulletin* 893). On September 12, 1995, the court denied petitioner's motion for an emergency stay of the Board's orders. The case is pending.

Jones v. Board of Governors, No. 95-1359 (D.C. Circuit, filed July 17, 1995), is a petition for review of a Board order, dated June 19, 1995, approving the application by First Commerce Corporation, New Orleans, Louisiana, to acquire Lakeside Bancshares, Lake Charles, Louisiana (81 *Federal Reserve Bulletin* 793). On November 15, 1995, the court granted the Board's motion to dismiss the petition. The petitioner's motion for reconsideration is pending.

Money Station, Inc. v. Board of Governors, No. 95-1182 (D.C. Circuit, filed March 30, 1995), is a petition for review

of a Board order, dated March 1, 1995, approving notices by Banc One Corporation, Columbus, Ohio; CoreStates Financial Corp., Philadelphia, Pennsylvania; PNC Bank Corp., Pittsburgh, Pennsylvania; and KeyCorp, Cleveland, Ohio, to acquire certain data processing assets of National City Corporation, Cleveland, Ohio, through a joint venture (81 *Federal Reserve Bulletin* 491). The case is pending.

Jones v. Board of Governors, No. 95-1142 (D.C. Circuit, filed March 3, 1995), is a petition for review of a Board order, dated February 2, 1995, approving applications by First Commerce Corporation, New Orleans, Louisiana, to merge with City Bancorp, Inc., New Iberia, Louisiana, and First Bankshares, Inc., Slidell, Louisiana (81 *Federal Reserve Bulletin* 379). Petitioner's motion for injunctive relief and for a stay of the Board's order was denied on August 17, 1995. The case is pending.

Kuntz v. Board of Governors, No. 95-3044 (6th Circuit, filed January 12, 1995) was a petition for review of a Board order, dated December 19, 1994, approving an application by KeyCorp, Cleveland, Ohio, to acquire BankVermont Corp., Burlington, Vermont (81 *Federal Reserve Bulletin* 160). On September 21, 1995, the court granted the Board's motion to dismiss.

National Title Resource Agency v. Board of Governors, No. 94-2050 (8th Circuit, filed April 28, 1994), was a petition for review of a Board order, issued March 30, 1994, approving the application of Norwest Corp., Minneapolis, Minnesota, to acquire Double Eagle Financial Corp., Phoenix, Arizona, and its subsidiary, and thereby

engage in title insurance agency activities and real estate settlement services (80 *Federal Reserve Bulletin* 453 (1994)). On January 10, 1995, the court upheld the Board's order (1995 U.S. App. Lexis 284, unpublished opinion).

Litigation under the Financial Institutions Supervisory Act

In *Board of Governors v. Hotchkiss*, Adversary No. 95-3146 (United States Bankruptcy Court, N.D. Ohio, filed May 1, 1995), the Board sought a determination that a restitution obligation arising from a Board consent order was nondischargeable in bankruptcy (81 *Federal Reserve Bulletin* 406). On December 15, 1995, the court granted the Board's motion for summary judgment. The debtor filed a notice of appeal on December 22, 1995.

Board of Governors v. Scott, Misc. No. 95-127 (LFO/PJA) (D. District of Columbia, filed April 14, 1995) is an application to enforce an administrative investigatory subpoena for documents and testimony. On August 3, 1995, the magistrate judge issued an order granting in part and denying in part the Board's application. The intervenor moved for reconsideration of a portion of the magistrate's ruling. The case is pending.

In *Board of Governors v. Din*, No. 95-1542 (J.C.L.) (D. New Jersey, filed March 30, 1995), the Board filed a petition seeking to compel the defendant to comply with an administrative subpoena duces tecum issued in connection with a Board investigation. On April 26, 1995, the court granted the Board's petition.

In *Board of Governors v. Interamericas Investments, Ltd.*, No. H-95-565 (S.D. Texas, filed February 24, 1995), the Board sought to freeze certain assets of a company pending the administrative adjudication of a civil money

penalty assessment by the Board. On March 1, 1995, the court issued a stipulated order requiring the company to deposit \$1 million into the registry of the court.

In *DLG Financial Corp. v. Board of Governors*, No. 94-891 (U.S. Supreme Court, filed November 14, 1994), appellants sought review of an order of the Fifth Circuit Court of Appeals (29 F.3d 993) affirming both an asset freeze order obtained by the Board in connection with a pending enforcement action and the district court's dismissal of appellants' claims seeking an injunction and damages against the Board and the Federal Reserve Bank of Dallas relating to the same enforcement action. On February 15, 1995, the Supreme Court dismissed appellants' petition for a writ of certiorari (115 S. Ct. 1085).

In *Cavallari v. Board of Governors*, No. 94-4183 (2d Circuit, filed October 17, 1994), a former outside counsel to a national bank sought review of a Board order of prohibition (80 *Federal Reserve Bulletin* 1046 (1994)). The case was consolidated with a petition for review of orders issued by the Office of the Comptroller of the Currency imposing a civil money penalty and cease and desist order against petitioner (*Cavallari v. OCC*, No. 94-4151). On May 11, 1995, the court upheld the Board's prohibition order and the comptroller's civil money penalty order and remanded to the comptroller for further proceedings regarding the order to cease and desist (57 F.3d 137).

In *Board of Governors v. Pharaon*, No. 91-CIV-6250 (S.D. New York, filed September 17, 1991), the Board sought to freeze the assets of an individual pending the administrative adjudication of a civil money penalty assessment by the Board. On September 17, 1991, the court issued an order temporarily restraining the transfer or disposi-

tion of the individual's assets. The order has been extended by agreement.

Other Actions

Menick v. Greenspan, No. 95-CV-01916 (D. District of Columbia, filed October 10, 1995), is a complaint alleging sex, age, and handicap discrimination in employment. The case is pending.

Kuntz v. Board of Governors, No. 95-1495 (D.C. Circuit, filed September 21, 1995), is a petition for review of a Board order issued under the Federal Reserve Act and the Bank Merger Act approving the application of the Fifth Third Bank, Cincinnati, Ohio, to acquire certain assets and assume certain liabilities of twelve branches of PNC Bank, Ohio, N.A., Cincinnati, Ohio, and to establish certain branches (81 *Federal Reserve Bulletin* 976). The case is pending.

Vu Ti v. Board of Governors, No. CA 95-1663 (D. District of Columbia, filed August 28, 1995), was a complaint seeking injunctive relief and damages from the Board for alleged violations of plaintiff's civil and constitutional rights stemming from the cessation of her business as a sidewalk vendor. On October 19, 1995, the plaintiff voluntarily dismissed the complaint.

Beckman v. Greenspan, No. 95-35473 (9th Circuit, filed May 4, 1995), is an appeal of an order dismissing an action against the Board and others seeking damages for alleged violations of constitutional and common law rights. The case is pending.

In re Subpoena Duces Tecum, No. 95-5034 (D.C. Circuit, filed January 26, 1995), was an appeal of a partial denial of plaintiff's motion to compel production of examination and other supervisory materials in connection with a shareholder derivative action against a

bank holding company. The case was dismissed on August 24, 1995.

In *In re Subpoena Duces Tecum*, Misc. No. 95-06 (D. District of Columbia, filed January 6, 1995), the plaintiff sought to enforce a subpoena for pre-decisional supervisory documents relating to an action by Bank of England Corporation's trustee in bankruptcy against the Federal Deposit Insurance Corporation. The case is pending.

Zemel v. Board of Governors, No. 95-5007 (D.C. Circuit, filed December 30, 1994), was an appeal of a district court order dismissing an action against the Board under the Age Discrimination in Employment Act. On March 8, 1995, the court granted appellant's motion to withdraw the appeal and dismissed the action.

In re Subpoena Duces Tecum, No. 94-MS-214 (D. District of Columbia, filed June 27, 1994), was a subpoena enforcement action by the plaintiff in a securities fraud class action who was seeking examination reports and internal memos from the Board. On February 1, 1995, the court granted the plaintiff's motion to compel, subject to the Board's right to claim privilege with respect to the documents sought.

Bennett v. Greenspan, No. 93-1813 (D. District of Columbia, filed April 20, 1993), was an employment discrimination action. A jury verdict for the plaintiff was rendered on October 13, 1994. The Board's motion for a new trial on the issue of damages was denied on January 9, 1995. ■

Legislation Enacted

Among the legislation enacted by the Congress during 1995, the Truth in Lending Act Amendments of 1995, the Mexican Debt Disclosure Act of 1995, and the Paperwork Reduction Act of 1995 directly affect the Federal Reserve System or the institutions it regulates.

Truth in Lending Act Amendments of 1995

The Truth in Lending Act Amendments of 1995 (TILA), Public Law 104-29, was enacted on September 30, 1995. TILA is intended to address concerns of mortgage lenders arising out of a 1994 court decision, *Rodash v. AIB Mortgage Co.*, 16 F.3d 1142 (11th Cir. 1994).

In *Rodash* the U.S. Court of Appeals ruled that in connection with a mortgage refinancing, the creditor incorrectly disclosed \$22 in courier fees and a state intangibles tax of approximately \$200, with the result that both the finance charge and the annual percentage rate were understated. Because of these and other errors, the consumer was permitted to rescind the loan and recover all fees and finance charges that had been paid. A number of class action lawsuits filed subsequent to *Rodash* alleged violations for the failure to disclose certain fees as finance charges and sought the remedy of rescission for thousands of loans. Many of these lawsuits were put on hold in May 1995, when the Congress enacted a temporary moratorium on such litigation. The moratorium expired October 1, 1995, and has now been replaced by the TILA amendments. Those lawsuits will now proceed under the new law, which limits the lenders' liability.

TILA limits lender liability for mortgage transactions consummated before September 30, 1995, except where borrowers sought to assert their legal rights before the dates specified in the act. For these transactions, creditors will have no civil, administrative, or criminal liability, and borrowers will have no right to rescind their loans based on an inaccurate finance charge disclosure if the lender understated the finance charge by \$200 or less or if the lender overstated the actual finance charge. In addition, for purposes of the borrower's right to rescind a mortgage loan, the disclosed finance charge will be considered accurate if it did not vary from the actual charge by more than 1 percent of the amount of credit extended for most refinancings in which no new money is advanced (or by more than 1/2 percent for other rescindable mortgage loans).

The act is intended to prevent litigation concerning future mortgage loans that involve relatively minor disclosure violations and creates a separate set of tolerance rules for new loans secured by real property or dwellings. For these transactions, the act considers the disclosed finance charge to be accurate and absolves lenders from any type of liability if the disclosed amount is understated by \$100 or less or if it is overstated. Borrowers who can establish a violation of the Truth in Lending Act under the new tolerance levels may, however, receive larger damage awards under the new law. If a borrower seeks rescission after foreclosure proceedings are initiated on the borrower's primary dwelling, a lower tolerance will be applied to determine the borrower's right to rescind the transaction. In such

a case, the disclosed finance charge will be considered accurate if it is understated by \$35 or less or if it is overstated.

The act also provides greater clarity with respect to the disclosure requirements for mortgage transactions by listing closing-related costs that are to be excluded from the finance charge. Among these are fees imposed by third-party closing agents that are neither required nor retained by the lender, fees for preparing loan-related documents, fees related to property inspections conducted prior to closing, and taxes on security instruments or documents evidencing indebtedness that are paid as a precondition for recording the instrument. On the other hand, the act requires the Board to promulgate a regulation that would include all mortgage broker fees paid by a borrower in the finance charge.

Finally, the act directs the Board to report to the Congress within six months with recommendations for statutory and regulatory changes necessary to assure that disclosed finance charges more accurately reflect the cost of credit. In the report, the Board must address the feasibility of including in the disclosed finance charge all fees paid directly or indirectly by the borrower and imposed directly or indirectly by the lender (other than those payable in a strictly "cash" transaction). The report must also address "abusive refinancing practices" used by lenders in order to avoid borrowers' right of rescission. The act directs the Board to modify Regulation Z within one year to implement the report's recommendations in a manner consistent with the existing statutory provisions.

Mexican Debt Disclosure Act of 1995

The Mexican Debt Disclosure Act, Public Law 104-6, was enacted on April 10, 1995. The act requires the Department of the Treasury to provide detailed monthly reports concerning all guarantees issued to, and short-term and long-term currency swaps with, the government of Mexico by the U.S. government, including the Federal Reserve. The act requires the President to submit reports semiannually to the House and Senate Banking committees describing changes in the Mexican economy, regulatory actions taken by the Mexican government, and all outstanding loans, credits, and guarantees provided to the Mexican government by the U.S. government, including the Federal Reserve. The act also includes a provision for Presidential certification of certain currency swaps between Mexico and the United States by either the Exchange Stabilization Fund or the Federal Reserve.

Paperwork Reduction Act of 1995

The Paperwork Reduction Act of 1995, Public Law 104-13, was enacted on May 22, 1995, and took effect on October 1, 1995. It reauthorizes and amends the Paperwork Reduction Act of 1980, which gave the White House authority to review government paperwork requirements in order to reduce the paperwork burdens imposed by the federal government on the public. The 1995 act reaffirms the authority of the Office of Management and Budget (OMB) to review and approve federal requests for paperwork, and it reverses a 1990 Supreme Court decision that held

that the 1980 act did not apply to requirements to disclose information to third parties.

The 1995 act reaffirms the authority of the OMB's Office of Information and Regulatory Affairs (OIRA) to review and approve federal requests for paperwork. The act requires OIRA to assign to all federal information requests a control number. Once a control number is assigned, the director of OMB must take action on the proposed request within sixty days. If OMB fails to take action within sixty days, the control number expires within a year. The public is not required to respond to a federal request for information unless it displays a valid control number. Individuals can point to the lack of a control number as a defense against a penalty assessment or similar action arising from the failure to comply with a request for information. The act also allows individuals to request a written determination from OMB as to whether a federal paperwork requirement complies with the act, and it gives the director of OMB authority to seek remedial action.

The act gives OIRA the authority to establish standards to be used by federal regulators in estimating the burdens imposed on the public by proposed paperwork requirements and directs OIRA to work with OMB's federal procurement office to reduce burdens associated with federal contracting. The act also gives OIRA broader authority to establish governmentwide policy on information resources management and ties decisionmaking on such management to an agency's performance.

Finally, the act overturns the 1990 Supreme Court decision in *Dole v. United Steelworkers of America*, 494 U.S. 26 (1990). In *Dole* the Court held

that under the 1980 act, the clearance process for collection devices did not include devices designed to disclose information to parties other than the government. The 1995 act reverses *Dole* and requires that both information collected directly from businesses and disclosures that businesses must make to third parties be included in estimates of paperwork burdens.

The act provides a six-year reauthorization of appropriations for OIRA for fiscal years 1996–2001, at \$8 million per year. The act sets a goal of reducing federal paperwork burdens 10 percent in fiscal 1996 and 1997 and 5 percent in each of the following years through fiscal 2001. ■

Banking Supervision and Regulation

The U.S. commercial banking industry in 1995 booked its fourth consecutive year of record profits. Earnings growth was fueled in part by a continued strong expansion in lending activity and by increases in fee income and trading revenue. Banks also benefitted from favorable trends in overhead expense, in part because of lower deposit insurance premiums. Financial markets viewed these events favorably, with share prices of the largest institutions increasing more rapidly than broad market indexes. The favorable valuation also reflects several large mergers during the year that accentuated the trend toward consolidation in the industry.

The number and assets of failed commercial banks remained small in 1995, and those of problem banks declined sharply. These trends, combined with continued efforts by the industry to control asset quality and to strengthen its capital position, reflect favorably on the industry's condition and its ability to meet the nation's financial needs.

Despite its general strength, the banking industry continues to face important challenges. As underscored by the failure of Barings PLC and serious losses at the U.S. offices of Daiwa Bank, the application of sound risk management to expanding lines of business and products requires the careful attention of institutions, especially in light of the swift pace of financial and technological innovation and the increasing complexity of many financial products. Accordingly, the Federal Reserve in 1995 continued to place increasing supervisory emphasis on the importance of risk management. Building upon earlier initiatives focusing on trading activities, the

Federal Reserve issued advisories to its examiners and regulated institutions outlining the key elements of risk management for both investments and end-user derivative activities. In addition, the Federal Reserve initiated a formal supervisory rating system for evaluating the strength of an institution's entire risk management process; beginning in 1996, formal ratings under the system will be fully incorporated into the supervisory ratings of banks and bank holding companies.

Along with the other banking agencies, the Federal Reserve in 1995 took steps to adjust and strengthen risk-based capital standards in several areas. In conjunction with an international agreement, the Board revised its capital requirements related to derivative instruments to recognize the effect of bilateral netting agreements and to refine the assessment of credit exposure arising from certain derivative contracts. The Board further amended its capital standards to take account of interest rate risk, to reduce capital requirements for certain assets sold with recourse, and to determine a treatment for purchased mortgage servicing rights. Also in conjunction with other national authorities, the Board published for comment a revised proposal to incorporate the market risk from trading activities into the capital standards.

Scope of Responsibilities for Supervision and Regulation

The Federal Reserve is the federal supervisor and regulator of all U.S. bank holding companies and of state-chartered commercial banks that are

members of the Federal Reserve System. In overseeing these organizations, the Federal Reserve primarily seeks to promote their safe and sound operation and their compliance with laws and regulations, including the Bank Secrecy Act and consumer and civil rights laws.¹ The Federal Reserve also examines the following specialized activities of these institutions: electronic data processing, fiduciary activities, mutual fund activities, government securities dealing and brokering, municipal securities dealing, securities clearing activities, and securities underwriting and dealing through special subsidiaries.

The Federal Reserve also has responsibility for the supervision of (1) all Edge Act corporations and agreement corporations, (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.² The Foreign Bank Supervision Enhancement Act of 1991 increased the Federal Reserve's authority over the establishment, examination, and termination of branches, agencies, commercial lending subsidi-

aries, and representative offices of foreign banks in the United States.

The Federal Reserve exercises important regulatory influence over the entry into, and the structure of, the U.S. banking system through its administration of the Bank Holding Company Act, the Bank Merger Act for state member banks, and the Change in Bank Control Act for bank holding companies and state member banks. Also, the Federal Reserve is responsible for imposing margin requirements on securities transactions. In carrying out these responsibilities, the Federal Reserve coordinates its supervisory activities with other federal and state regulatory agencies and with the bank regulatory agencies of other nations.

Supervision for Safety and Soundness

To ensure the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations and inspections and off-site surveillance and monitoring; it also undertakes 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. The Federal Reserve conducts *examinations* of state member banks, branches and agencies of foreign banks, Edge Act corporations, and agreement corporations; because the elements to be reviewed at bank holding companies and their subsidiaries are different than they are in examinations, the Federal Reserve conducts what are termed *inspections* of holding companies and their subsidiaries. However, regardless of whether it is an examination or inspection, the review entails (1) an appraisal of the quality of the institution's assets, (2) an

1. The Board's Division of Consumer and Community Affairs is responsible for coordinating the Federal Reserve's supervisory activities with regard to the compliance of banking organizations with consumer and civil rights. To carry out this responsibility, the Federal Reserve specifically trains a number of its bank examiners to evaluate institutions with regard to such compliance. The chapter of this REPORT covering consumer and community affairs describes these regulatory responsibilities. Compliance with other statutes and regulations, which is treated in this chapter, is the responsibility of the Board's Division of Banking Supervision and Regulation and the Reserve Banks, whose examiners check for safety and soundness.

2. Edge Act corporations are chartered by the Federal Reserve, and agreement corporations are chartered by the states, to provide all segments of the U.S. economy with a means of financing international trade, especially exports.

evaluation of management, including an assessment of internal policies, procedures, risk management, controls, and operations, (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 1995, 1,042 state-chartered banks belonged to the Federal Reserve System (excluding nondepository trust companies and private banks), an increase of 62 from year-end 1994. These banks represented about 10 percent of all insured commercial banks and held about 23 percent of all insured commercial bank assets.

The guidelines for Federal Reserve examination are fully consistent with section 10 of the Federal Deposit Insurance Act as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994. A full-scope, on-site examination is required at least once during each twelve-month period for all depository institutions; however, well-capitalized and well-managed institutions with assets of less than \$100 million may be examined every eighteen months.

In conformance with legislated and internal examination guidelines, state member banks were examined as required in 1995. Altogether, the Reserve Banks conducted 613 examinations (some of them jointly with the state agencies), and state banking departments conducted 339 independent required examinations. As required under Federal Reserve examination guidelines, Reserve Bank officials held 238 meetings with directors of large state mem-

ber banks and with directors of those that displayed significant weaknesses.

Bank Holding Companies

At year-end 1995, the number of bank holding companies totaled 6,004, a decline of 15 from the preceding year. These organizations controlled about 7,577 insured commercial banks and held approximately 94 percent of the assets of all insured commercial banks in the United States.

Federal Reserve guidelines call for annual inspections of large bank holding companies and smaller companies with significant nonbank assets. Small companies (those with assets of less than \$150 million) that do not have problems are selected for inspection on a sample basis, and medium-sized companies (\$150 million to \$500 million in assets) that do not have problems are inspected on a three-year cycle. The inspection focuses on the operations of the parent holding company, its nonbank subsidiaries, and the overall condition of the consolidated organization.

In judging the financial condition of subsidiary banks, Federal Reserve examiners consult the examination reports of the federal and state banking authorities that have primary responsibility for the supervision of these banks, thereby minimizing duplication of effort and reducing the burden on banking organizations. In 1995 the Federal Reserve inspected 1,935 bank holding companies. Altogether, Federal Reserve examiners conducted 1,930 bank holding company inspections, 97 of which were conducted off-site, and state examiners conducted 80 independent inspections. During 1995, Reserve Bank officials held 271 meetings with the boards of directors of bank holding companies to discuss supervisory concerns.

Enforcement Actions, Civil Money Penalties, and Significant Criminal Referrals

In 1995 the Federal Reserve Banks recommended, and members of the Board's staff initiated and worked on, 132 enforcement cases involving 298 separate actions such as written agreements, cease and desist orders, removal and prohibition orders, civil money penalties, and prompt corrective action directives. Of these, 63 cases involving 109 actions were completed by year-end.

Of particular note were the actions that the Board of Governors, in conjunction with other federal and state bank supervisors, took against The Daiwa Bank, Limited, which resulted in the bank's consent to terminate its U.S. activities. The Daiwa case is the first in which the Board of Governors has exercised its termination authority under the Foreign Bank Supervision Enhancement Act. In other significant matters, the Board of Governors assessed civil money penalties totaling \$760,500 in 1995, including \$600,000 against one individual for violations of the Bank Holding Company Act and \$85,000 against a group of individuals for violations of, among other things, federal consumer protection laws and regulations. The Board of Governors also worked in coordination with the Department of Justice to address alleged discriminatory lending practices at a state member bank.

All final enforcement orders issued by the Board of Governors and all written agreements executed by the Federal Reserve Banks in 1995 are available to the public. Besides formal enforcement actions, the Federal Reserve Banks completed 183 informal enforcement actions, such as memorandums of understanding, commitment letters, and board resolutions.

In 1995 the staff of the Division of Banking Supervision and Regulation forwarded 703 criminal referrals to the Fraud Section of the Criminal Division of the Department of Justice for inclusion in its significant referral tracking system.

Specialized Examinations

The Federal Reserve conducts specialized examinations of banking organizations regarding electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing, securities clearing, and securities underwriting and dealing through so-called section 20 subsidiaries. The Federal Reserve also reviews state member banks and bank holding companies that act as transfer agents.

Electronic Data Processing

Under the Interagency EDP Examination Program, the Federal Reserve examines the electronic data processing (EDP) activities of state member banks, U.S. branches and agencies of foreign banks, Edge Act corporations, Agreement corporations, and independent data centers that provide EDP services to these institutions. During 1995, the Federal Reserve conducted 341 EDP examinations. The Federal Reserve also was the lead agency on one examination of large multiregional data processing servicers examined with the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

Fiduciary Activities

The Federal Reserve has supervisory responsibility for institutions that hold

more than \$6.7 trillion of discretionary and nondiscretionary assets in various fiduciary capacities. This group of institutions includes 316 state-chartered member banks and trust companies, 90 nonmember trust companies that are subsidiaries of bank holding companies, and 8 entities that are branches or agencies of foreign banking organizations or Edge Act corporation subsidiaries of domestic banking institutions.

On-site examinations are essential to ensure the safety and soundness of financial institutions that have fiduciary operations. These examinations comprise (1) an evaluation of management, policies, audit and control procedures, and risk management, (2) an assessment 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. During 1995, Federal Reserve examiners conducted 181 on-site trust examinations of state member banks and trust companies, branches and agencies of foreign banking organizations, and Edge Act corporation subsidiaries of domestic banking institutions; together, these institutions held approximately \$6.2 trillion in fiduciary assets.

Government Securities Dealers and Brokers

The Federal Reserve is responsible for examining the government securities dealing and brokering of state member banks and foreign banks for compliance with the Government Securities Act of 1986 and regulations of the Department of Treasury. Forty state member banks and five state branches of foreign banks have notified the Board that they are currently government securities dealers or brokers that are not otherwise exempt from Treasury's regulations. During

1995 the Federal Reserve conducted seventy-seven examinations of broker-dealer activities in government securities at state member banks and foreign banks.

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. The Board supervises forty-four banks that act as municipal securities dealers and four clearing agencies that act as custodians of securities involved in transactions settled by bookkeeping entries. In 1995 the Federal Reserve examined all four of the clearing agencies and twenty-two of the banks that deal in municipal securities.

Securities Subsidiaries of Bank Holding Companies

Section 20 of the Banking Act of 1933 (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 section 20 of the Glass-Steagall Act and with 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. This limit was subsequently increased in September

1989 to 10 percent. To calculate the 10 percent limit, the Board in January 1993 adopted an optional indexed revenue test that reflects the changes in the level and structure of interest rates since 1989.

In January 1989 the Board approved applications by five U.S. bank holding companies to underwrite and deal in corporate and sovereign debt and equity securities, subject, in each case, to reviews of managerial and operational infrastructure and other conditions and requirements specified by the Board. Four of these organizations subsequently received authorization to underwrite and deal in all of these types of securities.

At year-end 1995 thirty-seven bank holding companies had so-called section 20 subsidiaries authorized to underwrite and deal in ineligible securities. Of these, twenty could underwrite any debt or equity security; three could underwrite any debt security; and fourteen could underwrite only the limited types of debt securities approved by the Board in 1987. The Federal Reserve uses specialized procedures for reviewing operations of these securities subsidiaries; it conducted thirty-two such inspections in 1995.

Transfer Agents

Federal Reserve examiners also conduct examinations of state member banks and bank holding companies that are registered transfer agents. Among other things, transfer agents counter-sign and monitor the issuance of securities, register their transfer, and exchange or convert such securities. During 1995, Federal Reserve examiners conducted on-site examinations at 68 of the 190 banks and bank holding companies registered as transfer agents with the Board.

Surveillance and Monitoring

The Federal Reserve monitors the financial condition and performance of individual banking organizations and of the banking system as a whole to identify areas of supervisory concern. Reserve banks and the Board use automated screening systems to identify organizations with poor or deteriorating financial profiles and to identify adverse trends affecting the banking system as a whole. Information from these systems is then used in supervisory decisions such as allocating extra supervisory or examination resources to institutions with deteriorating financial conditions.

Among the automated screening systems is a model for estimating examination ratings, which helps in tracking the overall financial condition of individual organizations. Another primary offsite monitoring tool is a model that identifies banks with characteristics of organizations that have previously failed and that could potentially encounter deterioration within two years.

To assist supervisory staff in evaluating individual bank holding companies, the Federal Reserve implemented a revised surveillance program that incorporates results of the examination rating model and on-site examination ratings. The bank holding company surveillance program also identifies companies displaying positions out of line with the bulk of other institutions with respect to tier 1 capital, return on average assets, noncurrent assets, and investment activities. In addition, the Federal Reserve produces and distributes the quarterly Bank Holding Company Performance Report, which contains detailed financial information on the condition and performance of each bank holding company.

Automated monitoring systems rely heavily on the information in regulatory

reports filed by banking organizations. To ensure the timeliness and accuracy of the reports, the Federal Reserve maintains the Regulatory Reports Monitoring System to track domestic and foreign banking organizations that file late or inaccurately.

International Activities

The Federal Reserve is responsible for supervising the international activities of various banking entities.

Edge Act and Agreement Corporations

Edge Act 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 state-chartered company that enters into an agreement with the Board not to exercise any power that is impermissible for an Edge Act corporation. In 1995 the Federal Reserve examined seventy-six Edge Act and agreement corporations, which together at year-end held about \$33 billion in total assets.

Foreign-Office Operations of U.S. Banking Organizations

The Federal Reserve examines the international operations of state member banks, Edge Act corporations, and bank holding companies, principally at the U.S. head offices of these organizations, where the ultimate responsibility for the foreign offices lies. In 1995 the Federal Reserve conducted full-scope and targeted-scope examinations of five foreign branches of state member banks and sixty-four foreign subsidiaries of Edge Act corporations and bank holding companies. All of the examinations abroad were conducted with the coop-

eration of the supervisory authorities of the countries in which they took place; when appropriate, the examinations were coordinated with the Office of the Comptroller of the Currency. Also, examiners made seventy-one visitations to overseas offices (a visitation is a more general form of review) to obtain current financial and operating information and, in some instances, to evaluate their compliance with corrective measures or test-check their adherence to safe and sound practice.

U.S. Activities of Foreign Banks

Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 1995, 274 foreign banks from 63 countries operated 474 state-licensed branches and agencies (of which 35 are insured by the Federal Deposit Insurance Corporation) as well as 73 branches and agencies licensed by the Office of the Comptroller of the Currency (of which 8 have FDIC insurance). These foreign banks also directly owned 10 Edge Act corporations and 6 commercial lending companies. In addition, they held an equity interest of at least 25 percent in 98 U.S. commercial banks. Altogether, these U.S. offices of foreign banks controlled approximately 21 percent of U.S. banking assets at year-end. These foreign banks also operated 141 representative offices. An additional 109 foreign banks operated in the United States solely through a representative office.

The Federal Reserve has broad authority to supervise and regulate foreign banks that engage in banking and related activities in the United States through branches, agencies, commercial lending companies, representative offices, Edge Act corporations, banks, and certain nonbanking companies. The Federal Reserve conducted or partici-

pated with state and federal regulatory authorities in the examination of 804 such offices during 1995.

Before the enactment of the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), the Federal Reserve had residual authority to examine all branches, agencies, and commercial lending subsidiaries of foreign banks in the United States. The International Banking Act of 1978 instructed the Federal Reserve to use, to the extent possible, the examination reports of other state and federal regulators. FBSEA amended the International Banking Act and increased the Federal Reserve's authority with respect to these foreign bank operations, including representative offices. The Federal Reserve has acted to ensure that all state and federally licensed branches and agencies receive an on-site examination at least once during each twelve-month period either by the Federal Reserve or a state or other federal regulators.

FBSEA requires Federal Reserve approval of the establishment of branches, agencies, commercial lending company subsidiaries, and representative offices by foreign banks in the United States. In 1995 the Federal Reserve approved applications by fifteen banks from twelve foreign countries to establish branches, agencies, and representative offices.

Joint Program for Supervising the U.S. Operations of Foreign Banking Organizations

In 1995 the Federal Reserve, in cooperation with the other federal and state banking supervisory agencies, formally adopted the joint program for supervising the U.S. operations of foreign banking organizations (FBOs). The program consists of two major parts. The first focuses primarily on those FBOs that

have multiple U.S. entities and is intended to better coordinate the efforts of the various U.S. supervisory agencies.

The second part of the program is a review of the financial and operational profile of each FBO to assess its general ability to support its U.S. operations and to determine what risks, if any, the FBO poses through its U.S. operations. Together, the two processes will give critical information to the U.S. supervisors in a logical, uniform, and timely manner.

Examination Manual

Recently, the U.S. state and federal banking agencies worked together to develop a manual for conducting individual examinations of the U.S. branches and agencies of FBOs. The manual, completed in 1995, serves as a primary, comprehensive reference for examination guidelines and procedures both for examiners and for the foreign banking community in the United States. A task force was formed in October 1995 to review and, if necessary, revise the manual.

Technical Assistance

In 1995, System staff members participated on a number of technical assistance missions and training sessions on bank supervisory matters for central banks in Eastern Europe, Asia, the Caribbean, Latin America, and countries of the former Soviet Union.

Supervisory Policy

The Board amended its guidelines on risk-based capital and released for public comment other proposals in this area and in the areas of derivatives and interest rate and market risks.

Risk-Based Capital Standards

The risk-based capital requirements adopted by the Board in 1989 remained in effect in 1995. These requirements implement the international risk-based capital standards that were proposed by the Basle Committee on Banking Regulation and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten (G-10) countries in July 1988.³ The standards include a framework for calculating risk-adjusted assets and assigning assets to broad categories based primarily on credit risk. Banking organizations are expected to maintain capital equal to at least 8 percent of their risk-adjusted assets.

To supplement the risk-based capital standards, the Board in 1990 also issued leverage guidelines setting forth minimum ratios of capital to total assets to be used in the assessment of an institution's capital adequacy.

Amendments

During 1995 the Board adopted amendments to its risk-based and leverage capital guidelines in the following areas.

Interest rate risk. On August 2, 1995, the Board, together with the FDIC and the OCC, issued a final rule implementing the portion of section 305 of the Federal Deposit Insurance Corporation Improvement Act of 1991 dealing with interest rate risk. The final rule amends the risk-based capital standards to state explicitly that, effective September 1, 1995, the banking agencies will consider "a bank's exposure to declines in the economic value of its capital due to changes in interest rates" in evaluating

its capital adequacy. The final rule formalizes the existing supervisory practice of considering interest rate risk in the evaluation of an institution's capital adequacy and supplements that practice by identifying the use of economic value as a key consideration in the evaluation.

Recourse. The Board adopted a final amendment, effective March 22, 1995, reducing the capital requirements for low-level recourse transactions. The amendment implements section 350 of the Riegle Community Development and Regulatory Improvement Act of 1994, which requires the federal banking agencies to issue regulations limiting the amount of risk-based capital an insured depository institution can be required to hold for assets transferred with recourse; the limit is to be the maximum amount of recourse for which the institution is contractually liable.

Recourse transactions involving small business obligations. Section 208 of the Riegle community development act requires the federal banking agencies to revise the regulatory capital treatment applied to recourse transactions involving small business obligations. The Board adopted a final rule implementing section 208, effective September 1, 1995. The amendment permits qualifying banking organizations to maintain capital against only the amount of retained recourse on the transferred small business obligations rather than on the entire amount of assets sold with recourse, provided certain conditions are met.

To qualify for the preferential capital treatment, the banking organization transferring the small business obligations generally must be well capitalized, the transfer of the small business obligations must meet the sale criteria outlined under generally acceptable accounting

3. The Group of Ten consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

principles, and the transferring organization must establish noncapital reserves sufficient to meet its reasonably estimated liability under the recourse arrangement. Furthermore, the aggregate amount of recourse that is retained generally cannot exceed 15 percent of the institution's total risk-based capital.

Derivatives transactions. The Board adopted a final rule, effective October 1, 1995, addressing issues relating to the capital treatment of off-balance-sheet derivative transactions. The final rule, which implemented a revision to the Basle accord, amended and expanded the set of conversion factors used to calculate the potential future credit exposure of derivative contracts. The rule also permits institutions to recognize the effects of bilateral netting arrangements when calculating the potential future exposure for derivative contracts subject to qualifying bilateral netting arrangements.

Originated mortgage servicing rights. The Board, along with the other federal banking agencies, adopted an interim rule, effective August 1, 1995, amending the risk-based capital guidelines to treat originated mortgage servicing rights the same as purchased mortgage servicing rights for regulatory capital purposes. The interim rule was developed in response to the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 122, *Accounting for Mortgage Servicing Rights*, which eliminated the accounting distinction between originated and purchased mortgage servicing rights.

Country transfer risk. A modification to the Basle Accord that involves country transfer risk was completed during 1995. The Federal Reserve Board and

the other regulatory banking agencies issued a final revision to their respective risk-based capital standards that incorporated this modification. Claims on the central governments of the OECD-based group of countries continue to be eligible for preferential capital treatment, but under the revision, claims on any country in that group that has rescheduled its external sovereign debt will receive the standard capital treatment for five years after the rescheduling. The revision to the agencies' risk-based capital standards, and the modification to the accord on which it was based, were made to ensure that membership in the OECD-based group of countries coincides with relatively low transfer risk. The final revisions to the agencies' standards will become effective April 1, 1996.

Proposed Rule

During 1995 the Board issued for public comment a proposed supplement to the risk-based capital framework.

Measure for market risk. On July 25, 1995, the Board, together with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, issued a proposal to incorporate into the risk-based capital ratios a capital charge for the market risk in foreign exchange and commodity activities and in the trading of debt and equity instruments. Under the proposal, certain institutions with significant trading activity would calculate capital requirements for market risk using either their internal risk measurement models, subject to specified parameters, or risk measurement techniques developed by supervisors. The proposal was based on a proposed supplement to the Basle accord that was issued in April 1995. The comment period for the Board's

proposal ended in September 1995. A final amendment is expected in 1996 and would be effective at the end of 1997.

Risk Management Guidance

Throughout 1995 the Board continued to focus on the adequacy of risk management practices and controls at banking institutions.

Securities and Derivatives Used for Nontrading Purposes

Recognizing the increased complexity and sophistication of financial instruments and strategies, the Federal Reserve in March issued a supervisory letter to guide banking institutions in evaluating the risk management practices they use in their acquisition and management of securities and off-balance-sheet derivative contracts for nontrading purposes. The guidance emphasized the importance of active oversight by the board and senior management, adequate risk management policies and limits, appropriate risk measurement and reporting systems, and comprehensive internal controls as key elements of sound risk management. In addition, as with all risk-bearing activities, institutions were advised that they should fully support the risk exposures of nontrading activities with adequate capital. The guidance complements a supervisory letter issued in 1993 on trading activities at banking institutions.

Adequacy of Risk Management and Internal Controls

In response to the continuing changes in the nature of banking markets, the Federal Reserve introduced in November a formal supervisory rating system for evaluating the adequacy of an insti-

tution's risk management processes, including its internal controls. The rating system takes effect in 1996 for all state member banks and bank holding companies regardless of size; it represents a natural extension of current procedures, which incorporate an assessment of risk management and internal controls during each on-site, full-scope examination. The specific rating of risk management and internal controls will be given significant weight when evaluating management under the bank and bank holding company rating systems.

The greater focus on risk management recognizes the changes brought about by new technologies, product innovation, and the size and speed of financial transactions but does not diminish the importance of reviewing capital adequacy, asset quality, earnings, liquidity, and other areas relevant to the evaluation of safety and soundness. The rating of risk management will bring together and summarize many of the findings examiners have long made in their review of these areas with regard to an institution's process for managing and controlling risks.

Derivatives Disclosures and Supervisory Reporting

The Federal Reserve and the Basle Supervisors Committee have a number of initiatives underway to ensure that institutions involved in derivatives and capital markets activities follow safe and sound management practices, maintain adequate capital levels, and report the results of these activities in a transparent manner. In May 1995 the Basle Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commissions (IOSCO) established a joint framework for supervisory information about the derivatives activities of banks

and securities firms. The joint framework is part of a continuing effort to improve supervisors' access to, and evaluation of, timely and comprehensive information about institutions' activities involving over-the-counter and exchange-traded derivatives.

The framework has two main parts. The first part summarizes the risks associated with derivatives and discusses qualitative and quantitative information that supervisors could obtain to assess these risks. The framework also discusses earnings information that may be useful in conducting supervisory analysis. The second part sets forth a common minimum supervisory information framework that focuses on information useful for supervisors as they begin assessing the extent of an institution's derivatives activities and their effect on its credit risk profile. The Basle Committee on Banking Supervision and IOSCO plan to update the joint supervisory information framework periodically and incorporate information about market risk into the common minimum framework at a later stage.

Over the past few years, industry groups and regulators have been issuing accounting standards and regulations regarding the derivatives activities and disclosures made by banks. The main thrust of these efforts has been to make derivatives activities more transparent, in that relevant information will be presented in a way that allows the public and regulatory authorities to make informed judgments about a company's derivatives activity. In 1995 the Division of Banking Supervision and Regulation published an analysis of the derivatives-related disclosures in the 1993 and 1994 annual reports of the top ten U.S. banks that deal in derivatives (*Federal Reserve Bulletin*, vol. 81, September 1995, pp. 817-31). The article summarizes the accounting standards

and recommendations that contributed to the 1994 disclosures; it also reviews the improvements since 1993 in qualitative and quantitative disclosures about the credit and market risks of derivatives and about the earnings effects of derivatives.

In November 1995 another joint report on the public disclosure of trading and derivatives activities of banks and securities firms worldwide was issued by the Basle committee and IOSCO. The report provides an overview of the disclosures about trading and derivatives activities in the 1994 annual reports of a sample of the largest internationally active banks and securities firms in the G-10 countries and notes improvements since 1993.⁴ The analysis builds, in part, upon a framework used by the Federal Reserve in analyzing the trading and derivatives disclosures of major U.S. banking organizations.

The report's analysis revealed that a number of firms in the sample have made general improvements as well as significant voluntary innovations in their annual report disclosures. Many institutions, however, have continued to disclose very little about their trading and derivatives activities. The report makes recommendations for further improvements in disclosures of qualitative and quantitative information about institutions' involvement in trading and derivatives activities, including their risk exposures and risk management policies and the derivatives activities' effects on earnings. The Basle committee and IOSCO are planning to repeat the analysis in 1996 with the expectation that

4. The total sample consisted of seventy-nine institutions holding more than \$12 trillion in total assets and more than \$62 trillion in notional amounts of derivative instruments.

disclosure practices across international financial markets will converge further.

Retail Sales of Nondeposit Investment Products

In January 1995 the Federal Reserve along with the other federal banking agencies, entered into an Agreement in Principal with the National Association of Securities Dealers (NASD). Pursuant to the agreement, Federal Reserve examiners have been coordinating examinations of bank-affiliated broker-dealers with the NASD to the extent practicable. The agreement is intended to avoid duplication of supervisory efforts, lessen the burden on the broker-dealers, and enhance the overall supervisory process.

In September the federal banking agencies issued an interpretation of the February 1994 interagency statement entitled "Retail Sales of Nondeposit Investment Products." The interpretation addresses the application of the statement to a bank's dealer and trust departments and to standalone bank-affiliated broker-dealers. The interpretation also allows an abbreviated form of the minimum disclosures to be used exclusively in advertisements and indicates that the minimum disclosures are not required in other signs used exclusively to identify the location where products are available.

In October the federal banking agencies sent letters asking the New York Stock Exchange, the NASD, and the Municipal Securities Rulemaking Board to permit bank retail sales personnel to take the securities industry's professional qualification examinations. In the letters, the banking agencies indicated an intention to adopt rules requiring bank sales personnel to pass the appropriate professional qualification exami-

nation as a condition to selling, and to maintain a recordkeeping system for bank sales personnel comparable to the NASD's Central Registration Depository for broker-dealer personnel.

National Information Center

The Division of Banking Supervision and Regulation has overall responsibility for the management of the National Information Center (NIC). The NIC contains data bases that are maintained at the Board of Governors and made available to staff members at the Board, the Reserve banks, and other federal and state banking supervisors. The NIC comprises structure data for banks, non-banks, and bank holding companies; international data for U.S. holding companies and foreign banking organizations with activities in the United States; financial information, such as Call Report data for banks and FR-Y report data for bank holding companies; and supervisory information based on inspections and examinations.

During 1995, development of the Supervisory Information System (SIS) database was combined with that of the Federal Reserve Examination Database (FRED). The SIS contains all the supervisory information within the NIC structure. FRED is an executive information tool that facilitates fairly complex analysis of NIC information on a personal computer. The redesign effort currently under way and scheduled for completion in early 1997, will provide flexibility by enabling the System to use existing technology for future changes and enhancements.

To expand the use of NIC, training seminars were conducted for staff members throughout the System, and new applications were developed to make the vast amount of NIC data more easily accessible to the staff. In addition,

efforts have been made to make the NIC data and software available to state banking agencies for their use as a supervisory tool.

Staff Training

The Supervisory Education Program trains staff members having supervisory or regulatory responsibilities at the Reserve Banks, at the Board of Governors, and at state banking departments. The program covers the four disciplines of bank supervision: bank examinations, bank holding company inspections, surveillance and monitoring activities, and applications analysis. The program

provides training at basic, intermediate, and advanced levels. Classes may be conducted in Washington, D.C., or at regional locations and may be held jointly with regulators of other financial institutions. Training is also provided to staff members of the Division of Banking Supervision and Regulation and staff members of other divisions who are engaged in System supervisory and regulatory activities. Students from supervisory counterparts in foreign countries also attend on a space-available basis. An objective of the program is to provide students with an increased awareness and knowledge of the total supervisory and regulatory pro-

Number of Sessions of Training Programs for Banking Supervision and Regulation, 1995

Program	Total	Regional
<i>Schools or seminars conducted by the Federal Reserve</i>		
<i>Core Schools</i>		
Introduction to examinations	9	5
Financial institution analysis	11	8
Loan analysis	10	8
Bank management	6	1
Effective writing for banking supervision staff	24	24
Management skills	23	20
Conducting meetings with management	25	25
<i>Other Schools</i>		
Real estate lending seminar	5	3
Specialized lending seminar	5	...
Senior forum for current banking and regulatory issues	2	...
Bank operations	5	5
Bank applications	2	...
Bank holding company inspection	11	8
Basic entry-level trust	1	...
Advanced trust	1	...
Consumer compliance examination I	3	...
Consumer compliance examination II	4	...
Community Reinvestment Act training	5	5
Fair lending	3	...
Advanced Electronic Data Processing examination	1	...
Electronic Data Processing continuing education	1	...
Capital markets seminar	12	8
Section 20 securities seminar	6	5
Internal controls	3	3
Seminar for senior supervisors of foreign central banks ¹	2	1
<i>Other agencies conducting courses²</i>		
Federal Financial Institutions Examination Council	78	11
Federal Deposit Insurance Corporation or Office of the Comptroller of the Currency	8	...
Federal Bureau of Investigation ³	2	2

NOTE. ... Not applicable.

1. Conducted jointly with the World Bank.

2. Open to Federal Reserve employees.

3. Co-sponsored by the Federal Reserve, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Office of the Comptroller of the Currency, and the Resolution Trust Corporation.

cess, including the interrelationships of the four functional areas, thus providing a higher degree of cross training among staff members.

The System participates in training offered by the Federal Financial Institutions Examination Council and, to a limited extent, in the training offered by certain other regulatory agencies. Activities include developing and implementing basic and advanced training in various emerging issues as well as in such specialized areas as trust activities, international banking, electronic data processing, activities of municipal securities dealers, capital markets, payment systems risk, white collar crime, preparation and presentation of testimony, income property lending, management, and instructor training. The System also co-hosts the World Bank Seminar for students from developing countries.

During 1995 the Federal Reserve conducted a variety of schools and seminars, and Federal Reserve staff members participated in several courses offered by or cosponsored with other agencies, as shown on the accompanying table.

In 1995 the Federal Reserve trained 3,943 persons in System schools, 1,246 in schools sponsored by the Federal Financial Institutions Examination Council (FFIEC), and 217 in other schools for a total of 5,406 students including 206 representatives from foreign central banks. The number of stu-

dent days of training was 27,856 in 1995; 25,036 in 1994; 26,938 in 1993; and 20,555 in 1992.

The Federal Reserve System also gave scholarship assistance to the states for training their examiners in Federal Reserve and FFIEC schools. Through this program 761 state examiners were trained; 430 in Federal Reserve courses, 304 in FFIEC programs, and 27 in other courses. During 1995 the Federal Reserve also continued its participation in joint core supervision schools with the FDIC.

Every staff member wishing to obtain an examiner's commission is required to demonstrate mastery of the core curriculum and of a specialty area by passing the Core Proficiency Examination, which includes a core content area and a specialty (Safety and Soundness, Consumer Affairs, Trust, or EDP). In 1995, ninety-one people registered to take the Core Proficiency Examination, and sixty-seven took it by year-end (see table).

Federal Financial Institutions Examination Council

In November 1995 the Federal Reserve and the other federal banking agencies announced, under the auspices of the FFIEC, the planned full adoption of generally accepted accounting principles (GAAP) as the reporting basis for the

Status of Students Registered for the Core Proficiency Examination, 1995

Student status	Core	Specialty area			
		Safety and soundness	Consumer	Trust	Electronic data processing
Registrants	91	77	12	1	1
In queue	24	20	3	0	1
Taken	67	57	9	1	0
Passed	65	39	9	1	...
Failed	2	18	0	0	...

NOTE. Students choose a test in one specialty area to accompany the core examination.

balance sheet, income statement, and related schedules in bank Call Reports, effective with the March 1997 report date. While the accounting principles used for bank Call Report purposes have generally been based on GAAP, full adoption of GAAP as the reporting basis in the basic schedules of the Call Report will eliminate existing differences with GAAP. In addition, this change will bring the accounting principles used for bank regulatory reports into conformity with the GAAP reporting basis used in bank holding company FR-Y reports, savings association Thrift Financial Reports, and general purpose financial statements. Furthermore, this uniform reporting basis is consistent with the objectives of section 307 of the Riegle Community Development and Regulatory Improvement Act of 1994, which requires the federal banking agencies to work jointly to develop a single form for the filing of core information by banks, savings associations, and bank holding companies.

During 1995 the FFIEC implemented a number of improvements to disclosures for off-balance-sheet derivatives instruments. The FFIEC developed instructions to the bank Call Report effective as of the March 1995 report date, to implement an enhanced framework for derivatives reporting. Under the enhanced framework, banks report gross or notional amounts of derivative contracts by class of instrument, type of risk exposure, maturity, and use of the instruments. Banks also report the gross positive and negative fair values of derivatives broken down by type of risk exposure and use of the instruments.

In addition, the FFIEC collected data on the net credit exposure from derivatives (reflecting legally enforceable bilateral netting contracts), on the potential future credit exposure from derivatives, and on the effect of derivatives on

trading revenues and net interest margins. The FFIEC also agreed to make additional refinements to this information as of the March 1996 report date in a manner consistent with certain aspects of the Supervisory Information Framework issued jointly by the Basle Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commissions on May 16, 1995. Similar disclosures were instituted for regulatory reports by bank holding companies filed with the Federal Reserve.

The FFIEC published final guidance on the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* (SFAS 114), in February 1995 and developed instructions for the bank Call Report on this standard. The guidance clarifies that allowances calculated under SFAS 114 may continue to be included in tier 2 capital and reaffirms existing supervisory policies on non-accrual of interest income and the classification of certain troubled collateralized loans. The FFIEC also issued implementation guidance with respect to SFAS 122, *Accounting for Mortgage Servicing Rights*, and SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*.

In December 1995 the FFIEC announced a number of revisions to the Call Report. Several items will be deleted, effective as of the March 31, 1996, reporting date, to reflect the results of an annual review of the Call Reports. New items will be added to the Call Report to permit the agencies to monitor bank regulatory capital ratios more effectively, to provide better data on short-term liabilities and assets for liquidity purposes, and to provide information necessary for the supervision of bank activities in other areas.

The FFIEC also announced it is adopting a new trust income statement in the Annual Report of Trust Assets (FFIEC 001), effective for the December 1996 report date. In addition, it revised the supplement to the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) to adopt certain derivatives disclosures and to maintain consistency with the bank Call Report.

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 lending company. The Board has established regulations for the interstate banking activities of these foreign banks and for foreign banks that control a U.S. subsidiary commercial bank.

Bank Holding Company Act

By law a company must obtain the Federal Reserve's approval if it is to form a bank holding company by acquiring control of one or more banks. Moreover, once formed, a bank holding company must receive the Federal Reserve's approval before acquiring additional banks or nonbanking companies.

In reviewing an application or notice filed by a bank holding company, the Federal Reserve considers the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, and the competitive effects of the proposal.

Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1995

Proposal	Direct action by the Board of Governors		Action under authority delegated by the Board of Governors					Total
			Director of the Division of Banking Supervision and Regulation		Office of the Secretary	Federal Reserve Banks		
	Approved	Denied	Approved	Denied	Approved	Approved	Permitted	
Formation of holding company	33	2	0	0	5	253	47	340
Merger of holding company	22	0	0	0	14	69	0	105
Retention of bank Acquisition	0	0	0	0	0	0	0	0
Bank	55	1	0	0	16	248	0	320
Nonbank	183	2	0	0	29	1	386	601
Bank service corporation	0	0	0	0	0	153	0	153
Other	4	0	34	1	0	0	0	39
Total	297	5	34	1	64	724	433	1,558

In 1995, the Federal Reserve acted on 1,558 bank holding company and related applications or notices. The Federal Reserve received 340 proposals to organize bank holding companies and denied 2; approved all 105 proposals to merge existing bank holding companies; received 320 requests for acquisitions by existing bank holding companies and denied 1; received 601 requests by existing companies to acquire nonbank firms engaged in activities closely related to banking and denied 2; and approved 192 other applications. 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 of the applicant, the future prospects of the existing and combined institutions, the convenience and needs of the community to be served, and the competitive effects of the proposal. The Federal Reserve must also consider the views of certain other agencies on the competitive factors involved in the transaction.

During 1995 the Federal Reserve approved 133 merger applications. As required by law, each merger is described in this REPORT (in table 16 of the Statistical Tables chapter). When the FDIC, the OCC, or the OTS has jurisdiction over a merger, the Federal Reserve is asked to comment on the competitive factors to ensure comparable enforcement of the antitrust provisions of the act. The Federal Reserve and those

agencies have adopted standard terminology for assessing competitive factors in merger cases. The Federal Reserve submitted 1,014 reports on competitive factors to the other federal banking agencies in 1995.

Change in Bank Control Act

The Change in Bank Control Act requires persons seeking control of a bank or bank holding company to obtain approval from the appropriate federal banking agency in advance of the transaction. Under the act, the Federal Reserve is responsible for reviewing changes in the control of state member banks and of bank holding companies. In so doing, the Federal Reserve must review the financial position, competence, experience, and integrity of the acquiring person; consider the effect on the financial condition of the bank or bank holding company to be acquired; and 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 Federal Reserve routinely makes such a determination and verifies information contained in the proposal.

In 1995, the Federal Reserve acted on 148 proposed changes in control of state member banks and bank holding companies.

Public Notice of Federal Reserve Decisions

Each decision by the Federal Reserve that involves a bank holding company, bank merger, or a change in control is

effected by an order or announcement. Orders state the decision, the essential facts of the application or notice, and the basis for the decision; announcements state only the decision. All orders and announcements are released immediately to the public; they are subsequently 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 received by the Federal Reserve but not yet acted on.

Timely Processing of Applications

The Federal Reserve maintains target dates and procedures for the processing of applications. These target dates promote efficiency at the Board and the Reserve Banks and reduce the burden on applicants. The time allowed for a decision ranges from thirty to sixty days, depending on the type of application or notice. During 1995, 90 percent of the decisions met this standard.

Delegation of Applications

Historically, 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 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 staff members at both the Board and the Reserve Banks to work more efficiently by removing routine cases from the Board's agenda.

In 1995, 84 percent of the applications processed were acted on under delegated authority. The Board continued its efforts during the year to streamline its processing procedures.

Banking and Nonbanking Proposals

During 1995, the Board approved a variety of merger proposals involving some of the largest banking organizations in the United States. Most of these proposals generated many comments from the public, particularly with respect to the Community Reinvestment Act, fair lending, and competitive issues. For one of these proposals, the Board conducted public meetings in three separate cities. The meetings facilitated the receipt of comments from the many parties interested in that transaction. For another proposal, to form the largest banking holding company in the U.S., the Board conducted a two-day public meeting in New York City; the proposal was pending at year-end.

In 1995 the Board continued to approve proposals by domestic bank holding companies and by foreign banking organizations to engage in securities underwriting and dealing activities. For the first time, the Board permitted a bank holding company engaged in a limited number of section 20 activities (rather than all types of section 20 activities) to underwrite and deal in certain "private ownership" industrial revenue bonds.

During the year, the Board also approved a proposal by a U.S. bank holding company to indirectly acquire interests in partnerships that would invest in a variety of assets, including discounted bank loans and other debt instruments that are (or are expected to be) in default of their original terms.

Applications by State Member Banks

State member banks must obtain the permission of the Federal Reserve 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, although the notice period may be shortened or eliminated in specific cases.

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 Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital guidelines. In 1995 the Federal Reserve reviewed fifty-one proposed stock repurchases by bank holding companies, all of which were handled, under delegated authority, either by the Reserve Banks or by the Secretary 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 Act corporations, and bank holding companies; and of investments by bank holding companies in export trading companies. In addition, the Board is required to charter and regulate Edge Act corporations and their investments.

Foreign Branches of Member Banks

Under provisions of the Federal Reserve Act and of the Board's Regulation K (International Banking Operations), member banks must obtain 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 1995 the Board approved the opening of 14 foreign branches of 5 banks.

By the end of 1995, 110 member banks were operating 761 branches in foreign countries and overseas areas of the United States; 76 national banks were operating 640 of these branches, and 34 state member banks were operating the remaining 121 branches. In addition, 27 nonmember banks were operating 41 branches in foreign countries.

Edge Act Corporations and Agreement Corporations

Under sections 25 and 25(a) of the Federal Reserve Act, Edge Act and agreement corporations may engage in international banking and foreign financial transactions. These corporations, which are usually subsidiaries of member banks, may (1) 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) make foreign investments that 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.

In 1995 the Federal Reserve approved one new Edge Act corporation and three agreement corporations. At year-end,

seventy-six Edge Act and agreement corporations were operating with forty-two domestic branches. Effective January 1, 1993, the Board, in line with the latest revision to Regulation K, requires each Edge Act corporation that is "engaged in banking" to maintain a minimum ratio of qualifying total capital to weighted risk assets of 10 percent.

Foreign Investments

Under 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. Significant investments require advance review by the Board, although pursuant to Regulation K, most foreign investments may be made under general-consent procedures that involve only after-the-fact notification to the Board.

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 Act or agreement corporations, and bankers' banks to invest in export trading companies, subject to certain limitations and after Board review. The purpose of this amendment 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 activities. Since 1982 the Federal Reserve has acted affirmatively on notifications by forty-eight bank holding companies.

Enforcement of Other Laws and Regulations

The Board is also responsible for the enforcement of various laws, rules and regulations other than those specifically related to bank safety and soundness and the integrity of the banking structure.

Financial Disclosure by State Member Banks

State member banks must disclose certain information of interest to investors if they issue securities registered under the Securities Exchange Act of 1934. This information includes financial reports and proxy statements. By statute, the Board's financial disclosure rules must be substantially similar to those issued by the Securities and Exchange Commission. At the end of 1995, thirty-six state member banks, most of which are small or medium-sized, were registered with the Board under the Securities Exchange Act.

Bank Secrecy Act

The Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act) was originally designed as a means to create and maintain records of various financial transactions that otherwise would not be identifiable in an effort to trace the proceeds of illegal activities. In recent years, the Bank Secrecy Act has been regarded as a primary tool in the fight against money laundering. The records required to be reported and maintained by financial institutions under the Bank Secrecy Act provide law enforcement officials with useful data for aiding in the detection and prevention of unlawful activity. At the same time, these records provide assistance

in the determination of the safety and soundness of financial institutions.

In 1995 the Federal Reserve acted as the lead regulatory agency in the development of new anti-money laundering examination procedures as required by the provisions of section 404 of the Riegle Community Development and Regulatory Improvement Act of 1994. These procedures were added to the newly developed Federal Reserve Bank Secrecy Act examination procedures. The Federal Reserve, through its use of these procedures and other off-sight measures, continued its efforts to monitor compliance with the requirements of the Bank Secrecy Act by the institutions it supervises.

During 1995 the Federal Reserve, through its appointed representative, continued to provide expertise and guidance to the Bank Secrecy Act Advisory Council, a committee created by Congressional mandate to propose additional anti-money laundering measures to be taken under the Bank Secrecy Act. Also, through the Special Investigations and Examinations Section, the Federal Reserve has assisted in the investigation of money laundering activities and provided anti-money laundering training to designated staff members at each Reserve Bank.

The Federal Reserve has also continued its extensive participation in the Financial Action Task Force, which in 1995, provided anti-money laundering training to numerous foreign governments. A representative of the Federal Reserve participated in the Financial Action Task Force examinations of the progress made in adopting and implementing anti-money laundering measures by foreign governments. Through its representative, the Federal Reserve also participated in the Summit of the Americas Working Level Conference on Money Laundering. The purpose of the

summit was to develop a coordinated hemispheric response to money laundering activities in the Americas.

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. 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 applies 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 Board's securities credit regulations. The Securities and Exchange Commission, the National Association of Securities Dealers, and the national securities exchanges examine brokers and dealers for compliance with Regulation T. The federal banking agencies examine banks under their respective jurisdictions for compliance with Regulation U. The compliance of other lenders with Regulation G is examined by the Board, the Farm Credit Administration, the National Credit Union Administration, or the Office of Thrift Supervision, according to the jurisdiction involved. At the end of 1995, 743 lenders were registered under Regulation G, and 226 came under the Board's supervision. Of these 226, the Federal Reserve regularly inspects 216 either biennially or triennially, according to the type of credit they extend. The others are exempted from periodic on-site inspections by the Federal Reserve but are monitored through the filing of periodic regulatory reports. During 1995, Federal Reserve examiners

inspected 108 lenders for compliance with Regulation G.

In general, Regulations G and U impose credit limits on loans secured by publicly held securities when the purpose of the loan is to purchase or carry those or other publicly held equity securities. Regulation T limits the amount of credit that brokers and dealers may extend when the credit is used to purchase or carry publicly held debt or equity securities. Collateral for such loans at brokers and dealers must be securities in one of the following categories: those traded on national securities exchanges, certain over-the-counter (OTC) stocks that the Board designates as having characteristics similar to those of stocks listed on the national exchanges, or bonds that meet certain requirements.

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 1995 the OTC list was revised in February, May, August, and November. The November OTC list contained 4,253 stocks.

Pursuant to a 1990 amendment to Regulation T, the Board publishes a list of foreign stocks that are eligible for margin treatment at broker-dealers on the same basis as domestic margin secu-

rities. In 1995 the foreign list was revised in February, May, August, and November. The November foreign list contained 701 foreign stocks.

In 1995 the Board published proposed amendments to Regulation T for public comment. The amendments are part of the Board's periodic review of its regulations and reflect consideration of the comments submitted in response to its earlier Advance Notice of Proposed Rulemaking. Many of the proposed amendments feature increased reliance on rules of the Securities and Exchange Commission and self-regulatory organizations. Others would make Regulation T consistent with Regulation G and Regulation U.

Under section 8 of the Securities Exchange Act, a nonmember domestic or foreign bank may lend to brokers or dealers who post 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. The Board processed seven new agreements in 1995.

In 1995 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued twenty-four interpretations of the margin regulations. Those that presented sufficiently important or novel issues were published in the *Securities Credit*

Loans by State Member Banks to their Executive Officers, 1994-95

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
<i>1994</i>			
October 1-December 31	684	23,755,000	3.7-21.0
<i>1995</i>			
January 1-March 31	655	15,881,000	3.0-21.0
April 1-June 30	725	20,246,000	5.0-18.3
July 1-September 30	726	18,386,000	5.5-19.2

SOURCE: Call Report.

Transactions Handbook, which is part of the *Federal Reserve Regulatory Service*. These interpretations serve as a guide to the margin regulations.

Loans to Executive Officers

Under section 22(g) of the Federal Reserve Act, state member banks must include in each quarterly Call Report all extensions of credit made by the bank to its executive officers since the date of the bank's previous report. The accompanying table summarizes this information.

Federal Reserve Membership

At the end of 1995, 3,965 banks were members of the Federal Reserve System, a decrease of 146 from the previous year-end. Member banks operated 38,129 branches on December 31, 1995, a net increase of 1,041 for the year. Member banks accounted for 38 percent of all commercial banks in the United States and for 67 percent of all commercial banking offices; these values matched those for year-end 1994. ■

Regulatory Simplification

In 1978 the Board of Governors established the Regulatory Improvement Project in the Office of the Secretary to help minimize the burdens imposed by regulation. In 1986 the Board reaffirmed its commitment to regulatory improvement, renaming the project the Regulatory Planning and Review Section and assigning supervision of its work to the Board's Committee on Banking Supervision and Regulation.

The purposes of the regulatory improvement and simplification function are to ensure that the economic consequences for small business are considered when regulations are written, to afford interested parties the opportunity to participate in designing regulations and comment on them, and to ensure that regulations are written in simple and clear language. Staff members continually review regulations for their adherence to these objectives.

During 1995 the Board took a variety of actions to reduce the regulatory burden on supervised institutions. These actions included a major commitment to fulfill the mandate of section 303 of the Riegle Community Development and Regulatory Improvement Act, which requires reviews of all regulations and written policies. In addition, the Board took action to clarify recordkeeping requirements for wire transfers; to permit flexibility in consumer accounts on receipts at automated teller machines in order to reduce fraud; to establish a "safe harbor" from the anti-tying restrictions of the Bank Holding Company Act; and to revise the Community Reinvestment Act regulations to emphasize performance, promote consistency in evaluations, and eliminate unneces-

sary burden. The Board also took actions to provide safety and soundness guidelines that set forth broad, principle-based standards; to streamline the risk-based capital treatment of small business obligations transferred with recourse; and to expand the ability of U.S. banking organizations to invest in foreign companies without advance approval.

Comprehensive Reviews

Section 303(a)(1) of the Riegle Community Development and Regulatory Improvement Act of 1994 requires that each federal banking agency, including the Board, conduct a review of its regulations and written policies for purposes of streamlining, improving efficiency, reducing unnecessary costs, and removing inconsistencies and outmoded or duplicative requirements. The act also requires the agencies work jointly to make regulations and guidelines implementing common statutory and supervisory policies uniform. The Board and the other agencies must report to the Congress by September 1996 on the progress they have made.

The Board has placed a high priority on fulfillment of section 303's mandate and has devoted considerable resources to the project. The Board contemplates a comprehensive review of all its regulations and written policies, including policy statements, Board interpretations, Supervisory Letters, and the like.

Revised proposals for several Board regulations have already been issued for comment, including Regulation T (Securities Credit by Brokers and Dealers), Regulation E (Electronic Fund

Transfers), Regulation M (Consumer Leasing), Regulation U (Securities Credit by Banks), and Regulation K, subpart A (Investments by Foreign Banking Organizations in U.S. Subsidiaries). Interagency efforts to make common regulations and guidelines uniform are under way as are internal reviews of policies and related guidance.

Recordkeeping Requirements for Certain Financial Records

In January 1995 the Board, in conjunction with the Department of the Treasury, adopted a final rule that established enhanced recordkeeping requirements related to certain funds transfers and transmittals of funds (wire transfers) by all financial institutions. The final rule reflected modifications to the proposed rule which reduced the burden associated with the rule while maintaining its usefulness to law enforcement agencies.

Subsequent to the adoption of the rule, several banks expressed concerns that compliance would be complicated by differences in the meanings of definitions in the rule and the Uniform Commercial Code. The Treasury and the Board proposed amendments to the definitions and technical conforming changes to conform the meanings of the definitions in order to reduce confusion as to the applicability of the rule and to reduce the cost of complying with its requirements. The Board approved the conforming changes in December.

ATM Transaction Receipts

In March the Board adopted a final rule amending Regulation E to permit financial institutions more flexibility in identifying consumer accounts on receipts at automated teller machines (ATMs). The amendment eliminated the requirement that an electronic terminal receipt

uniquely identify the customer's account or card; this requirement had posed security risks for consumers and financial institutions by making accessible to criminals information that could be used to make fraudulent withdrawals. The revised rule will help to reduce fraud without compromising consumers' ability to identify transactions at ATMs. The Board had issued an interim rule to address this problem in November 1994.

Exception to Anti-tying Restrictions

In April the Board established a "safe harbor" from the anti-tying restrictions of the Bank Holding Company Act and Regulation Y. The safe harbor permits any bank or nonbank subsidiary of a bank holding company to offer a discount on any product or package of products if a customer maintains a minimum combined balance in deposits and other products specified by the institution. The Board believes such discounts are proconsumer and not anticompetitive and had previously granted a similar exception by order to a particular banking institution.

CRA

The purpose of the Community Reinvestment Act (CRA) regulations is to establish the framework and criteria by which the agencies assess an institution's record of helping to meet the credit needs of its community, including low- and moderate-income neighborhoods, consistent with safe and sound operations, and to provide that the assessment shall be taken into account in reviewing certain applications.

In April the federal banking agencies issued completely revised CRA regulations, which emphasize performance rather than process by requiring reports

on loans rather than on outreach efforts. The revisions also promote consistency in evaluations by recognizing that different types of institutions (large retail and small financial institutions, wholesale and limited-purpose institutions, and institutions electing strategic plans) require different standards. And the revisions reduce data collection and reporting requirements for smaller institutions.

Safety and Soundness Guidelines

As required by section 132 of the Federal Deposit Insurance Corporation Improvement Act, the Board issued final guidelines and a final rule, effective as of August, regarding standards for safety and soundness at state member banks. The guidelines set forth broad, principle-based standards that establish the objectives that proper operations and management should achieve, while leaving the methods for achieving those objectives to each institution. The final rule establishes deadlines for submission and review of safety and soundness compliance plans that may be required for insured depositories that fail to meet the guidelines.

At the same time, the Board issued proposed guidelines for safety and soundness standards relating to asset quality and earnings. As amended by the Community Development Act, section 132 no longer requires the agencies to prescribe quantitative standards in these areas but rather standards they deem appropriate. The agencies have proposed asset quality and earnings guidelines that emphasize monitoring, reporting, and preventive or corrective action. Final action on these proposed guidelines is expected in spring 1996.

Capital Treatment of Certain Small Business Obligations

To implement section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, the Board amended the risk-based capital treatment of certain small business obligations. Under the revised rule, adopted in August, qualifying institutions that transfer small business obligations with recourse would be required to maintain capital only against the amount of recourse retained rather than the entire amount of assets sold.

De Novo Investments in Foreign Companies

In December the Board amended Regulation K (International Banking Operations) to provide expanded general consent authority for de novo investments in foreign companies by U.S. banking organizations that are strongly capitalized and well managed. The expanded general consent authority is designed to permit such organizations to make larger investments without the need for advance approval or review.

Investments under the expanded authority are subject to an annual aggregate limit and a post-investment notice requirement. In addition, the amended rule streamlines the processing of notices for those investments that require advance notice to the Board. ■

Federal Reserve Banks

In 1995 the Federal Reserve Banks completed their first full year of operation under a new inter-Bank management structure for financial services. Under the new structure, a policy committee—chaired by the President of the Federal Reserve Bank of St. Louis, Thomas C. Melzer—establishes strategic directions and policies, and a management committee develops and implements business plans and coordinates activities of the product offices. A separate product office exists for each of the following services and is directed by the first vice president of the indicated Reserve Bank: retail payments (Boston), wholesale payments (New York), cash and fiscal agency operations (Philadelphia), and automation and accounting support services (San Francisco). The new management structure will guide the Reserve Banks as the financial services environment continues to evolve.

In other developments during 1995, the Reserve Banks completed the first phase of the transfer of mainframe computer operations to the System's consolidated data centers, managed by Federal Reserve Automation Services (FRAS). These data centers, located at the Richmond and Dallas Reserve Banks and at the East Rutherford (New Jersey) Operations Center of the New York Reserve Bank, now handle all Reserve Bank mainframe applications except the Fedwire funds and book-entry securities transfer applications of the New York Bank and the check applications of most Reserve Banks. The New York Bank plans to convert its wholesale payment operations to FRAS in 1997.

The Reserve Banks also completed several significant milestones in the

second phase of their plan to consolidate data processing within FRAS. Eleven Reserve Banks converted to the national funds transfer and account balance monitoring applications, and two Reserve Banks (Minneapolis and Kansas City) converted to the national automated clearinghouse (Fed ACH) application. Four Reserve Banks—Boston, New York, Philadelphia, and San Francisco—completed their conversions to shared environments at FRAS for the processing of individual District applications. In 1996 the Reserve Banks plan to complete their conversion to Fed ACH and begin their conversion to the new book-entry securities transfer and banking statistics applications.

Also during 1995 the Federal Reserve Banks continued implementing the System's new national communications network, Fednet, which is replacing the FRCS-80 backbone network and the twelve District networks. Fednet is a single unified communications network that eliminates variations in the level of service provided at different points in the System and improves the reliability, security, and disaster recovery capabilities of the network. In 1995 the Reserve Banks installed equipment to support communications among the Banks' local applications, such as electronic mail. In addition, the Banks continued converting to Fednet those depository institutions using leased-line connections to the Reserve Banks. The Reserve Banks expect to complete the conversions of institutions to Fednet during 1996.

The remainder of this chapter details 1995 results in Federal Reserve Bank priced services, currency and coin operations, and fiscal agency services,

and reports on examinations, income and expenses, holdings of securities and loans, and major construction activity.

Developments in Federal Reserve Services

The Monetary Control Act of 1980 requires the Federal Reserve System to establish fees that, over the long run, recover all direct and indirect costs of providing services to depository institutions, as well as imputed costs, such as the income taxes that would have been paid and the pretax return on equity that would have been earned had the services been provided by a private firm. These imputed costs are collectively referred to as the private sector adjustment factor (PSAF).¹ Over the past ten

years, the Federal Reserve System has recovered 101.0 percent of its costs, including the PSAF.

The revenue from priced services in 1995 was \$738.8 million, other income was \$26.4 million, and costs were \$764.8 million, resulting in net revenue of \$0.4 million and a recovery rate of 100.1 percent of costs, including the PSAF but before the cumulative effect of a change in accounting principle. The one-time charge for the cumulative effect on previous years of the retroactive application of the accrual method of accounting for postemployment and vacation benefits resulted in a net loss of \$19 million.² In 1994 the System's revenue was \$14.0 million less than total costs, resulting in a recovery rate of 98.2 percent.

1. The imputed costs that are part of the PSAF are interest on debt, return on equity, income and sales taxes, and assessments for deposit insurance from the Federal Deposit Insurance Corporation. In addition, assets and personnel costs of the Board of Governors that are directly related to priced services are allocated to the Reserve Banks' priced services. In the pro forma statements at the end of this chapter, expenses of the Board of Governors are included in operating expenses, and assets of the Board are part of long-term assets.

2. See the pro forma statements at the end of this chapter. *Other income* is the revenue from investment of clearing balances net of earnings credits, an amount known as net income on clearing balances. *Total cost* is the sum of operating expenses, imputed costs (interest on debt, interest on float, sales taxes, and the Federal Deposit Insurance Corporation assessment), imputed income taxes, and the targeted return on equity. *Net revenue* is revenue plus net income on clearing balances minus total cost.

Activity in Federal Reserve Priced Services, 1995, 1994, and 1993

Thousands of items except as noted

Service	1995	1994	1993	Percentage change	
				1994-95	1993-94
Commercial checks	15,465,209	16,479,161	19,008,808	-6.2	-13.3
Funds transfers	77,742	73,611	71,199	5.6	3.4
Securities transfers	3,689	3,693	3,638	-.1	1.5
Commercial ACH	2,125,445	1,805,095	1,544,848	17.8	16.8
Noncash collection	838	643	1,020	30.3	-37.0
Cash transportation	108	98	65	10.2	50.8
Definitive safekeeping .....	...	...	17	...	-100.0

NOTE. Amounts in bold are restatements due to a change in definition (securities transfers) and an error in previously reported data (cash transportation).

Activity in *commercial checks* is defined as the total number of commercial checks collected, including both processed and fine-sort items; in *funds transfers* and *securities transfers*, the number of transactions originated on line and off line; in *ACH*, the total number of commer-

cial items processed; in *noncash collection*, the number of items on which fees are assessed; in *cash transportation*, the number of armored-carrier stops; and in *definitive safekeeping*, the average number of issues or receipts maintained. The Federal Reserve withdrew from the definitive safekeeping service in 1993.

... Not applicable.

Check Collection

Federal Reserve Bank operating expenses and imputed costs for commercial check services in 1995 totaled \$559.8 million. Revenue from check operations totaled \$553.4 million, and other income amounted to \$20.6 million, resulting in income before income taxes of \$14.2 million.³ The Reserve Banks handled 15.5 billion checks, a decrease of 6.2 percent from the volume of checks handled in 1994. The volume of checks deposited in fine-sort deposit products, requiring the depositing bank to presort items by paying bank, declined 16.5 percent; the volume of checks deposited in other deposit products declined 3.5 percent.

The Reserve Banks continued to encourage the use of electronics to improve the efficiency of check processing. During 1995 nearly 1 billion checks, or 6.5 percent of all checks presented to paying banks, were presented electronically, an increase of approximately 70 percent over the 1994 level. The Reserve Banks also continued to offer electronic information products that enable depository institutions to provide timely cash-management information to their corporate customers. During the year, several additional Reserve Banks began to accept electronic cash letters from depositing institutions. Electronic cash letters are electronic files of the detailed check listings and totals that depositors must provide with every deposit. Their use streamlines check processing and reduces costs by automating information at an earlier stage than otherwise possible. In addition, by the end of the year, most Reserve Bank offices were able to accept requests for adjustments of check

transactions via electronic transmissions from depository institutions.

During 1995 the Federal Reserve continued to implement computer software that can capture and store check images. Paying banks that use truncation or other electronic check presentment products can use imaging technology to verify signatures on checks, streamline the handling of inquiries, and provide copies of checks in customers' statements rather than physical checks. The Cleveland and Dallas Banks and the Helena Branch of the Minneapolis Bank introduced image products during 1995. The Minneapolis Bank began offering these products during 1994. In addition, the Boston Bank offers an image-enhanced notification product for return items that provides institutions with images of certain returned checks one day sooner than they would otherwise be available.

In August 1995 the Chicago Bank opened a satellite facility in Peoria, Illinois, to reduce the cost and improve the quality of its check collection service.

Funds Transfer and Net Settlement

Federal Reserve Bank operating expenses and imputed costs for Fedwire funds transfer and net settlement services totaled \$78.7 million. Revenue from Fedwire and net settlement operations totaled \$87.8 million, and other income amounted to \$2.7 million, resulting in income before income taxes of \$11.8 million.

Funds Transfer

The number of Fedwire funds transfers originated increased 5.6 percent, to 77.7 million—75.9 million value (monetary) transfers and 1.8 million nonvalue messages.

During 1995 eleven Reserve Banks completed the conversion to a new cen-

3. See the pro forma income statement for Federal Reserve priced services, by service.

tralized Fedwire funds transfer application. The New York Bank implemented the new application in its local data center. This new application is expected to improve processing throughput, reliability, and the Reserve Banks' disaster recovery capabilities.

In addition, the Reserve Banks began development efforts to modify the Fedwire funds transfer and Fedline applications to accommodate the expanded format for transfer messages approved by the Board in late 1994. Depository institutions must be able to receive funds transfers in the new format by June 1997 and to send transfers by December 1997. The expanded format will reduce manual interventions in the transfer process, eliminate the need to truncate payment-related information when forwarding payment orders through Fedwire that were received via other large-value transfer systems, and allow additional information about the originator and beneficiary of a transfer to be included in the transfer message, as required by the new Bank Secrecy Act rules adopted by the Department of the Treasury.

In August 1995 the Board approved certain modifications to its Fedwire policy on third-party access to clarify its scope and to reduce the administrative burden of several provisions. Some depository institutions have entered into arrangements in which a third party provides operating facilities for their Fedwire funds and securities transfer services. Under such arrangements, the third party's actions may result in a debit to the institution's Federal Reserve account. The policy provides important safeguards both to depository institutions participating in third-party access arrangements and to the Reserve Banks. At the time the Board clarified certain provisions of the policy, it also placed a moratorium on any arrangements

involving a service provider that is located outside the United States, pending completion of a broader supervisory review of related issues in early 1996.

Net Settlement

The Federal Reserve provides net settlement services to more than 150 local, private-sector clearing and settlement arrangements and to four such arrangements that operate nationwide. These arrangements enable participants to settle their net positions either via Fedwire funds transfers using special settlement accounts at Federal Reserve Banks or via accounting entries, which are posted to participants' Federal Reserve accounts by Federal Reserve Banks.

Two of the national arrangements, the Clearing House Interbank Payments System and the Participants Trust Company, process and net large-dollar transactions, the former for interbank funds transfers and the latter for the settlement of mortgage-backed securities transactions. The other two national arrangements, Visa ACH and the National Clearing House Association, process and net small-dollar transactions, the former for automated clearinghouse transactions and the latter for check payments. The majority of local clearing arrangements are check clearinghouses.

Book-Entry Securities

Federal Reserve Bank operating expenses and imputed costs for book-entry securities transfer services totaled \$16.4 million. Revenue from book-entry securities operations totaled \$15.4 million, and other income amounted to \$0.5 million, resulting in a net loss before income taxes of \$0.5 million. The Federal Reserve Banks processed 3.7 million transfers of government agency securities on the Fedwire book-

entry securities transfer system during the year, a 0.1 percent decrease from 1994.⁴

In August 1995 the Board approved a firm closing time of 3:15 p.m. eastern time for the origination of transfers and 3:30 p.m. eastern time for reversals, both closing times to become effective January 2, 1996. The Board believes that these new closing times will benefit market participants by reducing uncertainty about the final closing time of the system due to ad hoc operating hour extensions. Market participants, therefore, will be able to manage resources and control costs more effectively than in the past. The Federal Reserve Banks, however, still retain the flexibility to extend the closing time to facilitate the smooth functioning of the government securities market and to minimize the systemic risk that may arise due to significant operating problems at one or more depository institutions or major dealers. Extensions are granted based on established criteria with regard to the total value of unsent transfers and the amount of time required to resolve the operational problems.

Throughout 1995, development work continued on the new National Book-Entry Securities System, the centralized application that will replace the two securities applications the Reserve Banks now use. The Reserve Banks plan to convert to the new application in 1996 and 1997.

4. The revenues, expenses, and volumes reflected here are for transfers of securities issued by federal government agencies, government-sponsored enterprises, and international institutions such as the World Bank. The Fedwire securities transfer service also provides custody, transfer, and settlement services for securities of the U.S. Treasury. The Reserve Banks act as fiscal agents when they transfer Treasury securities, and the Treasury Department assesses fees for the services. See the section on fiscal agency services in this chapter for more details.

Automated Clearinghouse

Federal Reserve Bank operating expenses and imputed costs for automated clearinghouse (ACH) services totaled \$69.0 million. Revenue from ACH operations totaled \$73.4 million, and other income amounted to \$2.3 million, resulting in income before income taxes of \$6.7 million. The Reserve Banks processed 2.1 billion commercial ACH transactions during the year, an increase of 17.8 percent over 1994 volume levels.

The development of software to support ACH services in the Federal Reserve's new consolidated data processing environment was completed. The new software incorporates a flow processing concept and will provide a number of new deposit and delivery options. It will also allow customers to trace ACH transactions or files of transactions electronically, check the status of a file in process, and obtain limited information from the Federal Reserve's database on other ACH participants. The Minneapolis and Kansas City Banks began processing ACH transactions with the new software in 1995. The remaining ten Districts are expected to convert to the new software during 1996.

In August 1995 the Board requested comment on the benefits and costs of a policy to control access to the ACH service by entities other than the institution whose Federal Reserve account will be debited. The proposed controls would apply to ACH credit transactions sent by third-party processors and respondent depository institutions directly to a Reserve Bank or private ACH operator. The proposed policy is similar to the Fedwire third-party access policy and would help to ensure the safety and soundness of the ACH service.

Noncash Collection

Federal Reserve Bank operating expenses and imputed costs for noncash collection services totaled \$4.8 million. Revenue from noncash operations totaled \$3.8 million, and other income amounted to \$0.2 million, resulting in a net loss before income taxes of \$0.8 million. The number of noncash collection items (maturing coupons and bonds) processed by the Reserve Banks increased 30.3 percent, to 838 thousand items, in part because of a major commercial provider's unexpected termination of its noncash collection services.

The Reserve Banks continued to consolidate noncash operations in 1995; by year-end only two Federal Reserve sites were processing noncash items—the Cleveland Bank and the Jacksonville Branch of the Atlanta Bank. In addition, the New York and Chicago Banks continued to present noncash items payable through members of the clearinghouses located in those two cities.

Cash Services

Federal Reserve Bank operating expenses and imputed costs for cash services totaled \$5.2 million. Revenue from cash operations totaled \$5.0 million, and other income amounted to \$0.2 million, resulting in a net loss before income taxes of \$0.1 million. Special priced cash services include cash transportation, coin wrapping services, and the provision of nonstandard currency packaging and nonstandard frequency of access to services.

Float

Federal Reserve float decreased in 1995 to a daily average of \$338.8 million; it was \$479 million in 1994. The Federal Reserve recovers the cost of float associ-

ated with priced services through fees for those services.

Developments in Currency and Coin

The Federal Reserve's cost to print new currency in 1995 was \$370 million. Reserve Bank operating expenses for processing and storing currency and coin, including priced cash services, totaled \$259.6 million. The Federal Reserve supplies currency and coin to the public through approximately 10,000 depository institutions throughout the United States. The value of currency and coin in circulation increased 5 percent in 1995 and exceeded \$420 billion by year-end. During 1995, the Reserve Banks received more than 22.5 billion Federal Reserve notes in deposits from depository institutions and paid more than 23.1 billion Federal Reserve notes to depository institutions.

The Federal Reserve Banks continued converting their currency processing to the new ISS-3000 high-speed currency processing machines. At the end of 1995, 94 of these machines were in use at the Reserve Banks. The Federal Reserve plans to install a total of 132 processors and to complete the conversion in 1997.

The Federal Reserve continued to work closely with Treasury and other agencies to deter counterfeiting and laundering of U.S. currency. Circulation of the new-design \$100 notes is expected to begin during the first quarter of 1996.

Developments in Fiscal Agency Securities and Government Depository Services

The Federal Reserve Act provides that, when required by the Secretary of the Treasury, Federal Reserve Banks will

act as “fiscal agents” and “depositories” of the United States. As fiscal agents of the Department of the Treasury, Reserve Banks provide debt-related services, such as issuing, servicing, and redeeming marketable Treasury securities and U.S. savings bonds, and processing secondary market transfers initiated by depository institutions. As depositories, Reserve Banks collect and disburse funds on behalf of the federal government. The Reserve Banks also provide fiscal agency services on behalf of several domestic and international government agencies.

In 1995 the total cost of providing fiscal agency and depository services to Treasury amounted to \$265.0 million. In addition, the Reserve Banks provide services to other government agencies, such as the processing of food coupons for the Department of Agriculture. The cost of providing such services amounted to \$46.3 million in 1995.

Fiscal Agency Securities Services

The Federal Reserve Banks handle marketable Treasury securities and savings bonds and monitor collateral pledged by depository institutions to the federal government.

Marketable Treasury Securities

Reserve Bank operating expenses for activities related to marketable Treasury securities amounted to \$55.3 million. The Reserve Banks processed more than 1.2 million commercial tenders for government securities in Treasury auctions. The volume of commercial tenders decreased 7.3 percent between 1994 and 1995. Starting in 1996, processing of commercial tenders will be consolidated at the New York, Chicago, and San Francisco Banks.

The Reserve Banks operate two book-entry securities systems for the custody and transfer of Treasury securities—the Fedwire book-entry securities transfer system and Treasury Direct. Most book-entry Treasury securities, 97.4 percent of the total par value outstanding at year-end 1995, were maintained on Fedwire, and 2.6 percent of the total was maintained on Treasury Direct.

The Reserve Banks processed 9.1 million Fedwire transfers of Treasury securities, an increase of 2.5 percent over the 1994 level. In addition, the Banks processed 40.4 million interest and principal payments for both Treasury and agency securities, an increase of 6.3 percent over 1994 volume levels. Depository institutions are charged the same transaction fees for sending and receiving Fedwire book-entry securities transfers of Treasury securities as they are charged for transfers of government agency securities. A portion of the Treasury security transfer fee is retained by the Federal Reserve to cover its settlement expenses and the remainder of the fee is remitted to Treasury to cover its expenses.

The Philadelphia Bank operates Treasury Direct, a system of book-entry securities accounts for nondepository institutions and individuals planning to hold their Treasury securities to maturity. The Treasury Direct system contains more than 1.7 million accounts. During 1995 the Reserve Banks processed 1.6 million tenders from Treasury Direct customers seeking to purchase Treasury securities in Treasury auctions, and they handled 3.5 million reinvestment requests. The volume of tenders decreased 8.5 percent, and the volume of reinvestment requests decreased 17.9 percent relative to 1994. In addition, 14.6 million payments for discounts, interest, and redemption proceeds were issued to investors.

Savings Bonds

Reserve Bank operating expenses for savings bonds activities amounted to \$82.7 million. The Reserve Banks printed and mailed a total of 122 million savings bonds on behalf of Treasury's Bureau of the Public Debt, an increase of 35.9 percent over 1994 volume. The Banks processed 20 million original issue transactions. Redemption, reissue, and exchange transactions totaled 1.2 million, an increase of 32.8 percent over 1994. The Reserve Banks also responded to 3 million service calls from owners of savings bonds this year, an increase of 30.4 percent relative to 1994 volume.

The Reserve Banks completed their consolidation of savings bond operations from twenty-five sites to five sites (Buffalo, Pittsburgh, Richmond, Minneapolis, and Kansas City) during 1995. All of these sites process savings bond transactions; only the Pittsburgh and Kansas City sites print savings bonds.

Other Initiatives

The Reserve Banks monitor collateral pledged by depository institutions that hold Treasury deposits, such as Treasury tax and loan account balances, and other government agency deposits. To ensure that the value of collateral pledged is adequate, the Reserve Banks began marking to market all physical securities (including more thinly traded instruments) pledged as collateral. The Reserve Banks plan to mark book-entry securities to market following completion of the conversion to the National Book-Entry System.

The Federal Reserve also worked with Treasury's Financial Management Service to implement a Treasury Offset Program on a pilot basis. This program electronically compares information about delinquent debts owed to the U.S.

government with information about payments being issued. If a match occurs, the program applies the payment to the delinquent debt.

Depository Services

The Reserve Banks maintain Treasury's checking account, accept deposits of federal taxes and fees, pay checks drawn on Treasury's account, and make electronic payments on behalf of the Treasury.

Federal Tax Payments

Reserve Bank operating expenses for federal tax payment activities were \$35.8 million. The Reserve Banks processed 12.7 million advices of credit from depository institutions accepting tax deposits from businesses and individuals. The Reserve Banks also received a small portion of tax payments directly, representing about 1 percent of the total value. Depository institutions that receive tax payments may place the funds in a Treasury tax and loan account, or remit the funds to a Reserve Bank.

The Reserve Banks continued working with Treasury to automate the flow of federal tax deposits (business tax payments) as part of Treasury's Electronic Federal Tax Payment System (EFTPS). Tax payments made via EFTPS flow to Treasury one day sooner than they do under the paper-based process, improving its investment opportunities and enabling it to manage its cash flows more efficiently. The Reserve Banks have developed and implemented new payment mechanisms for use by taxpayers that must send their payments on the same day their tax liability is established. The Reserve Banks also have supported Treasury's financial agents in

developing ACH tax payment mechanisms for EFTPS.

Payments Processed for Treasury

Operating expenses for government payment operations amounted to \$50.8 million. During the year, Treasury continued to increase the proportion of its payments made electronically. The volume of ACH transactions processed for Treasury amounted to 598.9 million, an increase of 4.3 percent over the 1994 level. The majority of government payments made via the ACH are for social security, pensions, and salaries. Treasury also uses the ACH to make vendor payments and has begun to experiment with using financial electronic data interchange for those payments.

The Reserve Banks processed 460 million government checks, a decrease of 2.1 percent from the 1994 level. The Reserve Banks also issued fiscal agency checks, which are used primarily to pay semiannual interest on registered, definitive Treasury notes and bonds and Series H and HH savings bonds. They are also used to pay the principal of matured securities and coupons and discounts to first-time purchasers of government securities through Treasury Direct. All recurring Treasury Direct payments and many definitive securities interest payments are made via the ACH.

During 1995 the Federal Reserve worked with Treasury to develop FedSelect checks, which will be introduced in 1996. FedSelect checks permit Treasury to guard against fraud by comparing checks presented for payment against information about checks issued by selected government agencies. The Chicago Reserve Bank will be the paying bank for FedSelect checks.

In September 1995 the Board of Governors approved a proposal from the

Reserve Banks to develop a system to capture and archive high-quality electronic images of government checks. The system, which is being developed at the request of Treasury, will enhance the truncation services the Reserve Banks provide to Treasury and improve their ability to research inquiries. The system will be implemented over several years, beginning in 1996.

Services Provided to Other Entities

When required to do so by the Secretary of the Treasury or when required or permitted to do so by federal statute, the Reserve Banks perform fiscal agency securities services and depository services for other domestic and international agencies. Depending on the authority under which services are provided, the Reserve Banks may (1) facilitate the issuance of government agency book-entry securities that are eligible to be transferred over Fedwire,⁵ (2) provide custody of the stock of unissued, definitive securities, (3) maintain and update balances of outstanding book-entry and definitive securities for issuers, (4) perform various other securities servicing activities, and (5) maintain funds accounts for some government agencies.

Food Coupons

Reserve Bank operating expenses for food coupon services were \$24.5 million in 1995. The Reserve Banks redeemed 4.0 billion food coupons, a decrease of 6.5 percent from 1994.

5. Unlike Treasury securities, agency securities cannot be purchased directly from a Federal Reserve Bank. The issuers generally rely on syndicates of securities dealers, including some commercial banks, to distribute original issues. As part of this process, the Federal Reserve facilitates the issuance of securities, through Fedwire, from the issuer to the syndicate members on original issue.

The Federal Reserve is assisting the Departments of Agriculture and the Treasury in their efforts to replace paper food coupons with an electronic benefit transfer system by developing settlement and reconciliation services.

Examinations

Section 21 of the Federal Reserve Act requires the Board of Governors to order an examination of each Federal Reserve Bank at least once per year, and the Board assigns this responsibility to its Division of Reserve Bank Operations and Payment Systems. The division engaged a public accounting firm to audit the year-end financial statements of two or three Reserve Banks each year in addition to the combined financial statements of the Reserve Banks beginning in 1995. In 1995 the year-end financial statements of the Atlanta and St. Louis Reserve Banks were audited by the public accounting firm, and the year-end financial statements of the other ten Banks were audited by the division.

To assess compliance with the policies established by the Federal Open Market Committee (FOMC), the division also annually audits the accounts and holdings of the System Open Market Account (SOMA) at the Federal Reserve Bank of New York and the foreign currency operations conducted by the Bank. The public accounting firm auditing the financial statements of the Banks certifies the balance sheet for SOMA, for System foreign currency operations, and for the foreign currency accounts distributed among the twelve Reserve Banks. Division personnel follow up on the audit results. Copies of the external audit reports are furnished to the FOMC as are reports on the division's follow-up.

Income and Expenses

The accompanying table summarizes the income, expenses and distribution of net earnings of the Federal Reserve Banks for 1995 and 1994.

Income was \$25,395 million in 1995 and \$20,911 million in 1994. Total ex-

Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1995 and 1994

Millions of dollars

Item	1995	1994
Current income	25,395	20,911
Current expenses	1,818	1,796
Operating expenses ¹	1,568	1,572
Earnings credits granted	251	224
Current net income	23,577	19,115
Net addition to (deduction from, -) current net income	896	2,398
Cost of unreimbursed services to Treasury	38	34
Assessments by the Board of Governors	531	515
For expenditures of Board	161	147
For cost of currency	370	368
Net income before payments to Treasury	23,903	20,964
Dividends paid	231	212
Transferred to surplus	283	282
Payments to Treasury (interest on Federal Reserve notes)	23,389	20,470

NOTE. Components may not sum to totals because of rounding.

1. Includes a net periodic credit for pension costs of \$119.2 million in 1995 and \$75.6 million in 1994.

penses were \$1,980 million (\$1,568 million in operating expenses, \$251 million in earnings credits granted to depository institutions, and \$161 million in assessments for expenditures by the Board of Governors). The cost of new currency was \$370 million. Revenue from financial services was \$739 million. Unreimbursed expenses for services provided to Treasury amounted to \$38 million.⁶

The profit and loss account showed a net profit of \$896 million. The profit was primarily a result of realized and unrealized gains on assets denominated in foreign currencies. Statutory dividends to member banks totaled \$231 million, \$19 million more than in 1994. 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 Treasury in the form of interest on Federal Reserve notes totaled \$23,389 million, up from \$20,470 mil-

lion in 1994. 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 chapter of this REPORT, table 6 details income and expenses of each Federal Reserve Bank for 1995, and table 7 shows a condensed statement for each Bank for 1914–95. A detailed account of the assessments and expenditures of the Board of Governors appears in the next chapter—Board of Governors Financial Statements.

Holdings of Securities and Loans

Average daily holdings of securities and loans during 1995 were \$376,069 million, an increase of \$22,068 million from 1994 (see accompanying table). From 1994 to 1995, holdings of U.S. government securities increased \$22,127 million, and loans decreased \$59 million.

Also during 1995, the average rate of interest increased from 5.44 percent to 6.34 percent on holdings of U.S. government securities and increased from 4.39 percent to 5.62 percent on loans.

6. Fiscal agency and depository services are not part of priced services (see note 4). The Reserve Banks bill Treasury for the cost of certain services, and the portions of the bills that are not paid are reported as unreimbursed expenses.

Securities and Loans of Federal Reserve Banks, 1993–95

Millions of dollars except as noted

Item and year	Total	U.S. government securities ¹	Loans ²
<i>Average daily holdings³</i>			
1993	320,528	320,347	181
1994	354,001	353,740	261
1995	376,069	375,867	202
<i>Earnings</i>			
1993	16,896	16,891	6
1994	19,259	19,247	11
1995	23,837	23,826	11
<i>Average interest rate (percent)</i>			
1993	5.27	5.27	3.08
1994	5.44	5.44	4.39
1995	6.34	6.34	5.62

1. Includes federal agency obligations.

2. Does not include indebtedness assumed by the Federal Deposit Insurance Corporation.

3. Based on holdings at opening of business.

Volume of Operations

Table 9, in the Statistical Tables chapter, shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1992 through 1995.

Federal Reserve Bank Premises

Construction continued in 1995 on the new headquarters building for the Minneapolis Bank and the expansion and renovation of the headquarters building of the Cleveland Bank.

The Board approved new building programs for the Atlanta Bank's headquarters building and its Birmingham

Branch. Subsequently, the Atlanta Bank purchased property for the new building and retained design consultants for the Birmingham project.

Multiyear renovation programs continued for the New York Bank's headquarters building, the Kansas City Bank's Oklahoma City Branch, and the San Francisco Bank's Seattle, Portland, and Salt Lake City Branches. Renovation projects for the cash departments at several Reserve Banks continued in preparation for installation of new currency-processing equipment.

The Dallas Bank sold its old headquarters building. The Chicago Bank leased a new satellite check processing facility in Peoria, Illinois.

Pro Forma Financial Statements for Federal Reserve Priced Services

Pro Forma Balance Sheet for Priced Services, December 31, 1995, and 1994

Millions of dollars

Item	1995	1994
<i>Short-term assets (Note 1)</i>		
Imputed reserve requirement on clearing balances	504.2	400.3
Investment in marketable securities ..	4,537.8	3,602.7
Receivables	63.7	60.6
Materials and supplies	10.6	10.2
Prepaid expenses	19.4	15.5
Items in process of collection	<u>2,397.4</u>	<u>2,316.7</u>
Total short-term assets	7,533.1	6,406.0
<i>Long-term assets (Note 2)</i>		
Premises	356.6	377.6
Furniture and equipment	170.3	168.4
Leases and leasehold improvements ..	24.2	8.6
Prepaid pension costs	<u>242.1</u>	<u>205.4</u>
Total long-term assets	<u>793.1</u>	<u>760.0</u>
Total assets	8,326.2	7,166.0
<i>Short-term liabilities</i>		
Clearing balances and balances arising from early credit of uncollected items	5,154.8	4,133.1
Deferred-availability items	2,284.5	2,186.6
Short-term debt	<u>93.7</u>	<u>86.3</u>
Total short-term liabilities	7,533.1	6,406.0
<i>Long-term liabilities</i>		
Obligations under capital leases	3.8	.6
Long-term debt	164.3	170.5
Accrued benefits cost	<u>176.1</u>	<u>140.5</u>
Total long-term liabilities	<u>344.3</u>	<u>311.6</u>
Total liabilities	7,877.4	6,717.6
Equity	<u>448.8</u>	<u>448.4</u>
Total liabilities and equity (Note 3) ..	8,326.2	7,166.0

NOTE. Components may not sum to totals because of rounding.

The priced services financial statements consist of these tables and the accompanying notes.

Pro Forma Income Statement for Federal Reserve Priced Services, 1995 and 1994

Millions of dollars

Item	1995	1994
Revenue from services provided to depository institutions (Note 4)	738.8	734.4
Operating expenses (Note 5)	<u>655.2</u>	<u>693.0</u>
Income from operations	83.6	41.4
Imputed costs (Note 6)		
Interest on float	19.0	18.6
Interest on debt	16.2	18.9
Sales taxes	22.1	10.8
FDIC insurance	<u>6.3</u>	<u>15.8</u>
Income from operations after imputed costs	19.9	-22.7
Other income and expenses (Note 7)		
Investment income on clearing balances ...	259.6	241.2
Earnings credits	<u>-233.2</u>	<u>208.4</u>
Income before income taxes	46.3	10.1
Imputed income taxes (Note 8)	<u>14.4</u>	<u>3.1</u>
Income before cumulative effect of a change in accounting principle	31.9	7.0
Cumulative effect on previous years from retroactive application of accrual method of accounting for postemployment and vacation benefits net of \$8.7 million tax) (Note 9)	<u>19.4</u>	<u>...</u>
Net income (Note 10)	<u>12.6</u>	<u>7.0</u>
MEMO: Targeted return on equity (Note 11) ..	31.5	21.0

NOTE. Components may not sum to totals because of rounding.

The priced services financial statements consist of these tables and the accompanying notes.

Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 1995

Millions of dollars

Item	Total	Com- mercial check collection	Funds transfer and net settlement	Book- entry securities	Com- mercial ACH	Noncash collection	Cash services
Revenue from operations	738.8	553.4	87.8	15.4	73.4	3.8	5.0
Operating expenses (Note 5)	<u>655.2</u>	<u>507.4</u>	<u>73.8</u>	<u>15.3</u>	<u>64.5</u>	<u>4.1</u>	<u>5.1</u>
Income from operations	83.6	46.0	14.0	.1	8.9	-2	-.1
Imputed costs (Note 6)	<u>63.7</u>	<u>52.4</u>	<u>4.9</u>	<u>1.1</u>	<u>4.5</u>	<u>.7</u>	<u>.1</u>
Income from operations after imputed costs	19.9	-6.5	9.1	-1.0	4.4	-1.0	-.2
Other income and expenses, net (Note 7)	<u>26.4</u>	<u>20.6</u>	<u>2.7</u>	<u>.5</u>	<u>2.3</u>	<u>.2</u>	<u>.2</u>
Income before income taxes ..	46.3	14.2	11.8	-.5	6.7	-.8	-.1

NOTE. Components may not sum to totals because of rounding.

The priced services financial statements consist of these tables and the accompanying notes.

FEDERAL RESERVE BANKS

NOTES TO FINANCIAL STATEMENTS FOR PRICED SERVICES

(1) SHORT-TERM ASSETS

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 is gross Federal Reserve cash items in process of collection (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; adjustments for items associated with non-priced items, such as those collected for government agencies; and adjustments 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 the cost 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.

(2) LONG-TERM ASSETS

Consists of 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 the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87). Accordingly, the Reserve Banks recognized credits to expenses of \$35.4 million in 1995 and \$20.1 million in 1994 and corresponding increases in this asset account.

(3) LIABILITIES AND EQUITY

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 fifty 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 accrued postemployment (see note 9) and postretirement benefits costs and obligations on capital leases.

(4) REVENUE

Revenue represents charges to depository institutions for priced services and is realized from each institution through one of two methods: direct charges to an institution's account or charges against its accumulated earnings credits.

(5) OPERATING EXPENSES

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services plus the expenses for staff members of the Board of Governors working directly on the development of priced services. The expenses for Board staff members were \$2.7 million in 1995 as well as in 1994. The credit to expenses under SFAS 87 (see note 2) is reflected in operating expenses.

The income statement by service reflects revenue, operating expenses, and imputed costs except for income taxes. Total operating expense does not equal the sum of operating expenses for each service because of the effect of SFAS 87. Although the portion of the SFAS 87 credit related to the current year is allocated to individual services, the amortization of the initial effect of implementation is reflected only at the System level.

(6) IMPUTED COSTS

Imputed costs consist of interest on float, interest on debt, sales taxes, and the FDIC assessment. 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 costs for checks, book-entry securities, noncash collection, ACH, and funds transfers.

Interest is imputed on the debt assumed necessary to finance priced-service assets. The sales taxes and FDIC assessment that the Federal Reserve would have paid had it been a private-sector firm are among the components of the PSAF (see note 3).

Float costs are based on the actual float incurred for each priced service. Other imputed costs are allocated among priced services according to the ratio of operating expenses less shipping expenses for each service to the total expenses for all services less the total shipping expenses for all services.

The following list shows the daily average recovery of float by the Reserve Banks for 1995 in millions of dollars:

Total float	602.0
Unrecovered float	14.0
Float subject to recovery	588.0
Sources of recovery of float	
Income on clearing balances	58.5
As-of adjustments	243.2
Direct charges	108.4
Per-item fees	157.9

Unrecovered float includes float generated by services to government agencies and 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 requirements. The income on clearing balances reduces the float to be recovered through other means. As-of adjustments and direct charges are mid-week 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 1995.

(7) OTHER INCOME AND EXPENSES

Consists of investment income on clearing balances and the cost of earnings credits. Investment income on clearing balances 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.

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 each service's ratio of income to total income.

(8) INCOME TAXES

Imputed income taxes are calculated at the effective tax rate derived from the PSAF model (see note 3). Taxes have not been allocated by service because they relate to the organization as a whole.

(9) POSTEMPLOYMENT AND VACATION BENEFITS

Effective Jan. 1, 1995, the Reserve Banks implemented SFAS 112, *Employers' Accounting for Postemployment Benefits*, and SFAS 43, *Accounting for Compensated Absences*. Accordingly, in 1995 the Reserve Banks recognized a one-time cumulative charge of \$28.1 million to reflect the retroactive application of these changes in accounting principles.

(10) ADJUSTMENTS TO NET INCOME FOR PRICE SETTING

In setting fees, certain costs are excluded in accordance with the System's overage and shortfalls policy and its automation consolidation policy. Accordingly, to compare the financial results reported in this table with the projections used to set prices, adjust net income as follows (amounts shown are net of tax):

	1995	1994
Net income	12.6	7.0
Amortization of the initial effect of implementing SFAS 87	-10.4	-10.5
Deferred costs of automation consolidation	-.1	13.6
Cumulative effect of retroactive application of SFAS 112 and SFAS 43	19.4	...
Adjusted net income	21.5	10.1

(11) RETURN ON EQUITY

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 (see note 3). This amount is adjusted to reflect the recovery of \$0.1 million of automation consolidation costs for 1995 and the deferral of \$13.6 million of such costs for 1994. The Reserve Banks plan to recover these amounts, along with a finance charge, by the end of the year 2001. After-tax return on equity has not been allocated by service because it relates to the organization as a whole.

Board of Governors Financial Statements

The financial statements of the Board were audited by Price Waterhouse, independent public accountants, for 1995 and 1994.

Price Waterhouse LLP



REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of the
Federal Reserve System

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the Board) as of December 31, 1995 and 1994, and the related statements of revenues and expenses and fund balance and of cash flows for the years 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 audits.

We conducted our audits in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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 as of December 31, 1995 and 1994, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Notes 1 and 3 to the financial statements, the Board implemented Statement of Financial Accounting Standards No. 112, *Employers' Accounting for Postemployment Benefits*, effective January 1, 1994.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 25, 1996 on our consideration of the Board's internal control structure and a report dated March 25, 1996 on its compliance with laws and regulations.

Price Waterhouse LLP

March 25, 1996
Arlington, Virginia

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
BALANCE SHEET

	As of December 31,	
	1995	1994
ASSETS		
CURRENT ASSETS		
Cash	\$16,142,195	\$14,949,285
Accounts receivable	1,900,155	1,898,061
Prepaid expenses and other assets	1,225,022	1,665,345
Total current assets	19,267,372	18,512,691
PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 4)	59,781,623	54,839,623
Total assets	<u>\$79,048,995</u>	<u>\$73,352,314</u>
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable	\$ 7,580,371	\$ 5,450,877
Accrued payroll and related taxes	4,868,497	3,920,065
Accrued annual leave	6,601,004	6,223,919
Capital lease payable (current portion)	75,840	3,119,522
Unearned revenues and other liabilities	2,184,882	1,852,614
Total current liabilities	21,310,594	20,566,997
CAPITAL LEASE PAYABLE (non-current portion)	232,638	303,358
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3)	17,074,588	16,274,446
ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 3)	1,093,400	1,320,018
FUND BALANCE	39,337,775	34,887,495
Total liabilities and fund balance	<u>\$79,048,995</u>	<u>\$73,352,314</u>

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF REVENUES AND EXPENSES
AND FUND BALANCE

	For the years ended December 31,	
	1995	1994
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures.....	\$161,347,900	\$146,866,100
Other revenues (Note 5).....	10,240,830	9,134,248
Total operating revenues	171,588,730	156,000,348
BOARD OPERATING EXPENSES		
Salaries	100,412,576	93,823,248
Retirement and insurance contributions.....	16,394,955	16,147,049
Contractual services and professional fees	11,240,373	7,426,406
Depreciation and net losses on disposals.....	7,525,971	7,081,892
Travel	4,920,996	4,774,914
Postage and supplies	4,523,272	4,163,095
Utilities	4,155,038	4,158,650
Repairs and maintenance	3,689,603	3,794,986
Equipment and facilities rental.....	3,853,657	3,348,643
Software	3,362,342	3,017,536
Printing and binding	3,144,178	2,697,789
Other expenses (Note 5).....	3,915,489	3,423,987
Total operating expenses	167,138,450	153,858,195
BOARD OPERATING REVENUES OVER EXPENSES	4,450,280	2,142,153
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	370,206,037	368,187,989
Expenses for currency printing, issuance, retirement, and shipping	370,206,037	368,187,989
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	—	—
TOTAL REVENUES OVER EXPENSES BEFORE EFFECT OF CHANGES IN ACCOUNTING		
	4,450,280	2,142,153
Less: Effect on prior years (to December 31, 1993) of change in accounting for postemployment benefits (Note 3).....	—	965,000
TOTAL REVENUES OVER EXPENSES	4,450,280	1,177,153
FUND BALANCE, Beginning of year.....	34,887,495	33,710,342
FUND BALANCE, End of year.....	\$ 39,337,775	\$ 34,887,495

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF CASH FLOWS

Increase (Decrease) in Cash

	For the years ended December 31,	
	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES		
Board operating revenues over expenses	\$ 4,450,280	\$1,177,153
Adjustments to reconcile operating revenues over expenses to net cash provided by operating activities:		
Effect of change in accounting for postemployment benefits	—	965,000
Depreciation and net losses on disposals	7,525,971	7,081,892
Increase in accrued postretirement benefits	800,142	393,704
(Decrease) increase in accrued postemployment benefits	(226,618)	355,018
Decrease (increase) in accounts receivable, and prepaid expenses and other assets	438,229	(877,486)
Increase in accrued annual leave	377,085	352,276
Increase in accounts payable	2,129,494	142,701
Increase in payroll payable	948,432	1,201,553
Increase in unearned revenue and other liabilities	332,268	347,951
Net cash provided by operating activities	<u>16,775,283</u>	<u>11,139,762</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals of furniture and equipment	12,112	27,081
Capital expenditures	(15,594,485)	(8,404,272)
Net cash used in investing activities	<u>(15,582,373)</u>	<u>(8,377,191)</u>
NET INCREASE IN CASH	1,192,910	2,762,571
CASH BALANCE, Beginning of year	<u>14,949,285</u>	<u>12,186,714</u>
CASH BALANCE, End of year	<u>\$16,142,195</u>	<u>\$14,949,285</u>

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

(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 costs 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 4 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.

Accounting Changes—Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, *Employers' Accounting for Postemployment Benefits* (FAS 112). Under this accounting method, the Board records the cost of these benefits during the employee's years of service rather than the previous pay-as-you-go method.

(2) RETIREMENT BENEFITS

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System 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. Contributions to the System's Plan are actuarially determined and funded by participating employers at amounts prescribed by the Plan's administrator. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 1995 and 1994, and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions. The Board is not accountable for the assets of this plan.

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The Board matches employee contributions to these plans. These defined benefits plans are administered by the Office of Personnel Management. The Board's contributions to these plans totaled \$802,200 and \$838,800 in 1995 and 1994 respectively. The Board has no liability

for future payments to retirees under these programs, and it is not accountable for the assets of the plans.

(3) OTHER BENEFIT PLANS

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 \$4,320,400 in 1995 and \$3,969,700 in 1994.

The Board also provides certain defined benefit health and life insurance for its active employees and retirees under Federal and Board sponsored programs. The net periodic postretirement benefit cost for 1995 and 1994 included the following components:

	1995	1994
Service cost (benefits attributed to employee services during the year)	\$ 418,649	\$ 260,677
Interest cost on accumulated postretirement benefit obligation	1,441,350	1,191,213
Amortization of gains and losses	(80)	6,542
Net periodic postretirement benefit cost	<u>\$1,859,919</u>	<u>\$1,458,432</u>

Although postretirement benefits are recorded using the accrual basis of accounting in accordance with FAS 106, the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The FAS 106 accumulated postretirement benefit obligation at December 31, 1995 and 1994, is comprised of:

	1995	1994
Retirees	\$11,455,617	\$11,301,461
Fully eligible active plan participants	2,947,889	2,419,656
Other active plan participants	3,510,808	4,392,114
	17,914,314	18,113,231
Unrecognized net loss	(839,726)	(1,838,785)
Liability for accumulated postretirement benefit obligation	<u>\$17,074,588</u>	<u>\$16,274,446</u>

The liability for the accumulated postretirement benefit obligation and the net periodic benefit cost was determined using an 8.75-percent discount rate. Unrecognized losses of \$839,726 result from larger than estimated 1995 and 1994 cash outlays. Under FAS 106, the Board may have to record some of these unrecognized losses in operations in future years. The assumed health care cost trend rate for measuring the increase in costs from 1995 to 1996 was 10.0 percent. These rates were assumed to gradually decline to an ultimate rate of 6.5 percent in the year 2004 for the purpose of calculating the December 31, 1995, accumulated postretirement benefit obliga-

tion. The effect of a 1-percent increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation by \$2,493,223 at December 31, 1995, and the net periodic benefit cost by \$253,220 for the year. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 5.5 percent.

The above accumulated postretirement benefit obligation is related to the Board sponsored health benefits and life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored programs upon retiring. Contributions for active employees participating in federally sponsored programs totaled \$3,477,300 and \$3,510,500 in 1995 and 1994 respectively.

The Board provides certain postemployment benefits to eligible employees after employment but before retirement. Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, Employers' Accounting for Postemployment Benefits (FAS 112), which requires that employers providing postemployment benefits to their employees accrue the cost of such benefits. Prior to January 1994, postemployment benefit expenses were recognized on a pay-as-you-go basis. A one-time charge for the adoption of FAS 112 of \$965,000 was recognized as the cumulative effect of a change in accounting principle in 1994.

(4) 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,	
	1995	1994
Land and improvements ...	\$ 1,301,314	\$ 1,301,314
Buildings	65,298,136	65,171,774
Furniture and equipment	52,215,976	45,742,097
	<u>118,815,426</u>	<u>112,215,185</u>
Less accumulated depreciation	59,033,803	57,375,562
Total property, buildings and equipment	<u>\$ 59,781,623</u>	<u>\$ 54,839,623</u>

(5) OTHER REVENUES AND OTHER EXPENSES

The following are summaries of the components of Other Revenues and Other Expenses.

	For the years ended December 31,	
	1995	1994
Other Revenues		
Data processing revenue	\$ 4,100,517	\$4,058,655
National Information Center	2,070,267	2,031,876
Subscription revenue	1,648,931	1,547,628
Reimbursable services to other agencies ..	383,752	441,316
Miscellaneous	<u>2,037,363</u>	<u>1,054,773</u>
Total other revenues	<u>\$10,240,830</u>	<u>\$9,134,248</u>
Other Expenses		
Tuition, registration, and membership fees	\$ 1,413,233	\$1,116,155
Cafeteria operations, net	788,506	708,394
Subsidies and contributions ...	755,857	676,989
Miscellaneous	<u>957,893</u>	<u>922,449</u>
Total other expenses	<u>\$ 3,915,489</u>	<u>\$3,423,987</u>

(6) COMMITMENTS

The Board has entered into several operating leases to secure office, training, and warehouse space for periods ranging from two to ten years and, in December 1994, a capital lease for a new mainframe computer. Minimum future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1995, are as follows:

	Operating	Capital
1996	3,672,449	75,840
1997	3,666,027	75,840
1998	3,720,255	75,840
1999	3,702,391	80,958
after 1999	<u>21,136,430</u>	<u>—</u>
	<u>\$35,897,552</u>	<u>\$308,478</u>

Rental expenses under the operating leases were \$3,301,186 and \$2,987,500 in 1995 and 1994 respectively.

(7) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1995 and 1994, the Board paid \$269,040 and \$197,200 respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1995 and 1994. During 1995 and 1994, the Board paid \$126,900 and \$125,900 respectively, for office space subleased from the Council. ■

Statistical Tables

1. Detailed Statement of Condition of All Federal Reserve Banks Combined,
December 31, 1995

Thousands of dollars

ASSETS			
Gold certificate account			11,050,060
Special drawing rights certificate account			10,168,000
Coin			424,452
<i>Loans and securities</i>			
Loans to depository institutions		135,440	
Federal agency obligations			
Bought outright		2,633,995	
Held under repurchase agreement		1,100,000	
U.S. Treasury securities			
Bought outright			
Bills	183,115,712		
Notes	151,013,150		
Bonds	44,068,604		
Total bought outright		378,197,466	
Held under repurchase agreement		12,762,000	
Total securities			390,959,466
Total loans and securities			394,828,901
<i>Items in process of collection</i>			
Transit items		4,179,015	
Other items in process of collection		1,101,279	
Total items in process of collection			5,280,294
<i>Bank premises</i>			
Land		166,903	
Buildings (including vaults)	882,954		
Building machinery and equipment	230,523		
Construction account	128,934		
Total bank premises		1,242,411	
Less depreciation allowance		283,562	958,849
Bank premises, net			1,125,753
<i>Other assets</i>			
Furniture and equipment		1,192,205	
Less depreciation		671,613	
Total furniture and equipment, net			520,592
Denominated in foreign currencies ¹		21,099,289	
Interest accrued		4,101,149	
Premium on securities		5,410,827	
Overdrafts		22,920	
Prepaid expenses		865,525	
Suspense account		13,398	
Real estate acquired for banking-house purposes		11,507	
Other		312,533	
Total other assets			32,357,740
Total assets			455,235,200

1.—Continued

LIABILITIES	
<i>Federal Reserve Notes</i>	
Outstanding (issued to Federal Reserve Banks)	481,044,070
Less held by Federal Reserve Banks	<u>-80,108,642</u>
Total Federal Reserve notes, net	400,935,428
<i>Deposits</i>	
Depository institutions	29,611,156
U.S. Treasury, general account	5,979,193
Foreign, official accounts	386,182
<i>Other deposits</i>	
Officers' and certified checks	25,622
International organizations	114,289
Other ²	<u>794,904</u>
Total other deposits	934,815
Deferred credit items	5,049,121
<i>Other liabilities</i>	
Discount on securities	3,613,735
Sundry items payable	95,718
Suspense account	15,153
All other	<u>682,621</u>
Total other liabilities	4,407,226
Total liabilities	447,303,121
CAPITAL ACCOUNTS	
Capital paid in	3,966,402
Surplus	3,966,402
Other capital accounts ³	0
Total liabilities and capital accounts	455,235,925

NOTE. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.

1. Of this amount \$7,316.6 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.

2. 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.

3. During the year, includes undistributed net income, which is closed out on December 31.

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1995 and 1994

Millions of dollars

Item	Total		Boston	
	1995	1994	1995	1994
ASSETS				
Gold certificate account.....	11,050	11,051	575	553
Special drawing rights certificate account.....	10,168	8,018	511	511
Coin.....	424	320	17	15
<i>Loans</i>				
To depository institutions.....	135	223	6	6
Other.....	0	0	0	0
Acceptances held under repurchase agreements.....	0	0	0	0
<i>Federal agency obligations</i>				
Bought outright.....	2,634	3,637	130	190
Held under repurchase agreements.....	1,100	1,025	0	0
<i>U.S. Treasury securities</i>				
Bought outright ¹	378,197	364,519	18,600	19,082
Held under repurchase agreements.....	12,762	9,565	0	0
Total loans and securities.....	394,829	378,969	18,736	19,278
Items in process of collection.....	5,280	5,199	299	293
Bank premises.....	1,126	1,076	94	93
<i>Other assets</i>				
Denominated in foreign currencies ²	21,099	22,031	799	797
All other.....	11,258	10,231	459	450
Interdistrict Settlement Account.....	0	0	7,063	-2,202
Total assets.....	455,235	436,896	28,552	19,788
LIABILITIES				
Federal Reserve notes.....	400,935	381,505	26,175	17,747
<i>Deposits</i>				
Depository institutions.....	29,611	30,789	1,414	1,214
U.S. Treasury, general account.....	5,979	7,161	0	0
Foreign, official accounts.....	386	250	5	5
Other.....	935	774	33	31
Total deposits.....	36,911	38,973	1,452	1,250
Deferred credit items.....	5,049	4,459	359	284
Other liabilities and accrued dividends ³	4,407	4,592	225	228
Total liabilities.....	447,302	429,529	28,211	19,509
CAPITAL ACCOUNTS				
Capital paid in.....	3,966	3,683	171	139
Surplus.....	3,966	3,683	171	139
Other capital accounts.....	0	0	0	0
Total liabilities and capital accounts.....	455,235	436,896	28,552	19,788
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank).....	481,044	454,642	31,502	22,868
Less: Held by Bank.....	80,109	73,137	5,327	5,121
Federal Reserve notes, net.....	400,935	381,505	26,175	17,747
<i>Collateral for Federal Reserve notes</i>				
Gold certificate account.....	11,050	11,051	...	...
Special drawing rights certificate account.....	10,168	8,018	...	...
Other eligible assets.....	0	0	...	...
U.S. Treasury and federal agency securities.....	379,717	362,437	...	...

2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1995	1994	1995	1994	1995	1994	1995	1994
4,273	4,134	433	393	621	660	862	902
3,903	2,808	413	303	584	556	790	652
20	19	26	19	24	17	71	56
0	0	1	17	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
1,047	1,344	114	142	152	229	202	291
1,100	1,025	0	0	0	0	0	0
150,316	134,693	16,408	14,256	21,802	22,978	29,047	29,138
12,762	9,565	0	0	0	0	0	0
165,225	146,627	16,523	14,416	21,954	23,207	29,249	29,428
764	649	254	332	265	269	552	392
146	137	49	47	66	46	127	134
5,654	6,267	923	737	1,476	1,449	1,698	1,481
5,378	4,160	413	353	524	529	907	902
-26,517	5,853	-237	2,232	220	-1,332	3,822	-867
158,846	170,653	18,797	18,833	25,734	25,400	38,077	33,080
139,004	151,608	16,223	16,733	23,524	22,542	34,912	28,847
8,658	7,105	1,702	1,491	1,161	1,814	1,555	2,782
5,979	7,161	0	0	0	0	0	0
283	149	6	5	10	9	11	9
433	261	29	26	40	41	86	70
15,353	14,677	1,737	1,523	1,211	1,864	1,652	2,862
734	551	251	32	232	222	592	447
1,642	1,843	206	183	250	257	338	332
156,733	168,678	18,416	18,511	25,217	24,885	37,494	32,487
1,057	988	190	161	259	258	292	296
1,057	988	190	161	259	258	292	296
0	0	0	0	0	0	0	0
158,846	170,653	18,797	18,833	25,734	25,400	38,077	33,080
167,545	174,495	19,585	18,463	26,869	26,124	41,346	35,331
28,541	22,888	3,362	1,690	3,344	3,581	6,435	6,484
139,004	151,608	16,223	16,773	23,524	22,542	34,912	28,847
...
...
...
...

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1995 and 1994—Continued

Millions of dollars

Item	Atlanta		Chicago	
	1995	1994	1995	1994
ASSETS				
Gold certificate account.....	556	542	1,220	1,217
Special drawing rights certificate account.....	523	318	1,079	1,036
Coin.....	66	46	35	23
<i>Loans</i>				
To depository institutions.....	9	28	1	18
Other.....	0	0	0	0
Acceptances held under repurchase agreements.....	0	0	0	0
<i>Federal agency obligations</i>				
Bought outright.....	122	163	304	417
Held under repurchase agreements.....	0	0	0	0
<i>U.S. Treasury securities</i>				
Bought outright ¹	17,558	16,293	43,602	41,758
Held under repurchase agreements.....	0	0	0	0
Total loans and securities.....	17,689	16,484	43,906	42,193
Items in process of collection.....	688	753	519	509
Bank premises.....	77	64	110	112
<i>Other assets</i>				
Denominated in foreign currencies ²	1,954	2,073	2,401	2,527
All other.....	460	423	1,119	1,069
Interdistrict Settlement Account.....	13,362	1,871	-3,016	-1,048
Total assets.....	35,375	22,573	47,374	47,638
LIABILITIES				
Federal Reserve notes.....	31,186	18,053	41,758	42,265
<i>Deposits</i>				
Depository institutions.....	2,481	3,018	3,539	3,397
U.S. Treasury, general account.....	0	0	0	0
Foreign, official accounts.....	13	13	16	16
Other.....	21	29	160	148
Total deposits.....	2,515	3,060	3,716	3,561
Deferred credit items.....	660	561	463	496
Other liabilities and accrued dividends ³	236	217	492	479
Total liabilities.....	34,597	21,891	46,428	46,800
CAPITAL ACCOUNTS				
Capital paid in.....	389	341	473	419
Surplus.....	389	341	473	419
Other capital accounts.....	0	0	0	0
Total liabilities and capital accounts.....	35,375	22,573	47,374	47,638
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank).....	36,869	23,368	48,453	48,257
Less: Held by Bank.....	5,683	5,315	6,695	5,992
Federal Reserve notes, net.....	31,186	18,053	41,758	42,265

NOTE. Components may not sum to totals because of rounding.

1. 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.

2. Valued monthly at market exchange rates.

3. 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	
1995	1994	1995	1994	1995	1994	1995	1994	1995	1994
484	429	203	230	382	436	405	453	1,036	1,102
490	168	180	186	342	199	376	377	977	904
20	23	20	21	41	22	49	28	37	33
9	89	4	11	3	20	0	0	103	33
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
121	145	48	80	101	156	85	138	209	343
0	0	0	0	0	0	0	0	0	0
17,308	14,497	6,828	8,028	14,451	15,637	12,262	13,786	30,016	34,373
0	0	0	0	0	0	0	0	0	0
17,437	14,731	6,879	8,119	14,555	15,813	12,348	13,924	30,328	34,749
220	195	450	380	361	370	333	513	574	544
30	30	54	46	55	54	158	157	159	156
486	481	563	589	797	830	1,414	1,594	2,935	3,207
408	334	180	196	352	361	319	343	739	1,111
357	4,308	-1,082	-1,897	-2,610	-1,929	3,287	-1,303	5,351	-3,685
19,932	20,698	7,448	7,870	14,276	16,154	18,689	16,086	42,137	38,122
18,427	19,229	5,990	6,553	12,267	13,948	15,570	12,917	35,901	31,024
876	941	741	612	1,119	1,336	2,178	2,140	4,188	4,938
0	0	0	0	0	0	0	0	0	0
3	3	4	4	5	5	9	10	20	21
30	22	2	15	26	23	21	26	55	80
909	966	746	631	1,150	1,365	2,208	2,176	4,262	5,039
195	158	412	380	361	358	258	332	533	640
205	175	102	110	194	205	161	168	357	395
19,736	20,528	7,250	7,673	13,972	15,876	18,196	15,592	41,053	37,098
98	85	99	98	152	139	246	247	542	512
98	85	99	98	152	139	246	247	542	512
0	0	0	0	0	0	0	0	0	0
19,932	20,698	7,448	7,870	14,276	16,154	18,689	16,086	42,137	38,122
20,751	21,908	7,143	8,043	13,880	15,280	19,726	16,819	47,377	43,685
2,324	2,679	1,153	1,491	1,613	1,333	4,156	3,902	11,476	12,662
18,427	19,229	5,990	6,553	12,267	13,948	15,570	12,917	35,901	31,024

3. Federal Reserve Open Market Transactions, 1995

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
U.S. TREASURY SECURITIES				
<i>Outright transactions (excluding matched transactions)</i>				
<i>Treasury bills</i>				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Exchanges	30,150	31,530	36,449	30,983
Redemptions	0	0	0	0
<i>Others within 1 year</i>				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Maturity shift	2,835	5,872	4,802	2,993
Exchanges	-737	-6,025	-2,096	0
Redemptions	621	0	0	370
<i>1 to 5 years</i>				
Gross purchases	0	0	0	2,549
Gross sales	0	0	0	0
Maturity shift	-2,145	-5,872	-4,802	-477
Exchanges	737	3,606	1,050	0
<i>5 to 10 years</i>				
Gross purchases	0	0	0	839
Gross sales	0	0	0	0
Maturity shift	-690	0	0	-2,516
Exchanges	0	1,720	1,046	0
<i>More than 10 years</i>				
Gross purchases	0	0	0	1,138
Gross sales	0	0	0	0
Maturity shift	0	0	0	0
Exchanges	0	700	0	0
<i>All maturities</i>				
Gross purchases	0	0	0	4,526
Gross sales	0	0	0	0
Redemptions	621	0	0	370
<i>Matched transactions</i>				
Gross purchases	163,615	178,877	168,800	148,306
Gross sales	164,526	176,232	170,724	147,616
<i>Repurchase agreements</i>				
Gross purchases	32,201	1,300	22,070	36,314
Gross sales	39,756	3,310	16,477	39,157
Net change in U.S. Treasury securities	-9,087	634	3,669	2,004
FEDERAL AGENCY OBLIGATIONS				
<i>Outright transactions</i>				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Redemptions	91	55	83	20
<i>Repurchase agreements</i>				
Gross purchases	5,243	25	4,926	4,415
Gross sales	4,948	1,345	3,821	5,020
Net change in agency obligations	204	-1,375	1,022	-625
Total net change in System Open Market Account	-8,883	-741	4,691	1,379

NOTE. Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Components may not sum to totals because of rounding.

3.—Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
0	4,470	0	433	409	1,350	4,271	0	10,933
0	0	0	0	0	0	0	0	0
31,663	42,983	25,213	39,195	30,333	29,397	39,057	31,535	398,488
0	0	0	0	0	900	0	0	0
0	0	0	0	0	0	0	390	390
0	0	0	0	0	0	0	0	0
7,174	2,177	2,063	7,805	0	1,745	6,108	0	43,574
-7,374	-1,392	-562	-5,599	0	-2,049	-4,937	0	30,771
0	0	300	0	485	0	0	0	1,776
0	0	0	0	100	0	0	2,317	4,966
0	0	0	0	0	0	0	0	0
-6,694	-2,177	-2,063	-3,379	0	-1,745	-5,292	0	-34,646
5,374	1,392	562	4,905	0	2,049	3,237	0	22,912
0	0	0	0	0	0	400	0	1,239
0	0	0	0	0	0	0	0	0
1,248	0	0	-319	0	0	-816	0	-3,093
2,000	0	0	1,800	0	0	1,700	0	8,266
0	0	0	0	100	0	0	1,884	3,122
0	0	0	0	0	0	0	0	0
-1,728	0	0	-525	0	0	0	0	-2,253
0	0	0	1,100	0	0	0	0	1,800
0	4,470	0	433	609	1,350	4,671	4,591	20,650
0	0	0	0	0	0	0	0	0
0	0	0	0	0	1,385	0	0	2,376
155,027	170,083	166,674	179,571	195,830	216,755	226,340	227,858	2,197,736
153,534	171,959	163,490	185,711	198,587	213,161	228,419	228,071	2,202,030
35,158	40,989	8,527	4,130	43,286	28,825	44,569	34,325	331,694
34,377	28,196	24,851	1,075	39,896	32,980	39,876	20,311	320,262
2,274	15,387	-13,141	-2,651	1,241	-597	7,285	18,392	25,410
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
30	262	333	122	46	83	120	58	1,303
6,155	1,941	711	1,610	1,434	3,740	3,763	2,888	36,851
5,955	2,180	1,172	1,510	1,459	3,605	3,973	1,788	36,776
170	-501	-794	-22	-71	52	-330	1,042	-1,228
2,444	14,886	-13,935	-2,673	1,170	-545	6,955	19,434	24,182

4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities,
December 31, 1993-95

Millions of dollars

Description	December 31			Change	
	1995	1994	1993	1994-95	1993-94
U.S. TREASURY SECURITIES					
Held outright ¹	390,534	372,561	339,583	17,973	32,978
<i>By remaining maturity</i>					
Bills					
1-91 days	101,564	98,129	90,186	3,435	7,943
92 days to 1 year	93,888	87,291	77,749	6,597	9,542
Notes and bonds					
1 year or less	41,419	34,978	35,423	6,441	-445
More than 1 year through 5 years	85,273	90,031	79,826	-4,758	10,205
More than 5 years through 10 years	31,469	27,552	24,659	3,917	2,893
More than 10 years	36,921	34,845	31,739	2,076	3,106
<i>By type</i>					
Bills	195,451	185,420	167,936	10,031	17,484
Notes	151,013	144,143	132,076	6,870	12,067
Bonds	44,069	42,998	39,572	1,071	3,426
Repurchase agreements	12,762	9,565	12,187	3,197	-2,622
MSPs, foreign accounts	12,336	8,041	7,568	4,295	473
MSPs, in the market	0	0	0	0	0
FEDERAL AGENCY SECURITIES					
Held outright ¹	2,634	3,637	4,638	-1,003	-1,001
<i>By remaining maturity</i>					
1 year or less	1,241	1,737	1,823	-496	-86
More than 1 year through 5 years	841	1,387	2,105	-546	-718
More than 5 years through 10 years	527	488	569	39	-81
More than 10 years	25	25	142	0	-117
<i>By issuer</i>					
Held outright	2,634	3,637	4,638	-1,003	-1,001
Federal Farm Credit Banks	912	1,050	1,201	-138	-151
Federal Home Loan Banks	230	796	1,249	-566	-453
Federal Land Banks	66	66	66	0	0
Federal National Mortgage Association	1,425	1,725	2,005	280	-280
Washington Metropolitan Area Transit Authority	0	0	117	0	-117
Repurchase agreements	1,100	1,025	1,025	75	0

NOTE. Components may not sum to totals because of rounding.

1. Excludes the effects of temporary transactions—repurchase agreements and matched sale-purchase agreements (MSPs).

5. Number and Annual Salaries of Officers and Employees of Federal Reserve Banks,
December 31, 1995

Federal Reserve Bank (including branches)	President	Other officers		Employees			Total	
	Salary (dollars)	Num- ber	Salaries (dollars)	Number		Salaries (dollars)	Num- ber	Salaries (dollars)
				Full- time	Part- time			
Boston	177,550	58	5,918,100	1,086	171	45,761,370	1,316	51,857,020
New York	228,500	204	25,046,545	3,822	82	163,937,766	4,109	189,212,811
Philadelphia	203,700	57	5,453,575	1,146	47	38,860,303	1,251	44,517,578
Cleveland	183,000	49	4,848,200	1,315	85	42,970,608	1,450	48,001,808
Richmond	178,500	76	6,902,900	1,850	173	59,858,472	2,100	66,939,872
Atlanta	235,900	75	7,049,030	2,157	39	69,229,567	2,272	76,514,497
Chicago	202,650	102	9,843,700	2,131	57	79,497,277	2,291	89,543,627
St. Louis	209,500	49	4,436,500	1,068	75	34,509,764	1,193	39,155,764
Minneapolis	192,300	49	4,750,300	1,130	123	38,619,581	1,303	43,562,181
Kansas City	178,700	58	5,311,800	1,529	84	50,253,075	1,672	55,743,575
Dallas	180,000	58	5,370,200	1,425	40	48,596,612	1,524	54,146,812
San Francisco	253,200	88	9,628,650	2,310	85	94,112,208	2,484	103,994,058
Federal Reserve Automation Service .....	...	27	2,898,100	537	7	26,849,461	571	29,747,561
Total	2,423,500	950	97,457,600	21,506	1,068	793,056,064	23,536	892,937,164

6. Income and Expenses of Federal Reserve Banks, 1995

Dollars

Item ¹	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Loans	11,349,948	145,809	1,579,408	167,833	231,626
U.S. Treasury and federal agency securities	23,825,601,437	1,184,564,568	9,387,450,289	996,324,388	1,400,033,105
Foreign currencies	783,871,627	29,585,740	211,055,484	33,744,503	54,586,655
Priced services	738,797,407	61,548,708	96,356,576	38,662,623	47,415,071
Other	35,327,940	515,639	26,462,928	991,072	438,273
Total	25,395,148,359	1,276,360,464	9,722,904,685	1,069,890,419	1,502,704,729
CURRENT EXPENSES					
Salaries and other personnel expenses	968,128,041	55,139,483	205,557,300	48,956,743	51,899,768
Retirement and other benefits ² ..	138,881,982	16,273,037	56,769,196	16,005,925	15,147,167
Fees	36,130,198	1,163,407	5,988,921	588,000	2,032,139
Travel	47,286,944	2,384,408	7,231,579	2,237,368	2,671,641
Software expenses	51,796,738	1,300,525	10,387,125	1,337,081	1,487,121
Postage and other shipping costs	78,135,828	35,936,275	6,352,209	1,656,413	2,626,454
Communications	9,983,821	458,023	2,092,635	393,221	756,508
Materials and supplies	59,351,008	3,134,005	10,944,955	3,571,298	3,537,614
<i>Building expenses</i>					
Taxes on real estate	25,095,917	3,772,154	4,291,798	1,657,086	1,505,371
Property depreciation	51,644,631	4,039,266	8,212,326	2,158,300	2,426,453
Utilities	30,947,281	2,381,156	6,494,577	2,814,936	1,751,924
Rent	31,739,518	663,440	13,743,277	221,589	441,602
Other	25,938,497	739,704	5,394,249	1,619,909	789,985
<i>Equipment</i>					
Purchases	8,653,193	297,107	1,655,641	350,719	344,003
Rentals	32,090,834	92,543	3,078,045	262,241	198,822
Depreciation	127,989,785	3,746,454	20,609,132	4,142,431	4,285,426
Repairs and maintenance	74,418,077	4,179,819	11,487,781	3,256,305	4,047,469
Earnings-credit costs	250,683,017	19,801,408	45,987,802	24,315,650	13,122,317
Other	46,475,891	2,507,778	8,749,609	1,423,912	3,591,833
Shared costs, net ³	3	-605,677	5,555,695	11,180,471	13,880,868
Recoveries	-52,196,489	-9,535,620	-6,882,913	-3,077,231	-2,213,989
Expenses capitalized ⁴	-3,344,060	-354,300	-14,711	-362,799	-363,558
Total	2,039,830,657	147,514,395	433,686,229	124,709,567	123,966,938
Reimbursements	-221,414,464	-10,451,456	-47,916,037	-17,792,525	-21,703,945
Net expenses	1,818,416,193	137,062,939	385,770,192	106,917,042	102,262,993

For notes see end of table.

6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
233,225	296,332	821,393	2,206,149	3,549,681	932,451	238,496	947,547
1,837,407,739	1,085,721,714	2,720,699,403	1,040,740,827	454,144,885	935,626,475	803,700,261	1,979,187,783
62,370,529	72,651,254	89,218,527	17,979,885	20,913,371	29,612,743	52,808,155	109,344,779
59,431,061	92,040,767	96,210,847	32,433,193	41,884,798	47,833,700	49,092,547	75,887,514
924,425	864,332	913,388	250,227	569,679	130,305	570,964	2,896,709
1,960,366,979	1,251,574,400	2,907,863,558	1,093,610,281	521,062,414	1,014,135,673	906,410,424	2,168,264,332
106,646,102	85,655,367	97,590,887	40,903,885	47,920,038	59,552,454	57,111,863	111,194,149
25,375,363	20,652,836	25,435,940	12,662,623	12,531,510	13,237,536	16,585,562	27,422,316
14,243,792	1,611,612	2,547,564	1,126,686	2,132,592	1,104,111	1,531,867	2,059,506
5,314,603	4,705,313	5,363,017	2,358,518	2,703,371	3,168,019	2,902,295	6,246,812
25,183,132	2,113,727	2,351,304	1,210,305	1,436,032	906,578	1,328,665	2,755,142
3,611,750	4,804,949	5,081,700	2,297,289	4,144,871	4,151,687	2,621,280	4,850,951
1,096,701	1,023,563	799,531	515,636	606,336	853,606	763,458	624,604
6,422,274	6,637,680	6,064,032	3,546,451	2,495,238	3,748,721	3,325,978	5,922,763
2,118,757	1,436,029	3,880,511	274,503	883,944	820,780	2,169,453	2,285,531
5,560,945	4,667,368	5,758,396	2,353,903	893,817	3,425,073	5,194,383	6,954,402
3,186,670	2,139,027	2,274,857	1,535,718	930,089	1,455,091	2,401,667	3,581,569
9,660,016	3,018,379	2,041,116	412,137	719,963	346,758	317,572	153,669
3,070,816	2,171,524	4,969,644	966,527	750,253	831,412	2,108,088	2,526,386
1,235,572	865,135	1,302,065	302,156	607,249	450,392	500,299	742,855
25,691,114	756,675	759,321	117,205	285,091	207,533	152,341	489,904
59,276,234	7,042,557	8,414,165	2,415,271	2,977,140	2,441,689	4,982,796	7,656,491
18,189,163	7,835,346	7,580,366	2,025,822	2,735,265	2,137,790	3,064,515	7,878,435
19,231,275	22,887,466	41,724,211	6,860,237	6,146,680	11,465,246	18,070,847	21,069,881
5,368,152	4,454,651	5,616,837	2,112,438	1,526,323	2,988,114	3,117,136	5,019,110
-130,330,534	17,262,583	23,247,676	11,726,256	7,645,698	17,396,930	14,257,400	8,782,638
-13,366,485	-2,331,474	-3,895,273	-1,258,831	-850,823	-575,482	-4,569,120	-3,639,247
-387,955	-493,096	-171,501	-134,306	-346,125	-544,483	-117,618	-53,607
196,397,456	198,917,216	248,736,365	94,330,429	98,874,552	129,569,555	137,820,724	224,524,258
-24,785,030	-13,758,203	-17,416,606	-9,189,092	-14,231,742	-17,715,058	-8,878,049	-17,576,720
171,612,426	185,159,013	231,319,759	85,141,337	84,642,810	111,854,497	128,942,675	206,947,539

6. Income and Expenses of Federal Reserve Banks, 1995—Continued

Dollars

Item ¹	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	23,576,732,165	1,139,297,525	9,456,351,521	962,973,377	1,400,441,737
<i>Additions to and deductions from (–) current net income⁵</i>					
Profits on sales of U.S. Treasury and federal agency securities	6,264,277	253,285	2,973,126	345,705	267,913
Net profit on foreign exchange	1,004,671,984	38,032,962	269,388,856	43,940,036	70,243,911
Other additions	146,749	2,725	54,636	599	13,175
Total additions	1,011,083,011	38,288,972	272,416,618	44,286,340	70,524,999
Deductions	–114,925,903	–3,310,102	–15,759,940	–5,026,076	–4,090,845
Total deductions	–114,925,903	–3,310,102	–15,759,940	–5,026,076	–4,090,845
Net addition to or deductions from (–) current net income	896,157,108	34,978,870	256,656,678	39,260,264	66,434,154
Cost of unreimbursed Treasury services	38,369,263	2,017,434	3,416,012	2,101,899	2,183,009
<i>Assessments by Board</i>					
Board expenditures ⁶	161,347,900	6,256,100	43,172,300	7,147,800	11,216,100
Cost of currency	370,202,935	17,221,230	147,117,303	16,276,500	21,874,736
Net income before payment to U.S. Treasury	23,902,969,175	1,148,781,632	9,519,302,585	976,707,442	1,431,602,046
Dividends paid	230,527,278	9,461,492	61,464,192	10,795,852	15,514,258
Payments to U.S. Treasury (interest on Federal Reserve notes)	23,389,366,647	1,107,918,189	9,388,855,493	936,813,240	1,414,849,038
Transferred to surplus	283,075,250	31,401,950	68,982,900	29,098,350	1,238,750
Surplus, January 1	3,683,326,700	139,436,350	987,632,750	161,092,850	257,528,050
Surplus, December 31	3,966,401,950	170,838,300	1,056,615,650	190,191,200	258,766,800

1. Components may not sum to totals because of rounding.

2. The effect of the 1987 implementation of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87), 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 sum to Current net income. The effect of SFAS 87 on the Reserve Banks was a reduction in expenses of \$119,217,028.

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. Includes reimbursement from the U.S. Treasury for uncut sheets of Federal Reserve notes, gains and losses on the sale of Reserve Bank buildings, counterfeit currency that is not charged back to the depositing institution, and stale Reserve Bank checks that are written off.

6. For additional details, see the last five pages of the preceding section: Board of Governors Financial Statements.

6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,788,754,554	1,066,415,387	2,676,543,799	1,008,468,944	436,419,604	902,281,176	777,467,749	1,961,316,793
426,981	320,687	734,844	390,338	44,434	158,280	109,757	238,928
80,828,706	93,016,566	114,291,538	23,123,372	26,801,887	37,964,390	67,326,215	139,713,545
8,156	24,943	6,738	1,267	170	0	31,201	3,138
81,263,843	93,362,196	115,033,120	23,514,978	26,846,490	38,122,670	67,467,173	139,955,612
-6,941,624	-24,164,016	-6,740,193	-4,069,780	-19,832,670	-3,299,300	-15,036,655	-6,654,703
-6,941,624	-24,164,016	-6,740,193	-4,069,780	-19,832,670	-3,299,300	-15,036,655	-6,654,703
74,322,219	69,198,180	108,292,927	19,445,198	7,013,820	34,823,370	52,430,519	133,300,909
5,276,706	3,426,379	3,890,671	2,114,326	2,641,117	2,910,429	2,613,099	5,778,183
12,737,000	14,966,500	18,572,800	3,729,600	4,262,200	6,092,400	10,755,300	22,439,800
27,991,998	17,518,905	41,012,869	18,659,898	6,355,547	13,534,714	12,534,061	30,105,174
1,817,071,069	1,099,701,783	2,721,360,385	1,003,410,318	430,174,560	914,567,003	803,995,808	2,036,294,545
17,570,732	21,940,216	27,267,891	5,343,579	5,862,866	8,645,518	14,866,370	31,794,310
1,804,318,337	1,029,816,767	2,640,392,094	984,871,839	423,620,594	893,335,785	789,512,588	1,975,062,684
-4,818,000	47,944,800	53,700,400	13,194,900	691,100	12,585,700	-383,150	29,437,550
296,334,000	341,017,100	419,015,350	84,774,850	98,261,800	139,184,950	246,831,200	512,217,450
291,516,000	388,961,900	472,715,750	97,969,750	98,952,900	151,770,650	246,448,050	541,655,000

7. Income and Expenses of Federal Reserve Banks, 1914-95

Dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
<i>All Banks</i>					
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, 1914-95—Continued

Dollars

Federal Reserve Bank and period	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	68,991,270
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 ¹	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	1,254,613,365 ²	89,579,700	175,043,736
1990.....	23,476,603,651	1,349,725,812	2,099,328,472 ²	103,752,200	193,006,998
1991.....	22,553,001,815	1,429,322,157	405,729,320 ²	109,631,000	261,316,379
1992.....	20,235,027,938	1,474,530,523	-987,787,687 ²	128,955,300	295,400,692
1993.....	18,914,250,574	1,657,799,914	-230,267,919 ²	140,465,600	355,947,291
1994.....	20,910,742,377	1,795,328,343	2,363,862,097	146,866,100	368,187,068
1995.....	25,395,148,359	1,818,416,193	857,787,845	161,347,900	370,202,935
Total, 1914-95.....	392,244,535,021	28,599,119,876	7,762,488,695	2,151,612,508	3,986,616,067
<i>Aggregate for each Bank, 1914-95</i>					
Boston.....	20,998,174,659	1,884,922,025	259,842,767	78,673,886	232,958,032
New York.....	124,710,601,541	5,848,718,027	2,247,319,208	574,799,086	1,227,870,745
Philadelphia.....	15,107,244,229	1,578,058,352	286,880,662	98,491,218	162,246,929
Cleveland.....	25,565,854,197	1,813,282,376	408,915,257	151,625,690	248,926,866
Richmond.....	31,017,849,656	2,431,492,140	475,958,494	125,774,976	350,237,963
Atlanta.....	17,095,830,663	2,614,161,751	705,494,009	177,636,860	210,715,683
Chicago.....	53,180,957,665	3,711,918,763	938,788,259	285,232,172	515,268,991
St. Louis.....	13,176,746,441	1,446,652,343	159,668,433	61,166,472	149,406,841
Minneapolis.....	7,336,239,151	1,340,467,212	199,958,251	62,065,415	73,168,166
Kansas City.....	15,937,281,891	1,834,636,831	274,644,567	87,651,309	168,121,665
Dallas.....	20,484,315,458	1,762,687,946	614,561,745	146,908,073	202,042,792
San Francisco.....	47,633,439,470	3,108,224,871	1,190,457,043	301,587,351	445,651,394
Total.....	392,244,535,021	28,599,119,876⁴	7,762,488,695	2,151,612,508	3,986,616,067

NOTE. Components may not sum to totals because of rounding.

1. For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

2. Data are revised to reflect services provided to the Treasury by the Federal Reserve for which reimbursement was not received.

3. The \$4,095,074,149 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 (1955), leaving a balance of \$3,966,401,948 on December 31, 1995.

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
140,757,879	...	...	23,608,397,730	...	180,291,500
152,553,160	...	...	20,777,552,290	...	228,356,150
171,762,924	...	...	16,774,476,500	...	402,114,350
195,422,234	...	...	15,986,764,712	...	347,582,900
212,090,446	...	...	20,470,010,815	...	282,121,700
230,527,278	...	...	23,389,366,647	...	283,075,250
3,393,029,751	149,138,300	2,188,893	357,630,247,822	-3,657	4,095,074,149³
135,469,012	7,111,395	280,843	18,737,533,697	135,411	180,933,125
928,684,134	68,006,262	369,116	117,992,137,332	-433,412	1,093,872,221
168,264,402	5,558,901	722,406	13,175,970,600	290,661	204,521,422
251,261,123	4,842,447	82,930	23,232,757,333	-9,906	272,000,593
192,926,894	6,200,189	172,493	28,089,679,070	-71,517	297,395,808
265,386,408	8,950,561	79,264	14,130,160,343	5,491	394,228,440
444,721,439	25,313,526	151,045	48,649,083,797	11,682	488,044,504
98,490,163	2,755,629	7,464	11,474,873,104	-26,515	103,089,378
94,609,092	5,202,900	55,615	5,857,734,012	64,874	102,830,113
136,341,949	6,939,100	64,213	13,822,269,464	-8,674	155,910,600
220,733,658	560,049	102,083	18,515,061,737	55,337	250,725,528
456,141,475	7,697,341	101,421	43,952,987,331	-17,089	551,522,417
3,393,029,751	149,138,300	2,188,893	357,630,247,822	-3,657	4,095,074,149

8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1995

Dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate ³
	Land	Buildings (including vaults) ¹	Building machinery and equipment	Total ²		
BOSTON	22,073,501	89,499,467	7,135,909	118,708,877	94,278,515	...
NEW YORK	20,330,426	112,200,615	47,198,929	179,729,970	142,563,924	...
Buffalo	887,844	2,693,268	2,844,131	6,425,243	3,923,917	...
PHILADELPHIA	2,251,556	56,966,200	6,340,260	65,558,016	47,863,835	...
CLEVELAND	2,298,644	41,553,212	6,967,450	50,819,306	42,956,601	...
Cincinnati	2,246,599	13,978,275	8,245,465	24,470,339	11,147,920	...
Pittsburgh	1,658,376	10,114,189	4,544,546	16,317,111	12,324,775	...
RICHMOND	6,111,681	58,755,396	16,463,414	81,330,490	68,482,713	5,708,457
Baltimore	6,476,335	27,100,992	3,842,189	37,419,516	27,742,419	...
Charlotte	3,129,645	27,402,251	4,737,485	35,269,381	30,303,237	...
ATLANTA	606,107	31,994,103	4,074,600	36,674,810	30,582,687	4,338,155
Birmingham	3,197,830	1,905,770	2,073,625	7,177,226	5,030,154	...
Jacksonville	1,665,439	16,395,261	2,851,236	20,911,935	17,421,848	48,365
Miami	3,810,291	12,214,625	2,726,244	18,751,160	13,486,293	...
Nashville	592,342	1,744,568	2,363,763	4,700,673	2,317,883	...
New Orleans	3,497,233	5,257,082	2,815,718	11,570,034	8,125,940	...
CHICAGO	4,565,008	114,242,044	13,591,362	132,398,414	101,919,572	...
Detroit	797,734	4,588,589	3,426,327	8,812,650	7,970,420	...
ST. LOUIS	700,378	16,477,933	5,298,206	22,476,517	18,606,504	...
Little Rock	1,148,492	2,357,733	1,003,022	4,509,247	3,525,112	...
Louisville	700,075	2,859,819	1,131,238	4,691,132	3,423,449	...
Memphis	1,135,623	4,216,382	2,280,473	7,632,478	4,890,611	...
MINNEAPOLIS	8,628,088	46,785,831	7,753,083	63,167,001	43,977,410	...
Helena	1,954,514	9,085,286	513,922	11,553,722	10,475,336	...
KANSAS CITY	2,048,446	24,473,922	8,117,503	34,639,871	27,956,190	...
Denver	3,187,962	5,462,145	3,311,080	11,925,187	8,353,012	...
Oklahoma City	646,386	3,290,083	8,254	3,944,722	2,610,446	...
Omaha	6,534,583	10,987,009	1,401,083	18,922,675	16,078,958	1,412,500
DALLAS	28,512,492	107,368,368	19,588,532	155,469,391	145,236,494	...
El Paso	262,477	1,969,950	404,946	2,637,373	2,266,079	...
Houston	2,205,500	4,266,808	1,264,396	7,736,704	7,091,760	...
San Antonio	482,284	2,437,084	1,669,052	4,588,420	3,051,025	...
SAN FRANCISCO	15,599,928	70,806,647	18,068,955	104,475,531	80,875,608	...
Los Angeles	3,891,887	51,184,892	8,876,766	63,953,546	52,544,944	...
Portland	2,248,415	7,784,968	2,328,714	12,362,097	11,092,575	...
Salt Lake City	494,556	4,893,058	2,490,226	7,877,841	6,415,939	...
Seattle	324,772	6,609,964	2,771,072	9,705,808	7,838,694	...
Total	166,903,447	1,011,887,789	230,523,179	1,409,314,414	1,125,752,800	11,507,476

NOTE. Components may not sum to totals because of rounding.

1. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.

2. Excludes charge-offs of \$17,698,968 before 1952.

3. 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, 1992-95

Operation	1995	1994	1993	1992
<i>Millions of pieces (except as noted)</i>				
Loans (thousands)	6	8	6	8
Currency received and counted	22,594	20,166	20,768	20,166
Currency verified and destroyed	8,911	7,244	7,376	7,506
Coin received and counted	7,578	6,950	7,690	8,660
Checks handled				
U.S. government checks	460	470	480	493
Postal money orders	203	200	192	181
All other	15,465	16,479	19,009	19,053
Government securities transfers ¹	13	13	12	12
Transfer of funds	76	72	70	68
Automated clearinghouse transactions				
Commercial	2,125	1,805	1,545	1,327
Government	599	574	555	531
Food stamps redeemed	3,954	4,229	4,198	4,183
<i>Millions of dollars</i>				
Loans	22,854	22,853	20,760	29,427
Currency received and counted	345,318	277,685	290,989	277,681
Currency verified and destroyed	113,828	76,620	79,599	96,744
Coin received and counted	1,112	1,045	1,143	1,275
Checks handled				
U.S. government checks	490,299	504,479	534,236	588,311
Postal money orders	24,835	23,764	22,207	20,188
All other	11,567,820	12,079,107	14,066,518	13,241,785
Government securities transfers ¹	149,764,431	144,702,226	146,220,304	139,675,710
Transfer of funds	222,954,083	211,201,540	207,629,814	199,175,034
Automated clearinghouse transactions				
Commercial	8,076,660	7,420,499	6,710,035	6,530,731
Government	1,117,452	948,984	885,011	859,774
Food stamps redeemed	20,862	21,867	21,661	21,452

1. Beginning with the 1994 *Annual Report*, "Government securities transfers" replaced the previous time series that included "Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities." This

change was made to enable consistent time series reporting for the fiscal area, where complex definitional changes have occurred over the reported years.

10. Federal Reserve Bank Interest Rates on Loans to Depository Institutions,
December 31, 1995

Reserve Bank	Adjustment credit ¹	Seasonal credit ²	Extended credit ³	
			First thirty days of borrowing	After thirty days of borrowing
All Federal Reserve Banks	5.25	5.75	5.25	6.25

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. As of May 20, 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.

2. 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. The discount rate on seasonal credit takes into account rates on market sources of funds and ordinarily is reestablished on the first business day of each two-week reserve maintenance period; however, it is never lower than the discount rate applicable to adjustment credit. See section 201.3(b) of Regulation A.

3. 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. See section 201.3(c) of Regulation A.

Extended-credit loans outstanding more than thirty days ordinarily will be charged a flexible rate somewhat above rates on market sources of funds; however, the rate will always be at least 50 basis points above the discount rate applicable to adjustment credit. In no case will the rate 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 discount rate applicable to adjustment credit may be charged on extended-credit loans that are outstanding less than thirty days.

11. Reserve Requirements of Depository Institutions, December 31, 1995

Type of deposit	Requirements	
	Percentage of deposits	Effective date
<i>Net transaction accounts</i> ¹		
\$0 million–\$52.0 million ²	3	12-19-95
More than \$52.0 million ³	10	12-19-95
Nonpersonal time deposits ⁴	0	12-27-90
Eurocurrency liabilities ⁵	0	12-27-90

NOTE. Required reserves must be held in the form of deposits with Federal Reserve Banks or vault cash. Nonmember institutions 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* or the *Federal Reserve Bulletin*. Under the Monetary Control Act of 1980, depository institutions include commercial banks, mutual savings banks, savings and loan associations, credit unions, agencies and branches of foreign banks, and Edge Act corporations.

1. Transaction accounts include all deposits against which the account holder is permitted to make withdrawals by negotiable or transferable instruments, payment orders of withdrawal, and telephone and preauthorized transfers for the purpose of making payments to third persons or others. However, money market deposit accounts (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 may be checks, are savings deposits, not transaction accounts.

2. 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 December 19, 1995 for institutions reporting quarterly and weekly, the amount was decreased from \$54.0 million to \$52.0 million.

Under the Garn–St Germain Depository Institutions Act of 1982, the Board adjusts the amount of reservable

liabilities subject to a 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 made in the event of a decrease. Effective December 19, 1995, the exemption was raised from \$4.2 million to \$4.3 million. The exemption applies only to accounts that would be subject to a 3 percent reserve requirement.

3. The reserve requirement was reduced from 12 percent to 10 percent on April 2, 1992, for institutions that report weekly, and on April 16, 1992, for institutions that report quarterly.

4. For institutions that report weekly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to 1½ percent for the maintenance period that began December 13, 1990, and to zero for the maintenance period that began December 27, 1990. The reserve requirement on nonpersonal time deposits with an original maturity of 1½ years or more has been zero since October 6, 1983.

For institutions that report quarterly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to zero on January 17, 1991.

5. The reserve requirement on Eurocurrency liabilities was reduced from 3 percent to zero in the same manner and on the same dates as the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years (see note 4).

12. Initial Margin Requirements under Regulations T, U, G, and X

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only ¹
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

NOTE. 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 value 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 October 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective March 11, 1968; and Regulation X, effective November 1, 1971.

On January 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 September 30, 1985, the Board changed the required margin on individual stock options, 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 June 6, 1988, the SEC approved new maintenance margin rules, permitting margins to be the current market value of the option plus 20 percent of the market value of the stock underlying the option.

1. From October 1, 1934, to October 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 in the United States, by Class of Bank, June 30, 1995 and 1994

Millions of dollars, except as noted

Item	Total	Member banks			Nonmember banks
		Total	National	State	
	1995				
ASSETS					
Loans and investments	2,989,950	2,223,301	1,663,696	559,605	766,648
Gross loans	2,203,551	1,660,229	1,272,736	387,493	543,322
Net loans	2,198,915	1,657,617	1,270,711	386,905	541,298
Investments	786,399	563,072	390,961	172,112	223,327
U.S. Treasury and federal agency securities	320,388	207,085	151,774	55,311	113,303
Other	466,011	355,987	239,186	116,801	110,024
Cash assets, total	197,464	157,071	117,407	39,664	40,393
LIABILITIES					
Deposits, total	2,425,001	1,775,412	1,325,357	430,055	669,589
Interbank	38,389	31,305	21,844	9,461	7,084
Other transaction	770,200	574,715	428,590	146,125	195,485
Other nontransaction	1,892,167	1,341,251	1,022,098	319,154	550,916
Equity capital	328,472	245,865	180,470	65,394	82,607
Number of banks	10,090	3,923	2,931	992	6,167
	1994				
ASSETS					
Loans and investments	2,791,623	2,045,608	1,584,368	461,240	746,015
Gross loans	1,960,814	1,451,045	1,145,627	305,417	509,770
Net loans	1,955,881	1,448,064	1,143,321	304,743	507,817
Investments	830,809	594,563	438,740	155,823	236,246
U.S. Treasury and federal agency securities	348,062	229,200	175,765	53,435	118,862
Other	482,747	365,363	262,975	102,388	117,383
Cash assets, total	191,826	152,671	113,515	39,156	39,155
LIABILITIES					
Deposits, total	2,352,643	1,691,922	1,317,010	374,912	660,721
Interbank	38,627	31,381	22,708	8,673	7,246
Other demand	782,177	581,697	447,663	134,064	200,481
Other time and savings	1,828,585	1,286,004	1,012,930	273,074	542,581
Equity capital	299,581	222,192	167,130	55,062	77,385
Number of banks	10,644	4,139	3,174	965	6,505

NOTE. Components may not sum to totals because of rounding.

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—
Year-End 1918–95, and Month-End 1995

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock ⁴	Special drawing rights certificate account	Treasury currency outstanding ⁵
	U.S. Treasury and federal agency securities			Loans	Float ¹	All other ²	Other Federal Reserve assets ³	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 end of table.

14.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings ⁶	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts ³	Required clearing balances	Other Federal Reserve liabilities and capital ³	Member bank reserves ⁷			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin ⁸	Required ⁹	Excess ⁹
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 1918–95 and Month-End 1995—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding							Gold stock ⁴	Special drawing rights certificate account	Treasury currency outstanding ⁵	
	U.S. Treasury and federal agency securities			Loans	Float ¹	All other ²	Other Federal Reserve assets ³				Total
	Total	Bought outright ¹⁰	Held under repurchase agreement ¹¹								
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	19,628
1990.....	259,786	241,432	18,354	190	2,566	0	39,880	302,421	11,058	10,018	20,404
1991.....	288,429	272,531	15,898	218	1,026	0	34,524	324,197	11,059	10,018	21,017
1992.....	308,518	300,424	8,094	675	3,350	0	30,278	342,820	11,056	8,018	21,452
1993.....	349,865	336,653	13,212	94	963	0	33,394	384,316	11,053	8,018	22,101
1994.....	378,746	368,156	10,590	223	740	0	33,441	413,150	11,051	8,018	22,912
1995.....	394,693	380,831	13,862	136	231	0	33,483	428,543	11,050	10,168	23,951

14.—Continued

Factors absorbing reserve funds											
Cur- rency in cir- cu- lation	Treasury cash hold- ings ⁶	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve ac- counts ³	Re- quired clear- ing bal- ances	Other Federal Reserve lia- bilities and capital ³	Member bank reserves ⁷			
		Treasury	For- eign	Other				With Federal Reserve Banks	Cur- rency and coin ⁸	Re- quired ⁹	Ex- cess ^{9,12}
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	1,919	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 ¹²
72,497	317	2,542	251	1,419 ¹³	0	0	2,669	27,060	6,781	35,268	-1,360
79,743	185	2,113	418	1,275 ¹³	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 ¹⁴
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	↑	↑	↑
260,456	450	6,217	589	1,298	0	1,618	8,486	36,713	n.a.	n.a.	n.a.
286,965	561	8,960	369	242	0	1,963	8,147	36,695	↑	↑	↑
307,759	636	17,697	968	1,706	0	3,945	8,113	25,467	↑	↑	↑
334,706	508	7,492	206	372	0	5,897	7,984	26,181	↑	↑	↑
365,299	377	14,809	386	397	0	6,332	9,292	28,614	↑	↑	↑
403,762	335	7,161	250	876	0	4,239	11,959	26,550	↑	↑	↑
424,192	270	5,979	386	932	0	5,171	12,342	24,441	↑	↑	↑

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–95, and Month-End 1995—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding							Gold stock ⁴	Special drawing rights certificate account	Treasury currency outstanding ⁵	
	U.S. Treasury and federal agency securities			Loans	Float ¹	All other ²	Other Federal Reserve assets ³				Total
	Total	Bought outright ¹⁰	Held under repurchase agreement ¹¹								
1995											
Jan. ...	369,863	366,533	3,330	77	636	0	33,738	404,314	11,050	8,018	23,073
Feb. ...	369,122	369,122	0	54	2,371	0	34,209	405,756	11,050	8,018	23,138
Mar. ...	373,813	367,115	6,698	84	62	0	35,495	409,454	11,053	8,018	23,234
Apr. ...	375,192	371,942	3,250	156	298	0	35,799	411,445	11,055	8,018	23,304
May ...	377,636	373,405	4,231	169	1,174	0	33,915	412,894	11,054	8,018	23,359
June ...	392,522	375,737	16,785	217	357	0	34,988	428,084	11,054	8,018	23,498
July ...	378,587	378,587	0	248	202	0	34,480	413,517	11,053	10,518	23,568
Aug. ...	375,914	372,759	3,155	269	90	0	31,529	407,802	11,053	10,518	23,682
Sept. ...	377,084	370,564	6,520	421	196	0	32,580	410,282	11,051	10,168	23,769
Oct. ...	376,539	374,039	2,500	124	1,007	0	32,391	410,061	11,051	10,168	23,825
Nov. ...	383,494	376,511	6,983	55	487	0	31,054	415,090	11,050	10,168	23,895
Dec. ...	394,693	380,831	13,862	136	231	0	33,483	428,543	11,050	10,168	23,951

NOTE. 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 sum to totals because of rounding.

... Not applicable.

n.a. Not available.

r Revised.

1. Beginning in 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

2. Principally acceptances and, until August 21, 1959, industrial loans, authority for which expired on that date.

3. For the period before April 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 is reported as "Other Federal Reserve accounts"; thereafter, "Other Federal Reserve assets" and "Other Federal Reserve liabilities and capital" are shown separately.

4. Before January 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

5. 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*.

6. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

7. Beginning in November 1979, includes reserves of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks. Beginning on November 13, 1980, includes reserves of all depository institutions.

Beginning in 1984, data on "Currency and coin" and "Required" and "Excess" reserves changed from daily to biweekly basis.

8. Between December 1, 1959, and November 23, 1960, part was allowed as reserves; thereafter all was allowed.

9. Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call date was December 29). Beginning on September 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											
Cur- rency in cir- cu- lation	Trea- sury cash hold- ings ⁶	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve ac- counts ³	Re- quired clear- ing bal- ances	Other Federal Reserve lia- bilities and capital ³	Member bank reserves ⁸			
		Trea- sury	For- eign	Other				With Federal Reserve Banks	Cur- rency and coin ⁸	Re- quired ⁹	Ex- cess ^{9,12}
396,041	335	13,964	185	308	0	4,159	12,854	18,609	↑	↑	↑
397,753	340	6,891	188	325	0	4,038	13,710	24,716	↑	↑	↑
401,630	361	4,543	370	398	0	3,925	14,449	26,084	↑	↑	↑
405,285	356	8,242	166	339	0	3,905	13,095	22,433	↑	↑	↑
411,104	322	4,646	227	215	0	4,133	12,181	22,497	↑	↑	↑
410,483	319	20,977	168	242	0	4,274	13,519	20,672	↑	↑	↑
409,508	306	11,207	190	304	0	4,178	12,671	20,293	n.a.	n.a.	n.a.
410,984	316	4,767	166	298	0	4,535	11,438	20,551	↓	↓	↓
409,275	322	8,620	201	332	0	4,556	13,088	18,877	↓	↓	↓
411,767	314	7,018	275	375	0	4,753	13,073	17,531	↓	↓	↓
416,682	276	5,703	194	282	0	4,870	12,697	19,500	↓	↓	↓
424,192	270	5,979	386	932	0	5,171	12,342	24,441	↓	↓	↓

10. Beginning in 1969, includes 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.

11. Beginning December 1, 1966, includes federal agency obligations held under repurchase agreements and beginning September 29, 1971, includes federal agency issues bought outright.

12. Beginning with week ending November 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 November 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.

13. 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 December 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.

14. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy effective November 19, 1975.

15. Number of Banking Offices in the United States, December 31, 1994 and 1995

Type of office, number, and change	Total	Commercial banks ¹						State-chartered savings banks ²	
		Total	Member ³			Nonmember		Insured	Non- insured
			Total	National	State	Insured	Non- insured		
BANKS									
Number, Dec. 31, 1994 ..	11,352	10,820	4,111	3,127	984	6,401	308	532	0
<i>Changes during 1995</i>									
New banks	128	125	49	38	11	61	15	3	0
Ceased banking operation	-64	-57	-33	-26	-7	-13	-11	-7	0
Banks converted into branches ⁴	-597	-580	-260	-221	-39	-320	0	-17	0
Other ⁵	14	15	98	-6	104	-85	2	-1	0
Net change	-519	-497	-146	-215	69	-357	6	-22	0
Number, Dec. 31, 1995 ..	10,833	10,323	3,965	2,912	1,053	6,044	314	510	0
BRANCHES AND ADDITIONAL OFFICES									
Number, Dec. 31, 1994 ..	58,322	55,196	37,088	28,694	8,394	18,021	87	3,126	0
<i>Changes during 1995</i>									
De novo	2,614	2,367	1,649	1,350	299	716	2	247	0
Banks converted into branches	597	587	371	276	95	216	0	10	0
Discontinued	-1,407	-1,319	-1,045	-776	-269	-271	-3	-88	0
Other ⁵	241	147	66	56	10	81	0	94	0
Net change ⁵	2,045	1,782	1,041	906	135	742	-1	263	0
Number, Dec. 31, 1995 ..	60,367	56,978	38,129	29,600	8,529	18,763	86	3,389	0

NOTE. Preliminary. Final data will be available in the *Annual Statistical Digest, 1995*, forthcoming.

1. Includes nondeposit trust companies, private banks, industrial banks, and nonbank banks. Member institutions are those that are members of the Federal Reserve System.

2. Formerly called mutual savings banks.

3. Includes noninsured trust companies that are members of the Federal Reserve System.

4. Includes eight banks that converted to thrift institution branches.

5. Includes interclass changes and sales of branches.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities
Approved by the Board of Governors, 1995

Citizens Commercial & Savings Bank, Flint, Michigan to merge with Bank One banks of Fenton (N.A.), Ypsilanti (N.A.), East Lansing, and Sturgin, Michigan¹

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-23-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-6-95)

The applicant has assets of \$1.3 billion; the targets have assets of \$691.1 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Triangle East Bank, Raleigh, North Carolina to merge with Standard Bank and Trust Company, Dunn, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-10-95)

The applicant has assets of \$312.3 million; the target has assets of \$88.3 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Triangle East Bank, Raleigh, North Carolina to merge with Columbus National Bank, Whiteville, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-10-94)

The applicant has assets of \$312.3 million; the target has assets of \$58.9 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

South Trust Bank of West Florida, St. Petersburg, Florida to acquire assets and liabilities of the Tampa & New Port Richey branches of Anchor Savings Bank, F.S.B., Hewlett, New York

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-21-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-11-95)

The applicant has assets of \$827.7 million; the targets have assets of \$180.8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Interstate Bank of Commerce, Billings, Montana to merge with First Citizens Bank of Bozeman, Bozeman, Montana

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-21-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-12-95)

The applicant has assets of \$780.5 million; the target has assets of \$40.6 million. The parties do not operate in the same 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 TideMark Bank, Newport News, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-6-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-19-95)

The applicant has assets of \$12.6 billion; the target has assets of \$482.2 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Triangle East Bank, Raleigh, North Carolina to merge with Unity Bank & Trust Company, Rocky Mount, North Carolina

1. The institution or group of institutions named before the italicized words is referred to subsequently as the applicant, and the institution or group of institutions named after the italicized words is referred to subsequently as the target.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1995—Continued

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-23-95)

The applicant has assets of \$312.3 million; the target has assets of \$180.6 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

BancFirst, Oklahoma City, Oklahoma to merge with State National Bank, Marlow, Oklahoma

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-24-95)

The applicant has assets of \$870.0 million; the target has assets of \$101.0 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Callaway Bank, Fulton, Missouri to merge with Steedman Bank, Mokane, Missouri

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-1-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1-27-95)

The applicant has assets of \$120.0 million; the target has assets of \$12.1 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Centura Bank, Rocky Mount, North Carolina to acquire assets and liabilities of the Fayetteville branch of Progressive Savings & Loan, Ltd., Lumberton, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-1-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-10-95)

The applicant has assets of \$4.2 billion; the target has deposits of \$3.2 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Minden Bank & Trust Company, Minden, Louisiana to acquire assets and liabilities of the 1633 North Market Street, 3400 Line Avenue, and 6250 Hearne Avenue branches (all of Shreveport) of Hibernia National Bank, New Orleans, Louisiana

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-15-95)

The applicant has assets of \$172.5 million; the targets have assets of \$42.3 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Farmers Trust Bank, Lebanon, Pennsylvania to acquire assets and liabilities of the Schaefferstown branch of Meridian Bank, Reading, Pennsylvania

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-1-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-17-95)

The applicant has assets of \$152.7 million; the target has assets of \$315.0 thousand. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank of Great Neck, Great Neck, New York to acquire assets and liabilities of the Great Neck branch of North Fork Bank, Mattituck, New York

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

16.—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-23-95)

The applicant has assets of \$120.2 million; the target has assets of \$29.1 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Enterprise Bank and Trust Company, Winston-Salem, North Carolina to acquire assets and liabilities of the Danbury branch of First Union National Bank of North Carolina, Charlotte, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (1-25-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-24-95)

The applicant has assets of \$48.9 million; the target has assets of \$9.3 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Pace American Bank, Lawrenceville, Virginia to acquire assets and liabilities of the Alberta, Bedford, Big Island, Brodnax, Chase City, Chatham, Crewe, Drakes Branch, and Victoria branches of NationsBank of Virginia, N.A., Richmond, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (1-25-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-24-95)

The applicant has assets of \$58.4 million; the targets have assets of \$157.7 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First United Bank, Boca Raton, Florida to merge with Jupiter Tequesta National Bank, Tequesta, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-1-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-2-95)

The applicant has assets of \$259.6 million; the target has assets of \$57.4 million. The parties operate in the same 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 First Trust Bank, Ontario, California

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 Trust Bank.²

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-3-95)

The applicant has assets of \$25.9 billion; the target has assets of \$198.0 million. The State has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Premier Bank, North, Haysi, Virginia to acquire assets and liabilities of the Coeburn and Big Stone Gap branches of NationsBank of Virginia, N.A., Richmond, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-23-95)

The applicant has assets of \$97.9 million; the targets have assets of \$49.8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Merchants Bank, Vicksburg, Mississippi to merge with Bank of Edwards, Edwards, Mississippi

2. In such cases hereafter, the entry for the summary report by the Attorney General will read, "Request for report dispensed with as authorized by the Bank Merger Act."

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1995—Continued

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 Bank of Edwards.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-31-95)

The applicant has assets of \$174.0 million; the target has assets of \$14.8 million. The State has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Community Bank and Trust, Neosho, Missouri to merge with State Bank of Seneca, Seneca, Missouri

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-22-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-14-95)

The applicant has assets of \$127.9 million; the target has assets of \$21.0 million. The parties operate in the same market. The bank factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Community Bank, Glasgow, Montana to merge with Citizens First National Bank of Wolf Point, Wolf Point, Montana

SUMMARY REPORT BY THE ATTORNEY GENERAL (4-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-14-95)

The applicant has assets of \$72.2 million; the target has assets of \$13.3 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fifth Third Bank of Northeastern Ohio, Cleveland, Ohio to merge with Falls Savings Bank, F.S.B., Cuyahoga Falls, Ohio

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-16-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-19-95)

The applicant has assets of \$725.0 million; the target has assets of \$595.8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Centura Bank, Rocky Mount, North Carolina to merge with First Southern Savings Bank, Inc., SSB, Asheboro, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (4-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-21-95)

The applicant has assets of \$4.3 billion; the target has assets of \$317.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Premier Bank, Inc., Wytheville, Virginia to acquire assets and liabilities of the Fries, Galax, Independence, and Rural Retreat branches of NationsBank of Virginia, N.A., Richmond, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-24-95)

The applicant has assets of \$195.8 million; the targets have assets of \$63.4 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Vail Bank, Vail, Colorado to merge with Snow Bank, N.A., Dillon, Colorado

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-27-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-28-95)

16.—Continued

The applicant has assets of \$88.0 million; the target has assets of \$32.0 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Westamerica Bank, San Rafael, California to merge with CapitolBank, Sacramento, California

SUMMARY REPORT BY THE ATTORNEY GENERAL (5-5-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5-2-95)

The applicant has assets of \$1.8 billion; the target has assets of \$139.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Manufacturers and Traders Trust Company, Buffalo, New York to acquire assets and liabilities of the Saugerties, Niagara Falls, Poughkeepsie, and LaGrangeville branches of The Chase Manhattan Bank, N.A., New York, New York

SUMMARY REPORT BY THE ATTORNEY GENERAL (4-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5-4-95)

The applicant has assets of \$8.8 billion; the targets have assets of \$89.3 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Fifth Third Bank, Cincinnati, Ohio to acquire assets and liabilities of the Lebanon branch of Bank One Dayton, N.A., Dayton, Ohio

SUMMARY REPORT BY THE ATTORNEY GENERAL (5-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5-31-95)

The applicant has assets of \$9.2 billion; the target has assets of \$18.0 million. The parties operate in

the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

West One Bank, Idaho, Boise, Idaho to acquire assets and liabilities of the Burley, Idaho, branch of Washington Federal Savings and Loan Association, Seattle, Washington

SUMMARY REPORT BY THE ATTORNEY GENERAL (5-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6-1-95)

The applicant has assets of \$4.4 billion; the target has assets of \$5.3 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

United Jersey Bank, Hackensack, New Jersey to merge with New Jersey Savings Bank, Somerville, New Jersey

SUMMARY REPORT BY THE ATTORNEY GENERAL (5-5-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6-9-95)

The applicant has assets of \$12.4 billion; the target has assets of \$507.3 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Citizens Bank & Trust Company, Lawrenceville, Virginia to acquire assets and liabilities of the Clifton Forge branch of Crestar Bank, Richmond, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (5-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6-21-95)

The applicant has assets of \$58.4 million; the target has assets of \$24.7 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1995—Continued

Westamerica Bank, San Rafael, California to merge with Novato National Bank, Novato, California

SUMMARY REPORT BY THE ATTORNEY GENERAL
(6-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE
(6-21-95)

The applicant has assets of \$2.0 billion; the target has assets of \$93.5 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Princess Anne Bank, Virginia Beach, Virginia to acquire assets and liabilities of three branches of Cent Bank, F.S.B., Norfolk, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL
(5-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE
(6-29-95)

The applicant has assets of \$81.2 million; the targets have assets of \$89.6 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Sterling Bank & Trust Co., Baltimore, Maryland to acquire assets and liabilities of the Annapolis branch of First Union National Bank of Maryland, Rockville, Maryland

SUMMARY REPORT BY THE ATTORNEY GENERAL
(5-26-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE
(6-29-95)

The applicant has assets of \$76.4 million; the target has assets of \$13.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Terrace Bank of Florida, Tampa, Florida to merge with University State Bank, Tampa, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL
(5-5-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE
(7-3-95)

The applicant has assets of \$41.1 million; the target has assets of \$21.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Texas State Bank, McAllen, Texas to acquire assets and liabilities of the Roma and Rio Grande City branches of First National Bank of South Texas, San Antonio, Texas

SUMMARY REPORT BY THE ATTORNEY GENERAL
(6-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE
(7-19-95)

The applicant has assets of \$539.0 million; the targets have assets of \$87.0 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank of Naples, Naples, Florida to merge with Fifth Third Trust Company and Savings Bank, F.S.B., Naples, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL
(6-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE
(7-20-95)

The applicant has assets of \$56.9 million; the target has assets of \$75.7 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Virginia Bank—Colonial, Richmond, Vir- ginia to acquire assets and liabilities of the four Richmond, Virginia, branches of Citizens Fed- eral Bank, a Federal Savings Bank, Miami, Florida

16.—Continued

SUMMARY REPORT BY THE ATTORNEY GENERAL (6-15-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7-20-95)

The applicant has assets of \$379.3 million; the targets have assets of \$200.4 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Cortland Savings and Banking Company, Cortland, Ohio to acquire assets and liabilities of the North Bloomfield branch of Bank One, Youngstown, N.A., Youngstown, Ohio

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-20-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7-28-95)

The applicant has assets of \$317.7 million; the target has assets of \$13.5 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First State Bank of Taos, Taos, New Mexico to merge with First Bank of Grants, Grants, New Mexico

SUMMARY REPORT BY THE ATTORNEY GENERAL (6-30-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7-28-95)

The applicant has assets of \$203.4 million; the target has assets of \$40.5 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Westamerica Bank, San Rafael, California to acquire assets and liabilities of the Point Arena branch of Bank of America NT&SA, San Francisco, California

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-28-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7-31-95)

The applicant has assets of \$2.0 billion; the target has assets of \$13.4 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Orrstown Bank, Orrstown, Pennsylvania to acquire assets and liabilities of the Path Valley Road branch of Dauphin Deposit Bank and Trust Company, Harrisburg, Pennsylvania

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-20-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8-2-95)

The applicant has assets of \$128.5 million; the target has assets of \$14.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Triangle Bank, Raleigh, North Carolina to merge with The Village Bank, Chapel Hill, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8-11-95)

The applicant has assets of \$637.8 million; the target has assets of \$61.7 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Fifth Third Bank, Cincinnati, Ohio to acquire assets and liabilities of twelve branches of PNC Bank, Ohio, N.A., Cincinnati, Ohio

SUMMARY REPORT BY THE ATTORNEY GENERAL (6-30-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8-23-95)

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1995—Continued

The applicant has assets of \$9.2 billion; the targets have assets of \$257.7 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Triangle Bank, Raleigh, North Carolina to acquire assets and liabilities of four branches of NationsBank, N.A. (Carolinas), Charlotte, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-28-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8-29-95)

The applicant has assets of \$699.5 million; the targets have assets of \$48.8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Commercial Bank, Arlington, Virginia to merge with Bank First, N.A., McLean, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8-29-95)

The applicant has assets of \$60.9 million; the target has assets of \$20.2 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank of Oakfield, Oakfield, Wisconsin to acquire assets and liabilities of the Van Dyne branch of M&I Central State Bank, Ripon Wisconsin

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-28-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-5-95)

The applicant has assets of \$19.1 million; the target has assets of \$2.3 million. The parties operate in the same market. The banking factors and

considerations relating to the convenience and needs of the community are consistent with approval.

FCNB Bank, Frederick, Maryland to acquire assets and liabilities of the Monrovia branch of Laurel Federal Savings Bank, Laurel, Maryland

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-8-95)

The applicant has assets of \$444.7 million; the target has assets of \$6.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Elkridge Bank, Elkridge, Maryland to merge with Laurel Federal Savings Bank, Laurel, Maryland

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-8-95)

The applicant has assets of \$85.1 million; the target has assets of \$107.6 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Marine Midland Bank, Buffalo, New York to merge with United Northern Federal Savings Bank, Watertown, New York

SUMMARY REPORT BY THE ATTORNEY GENERAL (6-30-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-11-95)

The applicant has assets of \$18.6 billion; the target has assets of \$85.2 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

16.—Continued

Crestar Bank (MD), Bethesda, Maryland to acquire assets and liabilities of The Chase Manhattan Bank of Maryland, Baltimore, Maryland

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-28-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-22-95)

The applicant has assets of \$1.1 billion; the target has assets of \$454.7 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Valliwide Bank, Fresno, California to merge with El Capitan National Bank, Sonora, California

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-22-95)

The applicant has assets of \$1.1 billion; the target has assets of \$131.8 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Security Savings Bank, Farnhamville, Iowa to acquire assets and liabilities of the Harcourt and Lehigh branches of Boatmen's Bank of Fort Dodge, Fort Dodge, Iowa

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-29-95)

The applicant has assets of \$21.5 million; the targets have assets of \$3.1 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Fifth Third Bank, Cincinnati, Ohio to acquire assets and liabilities of seven branches of**Bank One, Cincinnati, Ohio, N.A., Cincinnati, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-20-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-23-95)

The applicant has assets of \$8.8 billion; the targets have assets of \$135.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Vectra Bank, Denver, Colorado to merge with First National Bank of Denver, Denver, Colorado

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-1-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-26-95)

The applicant has assets of \$334.0 million; the target has assets of \$47.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Byron Center State Bank, Byron Center, Michigan to acquire assets and liabilities of the Moline branch of First of America Bank-Michigan, N.A., Grand Rapids, Michigan

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-27-95)

The applicant has assets of \$192.2 million; the target has assets of \$11.3 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fleet Bank-NH, Nashua, New Hampshire to merge with Shawmut Bank NH, Manchester, New Hampshire

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-31-95)

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1995—Continued

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-14-95)

The applicant has assets of \$1.8 billion; the target has assets of \$1.5 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fleet Bank, Albany, New York to merge with Shawmut Bank New York, N.A., Schenectady, New York

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-31-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-14-95)

The applicant has assets of \$14.8 billion; the target has assets of \$1.7 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

BancFirst, Oklahoma City, Oklahoma to merge with Bank of Johnston County, Tishomingo, Oklahoma

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-20-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-16-95)

The applicant has assets of \$966.2 million; the target has assets of \$10.6 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fayette Bank, Uniontown, Pennsylvania to merge with The Huntington National Bank of Pennsylvania, Uniontown, Pennsylvania

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-21-95)

The applicant has assets of \$273.0 million; the target has assets of \$108.0 million. The parties

operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Republic Security Bank, West Palm Beach, Florida to merge with Banyan Bank, Boca Raton, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-20-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-22-95)

The applicant has assets of \$276.0 million; the target has assets of \$48.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Tri-County Bank, Brown City, Michigan to acquire assets and liabilities of the Yale and Peck branches of NBD Bank, Detroit, Michigan

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-29-95)

The applicant has assets of \$55.1 million; the targets have assets of \$24.8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Republic Security Bank, West Palm Beach, Florida to acquire assets and liabilities of one branch of Century Bank, F.S.B., Sarasota, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-30-95)

The applicant has assets of \$274.0 million; the target has assets of \$32.6 million. The parties operate in the same market. The banking factors and considerations relating to the convenience

16.—Continued

and needs of the community are consistent with approval.

Triangle Bank, Raleigh, North Carolina to acquire assets and liabilities of the Benson, Clayton, Havelock, and Mount Olive branches of First Union National Bank of North Carolina, Charlotte, North Carolina

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-1-95)

The applicant has assets of \$770.2 million; the targets have assets of \$56.7 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Citizens Bank of Talladega, Talladega, Alabama to merge with Talladega Federal Savings and Loan Association, Talladega, Alabama

SUMMARY REPORT BY THE ATTORNEY GENERAL (9-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-1-95)

The applicant has assets of \$28.4 million; the target has assets of \$35.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Barnett Bank of Polk County, Lakeland, Florida to merge with First Federal Savings & Loan Association of Lake Wales, Lake Wales, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-1-95)

The applicant has assets of \$946.9 million; the target has assets of \$132.2 million. The parties operate in the same market. The banking factors and considerations relating to the convenience

and needs of the community are consistent with approval.

BancFirst, Oklahoma City, Oklahoma to merge with City Bank & Trust Company, Oklahoma City, Oklahoma

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-5-95)

The applicant has assets of \$977.0 million; the target has assets of \$139.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Wellington State Bank, Wellington, Texas to acquire assets and liabilities of the Childress and Memphis branches of Bank of America Texas, N.A., Irving, Texas

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-7-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-6-95)

The applicant has assets of \$69.0 million; the targets have assets of \$18.1 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First United Bank, Boca Raton, Florida to merge with The American Bank of the South, Merritt Island, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL (9-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-11-95)

The applicant has assets of \$307.0 million; the target has assets of \$166.5 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1995—Continued

The Fifth Third Bank of Northern Kentucky, Inc., Florence, Kentucky to merge with Kentucky Enterprise Bank, F.S.B., Newport, Kentucky

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-21-95)

The applicant has assets of \$976.3 million; the target has assets of \$268.4 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank of Essex, Tappahannock, Virginia to acquire assets and liabilities of the West Point branch of First Union National Bank of Virginia, Roanoke, Virginia

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-13-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-21-95)

The applicant has assets of \$91.8 million; the target has assets of \$17.2 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Sulphur Springs State Bank, Sulphur Springs, Texas to merge with Colonial Bank of Greenville, Greenville, Texas

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-29-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-21-95)

The applicant has assets of \$317.7 million; the target has assets of \$81.7 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Fifth Third Bank of Northeastern Ohio, Cleveland, Ohio to merge with First Nationwide Bank, F.S.B., Dallas, Texas

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-13-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-26-95)

The applicant has assets of \$1.0 billion; the target has assets of \$1.4 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Southeastern Bank of Florida, Alachua, Florida to acquire assets and liabilities of the Yulee, Calahan and Hilliard branches of Compass Bank, Jacksonville, Florida

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-13-95)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-28-95)

The applicant has assets of \$40.0 million; the targets have assets of \$26.0 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

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.

16.—Continued

Institution ¹	Assets (millions of dollars)	Date of approval
Integra Bank—Pittsburgh, Wheeling, West Virginia	7,500	2-8-95
<i>Merger</i>		
Integra Bank—North, Titusville, Pennsylvania	3,300	
Integra Bank—South, Uniontown, Pennsylvania	2,500	
Premier Bank—North (formerly Dickenson—Buchanan Bank), Haysi, Virginia	88	2-22-95
<i>Merger</i>		
Premier Bank—Central (Pound branch), (formerly Peoples Bank, Inc.), Honaker, Virginia	10	
Firstar Bank Illinois, Naperville, Illinois	2,780	3-1-95
<i>Merger</i>		
All American Bank, Chicago, Illinois	73	
Colonial Bank, Chicago, Illinois	329	
Community Bank & Trust Company of Edgewater, Chicago, Illinois	70	
Michigan Avenue National Bank, Chicago, Illinois	224	
First Colonial Bank Southwest, Burbank, Illinois	42	
First Colonial Bank of McHenry County, Crystal Lake, Illinois	48	
First Colonial Bank of Downers Grove, Downers Grove, Illinois	37	
York State Bank, Elmhurst, Illinois	152	
Fox Lake State Bank, Fox Lake, Illinois	94	
First Colonial Bank—Highwood, Highwood, Illinois	102	
First Colonial Bank—Mundelein, Mundelein, Illinois	89	
First Colonial Bank of DuPage County, Naperville, Illinois	59	
First Colonial Bank—Northwest, Niles, Illinois	88	
First Colonial Bank—Northlake, Northlake, Illinois	46	
Avenue Bank of Oak Park, Oak Park, Illinois	151	
First Colonial Bank—Rosemont, Rosemont, Illinois	117	
First Colonial Bank of Lake County, Vernon Hills, Illinois	56	
Old Kent Bank, Elmhurst, Illinois	1,900	3-2-95
<i>Merger</i>		
Edgewood Bank, Countryside, Illinois	196	
Fifth Third Bank of Northeastern Ohio, Cleveland, Ohio	De novo	3-8-95
<i>Merger</i>		
Fifth Third Bank (certain assets), Cincinnati, Ohio	725	
Shelby County State Bank, Shelbyville, Illinois	95	3-10-95
<i>Merger</i>		
Strasburg, State Bank, Strasburg, Illinois	17	
Commercial Bank of Fremont, Fremont, California	112	3-22-95
<i>Merger</i>		
Alameda First National Bank (two Fremont branches), Alameda, California	39	

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities
Approved by the Board of Governors—Continued

Institution ¹	Assets (millions of dollars)	Date of approval
Concord Commercial Bank, Concord, California	53	3-22-95
<i>Merger</i>		
Alameda First National Bank (Concord branch), Alameda, California	25	
The Bank of San Ramon Valley, San Ramon, California	85	3-22-95
<i>Merger</i>		
Alameda First National Bank (San Ramon branch), Alameda, California	13	
Fifth Third Bank of Central Indiana, Indianapolis, Indiana	583	3-30-95
<i>Merger</i>		
Fifth Third Bank of Southeastern Indiana, Greensburg, Indiana	394	
ValliWide Bank, Fresno, California	739	5-3-95
<i>Merger</i>		
Community First Bank, Bakersfield, California	176	
First Interstate Bank of Commerce, Billings, Montana	789	5-18-95
<i>Merger</i>		
First National Park Bank in Livingston, Livingston, Montana	54	
First American Bank Valley, Grand Forks, North Dakota	164	5-25-95
<i>Merger</i>		
First American Bank and Trust of Grafton, Grafton, North Dakota ..	112	
First American Bank of Larimore, Larimore, North Dakota	31	
Old Kent Bank, Grand Rapids, Michigan	8,720	6-1-95
<i>Merger</i>		
First National Bank in Macomb County, Mount Clemens, Michigan ..	531	
Home Bank, Guntersville, Alabama	84	6-2-95
<i>Merger</i>		
Bank of Albertville, Albertville, Alabama	39	
First Bank of Arkansas, Jonesboro, Arkansas	243	6-13-95
<i>Merger</i>		
First Bank of Arkansas, Trumann, Arkansas	58	
Mercantile Bank of Kansas City, Kansas City, Missouri	777	6-14-95
<i>Merger</i>		
Citizens-Jackson County Bank, Warrensburg, Missouri	537	
1st Source Bank, South Bend, Indiana	1,540	6-19-95
<i>Merger</i>		
1st Source Bank of Starke County, Hamlet, Indiana	43	
M&I Marshall & Ilsley Bank, Milwaukee, Wisconsin	3,882	7-28-95
<i>Merger</i>		
M&I South Shore Bank, Cudahy, Wisconsin	99	
The Provident Bank, Cincinnati, Ohio	5,000	7-31-95
<i>Merger</i>		
Heritage Savings Bank, Cincinnati, Ohio	51	

16.—Continued

Institution ¹	Assets (millions of dollars)	Date of approval
Rolling Hills Bank & Trust, Atlantic, Iowa	27	9-22-95
<i>Merger</i>		
Griswold State Bank, Griswold, Iowa	12	
Signet Bank—Virginia, Richmond, Virginia	7,000	10-2-95
<i>Merger</i>		
Signet Bank—Maryland, Baltimore, Maryland	3,500	
BankWest, Goodland, Kansas	48	10-21-95
<i>Merger</i>		
BankWest, St. Francis, Kansas	21	
Rapides Bank and Trust Company, Alexandria, Louisiana	460	10-26-95
<i>Merger</i>		
Central Bank, Alexandria, Louisiana	59	
First Virginia Bank—Colonial, Richmond, Virginia	604	10-26-95
<i>Merger</i>		
First Virginia Bank—Southside, Farmville, Virginia	118	
The Northern Trust Company, Chicago, Illinois	15,671	11-21-95
<i>Merger</i>		
Northern Trust Bank—O'Hare, N.A., Chicago, Illinois	621	
Northern Trust Bank—Lake Forest, N.A., Chicago, Illinois	682	
Northern Trust Bank—DuPage, Chicago, Illinois	384	
Marine Midland Bank, New York, New York	18,844	11-21-95
<i>Merger</i>		
Hang Seng Bank Limited (two branches), New York, New York	417	
Baylake Bank—Kewaunee, Kewaunee, Wisconsin	64	11-30-95
<i>Merger</i>		
Baylake Bank, Sturgeon Bay, Wisconsin	245	
Hawkeye Bank, Des Moines, Iowa	271	11-30-95
<i>Merger</i>		
Hawkeye Bank of Ankeny, Ankeny, Iowa	41	
First Community Bank of Mercer County, Inc., Princeton, West Virginia	De novo	12-13-95
<i>Merger</i>		
First Community Bank, Inc. (certain assets), Princeton, West Virginia	434	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval. Some transactions

include the acquisition of only certain assets and liabilities of the affiliated bank.

Mergers Approved Involving a Nonoperating Institution with an Existing Bank

The following transactions have no significant effect on competition; they simply 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, 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
United Valley Bank, Philadelphia, Pennsylvania	112	3-1-95
<i>Merger</i>		
UVB Interim Bank, Philadelphia, Pennsylvania .....	...
Republic Bank, Philadelphia, Pennsylvania	106	3-3-95
<i>Merger</i>		
Republic Interim Bank, Philadelphia, Pennsylvania .....	...
Montour Bank, Danville, Pennsylvania	41	6-26-95
<i>Merger</i>		
Montour Interim Bank, Danville, Pennsylvania		
New U.S. Trust Company of New York, New York, New York .....	...	7-24-95
<i>Merger</i>		
United States Trust Company of New York, New York, New York ...	2,753	
Community Bank of the Islands, Sanibel, Florida	85	9-15-95
<i>Merger</i>		
Interim Bank of the Islands, Sanibel, Florida		
Southern Financial Bank, Warrenton, Virginia .....	...	9-28-95
<i>Merger</i>		
Southern Financial Federal Savings Bank, Warrenton, Virginia	158	

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, 1995

Members

Term expires January 31,

ALAN GREENSPAN, of New York, <i>Chairman</i> ¹	2006
ALAN S. BLINDER, of New Jersey, <i>Vice Chairman</i> ¹	1996
SUSAN M. PHILLIPS, of Iowa	1998
LAWRENCE B. LINDSEY, of Virginia	2000
EDWARD W. KELLEY, JR., of Texas	2004
JANET L. YELLEN, of California	2008

Officers

OFFICE OF BOARD MEMBERS

Joseph R. Coyne, *Assistant to the Board*
 Donald J. Winn, *Assistant to the Board*
 Theodore E. Allison, *Assistant to the Board
for Federal Reserve System Affairs*
 Lynn Fox, *Deputy Congressional Liaison*
 Bob Stahly Moore, *Special Assistant
to the Board*
 Winthrop P. Hambley, *Special Assistant
to the Board*
 Diane E. Werneke, *Special Assistant
to the Board*
 Portia W. Thompson, *Equal Employment
Opportunity Programs Adviser*

LEGAL DIVISION

J. Virgil Mattingly, Jr., *General Counsel*
 Scott G. Alvarez, *Associate General
Counsel*
 Richard M. Ashton, *Associate
General Counsel*
 Oliver Ireland, *Associate General
Counsel*
 Kathleen M. O'Day, *Associate General
Counsel*
 Robert deV. Frierson, *Assistant General
Counsel*
 Katherine H. Wheatley, *Assistant General
Counsel*

OFFICE OF THE SECRETARY

William W. Wiles, *Secretary*
 Jennifer J. Johnson, *Deputy Secretary*
 Barbara R. Lowrey, *Associate Secretary
and Ombudsman*

DIVISION OF INTERNATIONAL FINANCE

Edwin M. Truman, *Staff Director*
 Larry J. Promisel, *Senior
Associate Director*
 Charles J. Siegman, *Senior
Associate Director*
 Dale W. Henderson, *Associate Director*
 David H. Howard, *Senior Adviser*
 Donald B. Adams, *Assistant Director*
 Thomas A. Connors, *Assistant Director*
 Peter Hooper III, *Assistant Director*
 Karen H. Johnson, *Assistant Director*
 Catherine L. Mann, *Assistant Director*
 Ralph W. Smith, Jr., *Assistant Director*

DIVISION OF MONETARY AFFAIRS

Donald L. Kohn, *Director*
 David E. Lindsey, *Deputy Director*
 Brian F. Madigan, *Associate Director*
 Richard D. Porter, *Deputy Associate
Director*
 Vincent R. Reinhart, *Assistant Director*
 Normand R.V. Bernard, *Special Assistant
to the Board*

1. The designations as Chairman and Vice Chairman expire on March 2, 1996, and June 24, 1998, respectively, unless the service of these members of the Board shall have terminated sooner.

Board of Governors—Continued

DIVISION OF RESEARCH AND STATISTICS

Michael J. Prell, *Director*
Edward C. Ettin, *Deputy Director*
David J. Stockton, *Deputy Director*
Martha Bethea, *Associate Director*
William R. Jones, *Associate Director*
Myron L. Kwast, *Associate Director*
Patrick M. Parkinson, *Associate Director*
Thomas D. Simpson, *Associate Director*
Lawrence Slifman, *Associate Director*
Martha S. Scanlon, *Deputy
Associate Director*
Peter A. Tinsley, *Deputy
Associate Director*
Flint Brayton, *Assistant Director*
David S. Jones, *Assistant Director*
Stephen A. Rhoades, *Assistant Director*
Charles S. Struckmeyer, *Assistant Director*
Alice Patricia White, *Assistant Director*
Joyce K. Zickler, *Assistant Director*
John J. Mingo, *Senior Adviser*
Glenn B. Canner, *Adviser*

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Stephen C. Schemering, *Deputy Director*
Don E. Kline, *Associate Director*
William A. Ryback, *Associate Director*
Frederick M. Struble, *Associate Director*
Herbert A. Biern, *Deputy Associate
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Roger T. Cole, *Deputy Associate Director*
James I. Garner, *Deputy Associate Director*
Howard A. Amer, *Assistant Director*
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Stephen M. Hoffman, Jr., *Assistant
Director*
Laura M. Homer, *Assistant Director*
James V. Houpt, Jr., *Assistant Director*
Jack P. Jennings, *Assistant Director*
Michael G. Martinson, *Assistant Director*
Rhoger H. Pugh, *Assistant Director*
Sidney M. Sussan, *Assistant Director*
Molly S. Wassom, *Assistant Director*
William C. Schneider, Jr., *Project Director,*

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS

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Glenn E. Loney, *Associate Director*
Dolores S. Smith, *Associate Director*
Maureen P. English, *Assistant Director*
Irene Shawn McNulty, *Assistant Director*

DIVISION OF FEDERAL RESERVE BANK OPERATIONS AND PAYMENT SYSTEMS

Clyde H. Farnsworth, Jr., *Director*
David L. Robinson, *Deputy Director
(Finance and Control)*
Louise L. Roseman, *Associate Director*
Charles W. Bennett, *Assistant Director*
Jack Dennis, Jr., *Assistant Director*
Earl G. Hamilton, *Assistant Director*
Jeffrey C. Marquardt, *Assistant Director*
John H. Parrish, *Assistant Director*
Florence M. Young, *Assistant Director*

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S. David Frost, *Staff Director*
Sheila Clark, *Equal Employment
Opportunity Programs 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 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*

Board of Governors—Continued

DIVISION OF INFORMATION RESOURCES MANAGEMENT

Stephen R. Malphrus, *Director*
Marianne M. Emerson, *Assistant Director*
Po Kyung Kim, *Assistant Director*
Raymond H. Massey, *Assistant Director*
Edward T. Mulrenin, *Assistant Director*
Day W. Radebaugh, Jr., *Assistant Director*³
Elizabeth B. Riggs, *Assistant Director*
Richard C. Stevens, *Assistant Director*

DIVISION OF SUPPORT SERVICES

Robert E. Frazier, *Director*
George M. Lopez, *Assistant Director*
David L. Williams, *Assistant Director*

OFFICE OF THE INSPECTOR GENERAL

Brent L. Bowen, *Inspector General*
Donald L. Robinson, *Assistant Inspector General*
Barry R. Snyder, *Assistant Inspector General*

Federal Open Market Committee

December 31, 1995

Members

ALAN GREENSPAN, *Chairman*, Board of Governors
WILLIAM J. McDONOUGH, *Vice Chairman*, President, Federal Reserve Bank of New York
ALAN S. BLINDER, Board of Governors
THOMAS M. HOENIG, President, Federal Reserve Bank of Kansas City
EDWARD W. KELLEY, JR., Board of Governors
LAWRENCE B. LINDSEY, Board of Governors
THOMAS C. MELZER, President, Federal Reserve Bank of St. Louis
CATHY E. MINEHAN, President, Federal Reserve Bank of Boston
MICHAEL H. MOSKOW, President, Federal Reserve Bank of Chicago
SUSAN M. PHILLIPS, Board of Governors
JANET L. YELLEN, Board of Governors

Alternate Members

EDWARD G. BOEHNE, President, Federal Reserve Bank of Philadelphia
JERRY L. JORDAN, President, Federal Reserve Bank of Cleveland
ROBERT D. MCTEER, JR., President, Federal Reserve Bank of Dallas
ERNEST T. PATRIKIS, First Vice President, Federal Reserve Bank of New York
GARY H. STERN, President, Federal Reserve Bank of Minneapolis

Officers

DONALD L. KOHN,
Secretary and Economist
NORMAND R. V. BERNARD,
Deputy Secretary
JOSEPH R. COYNE,
Assistant Secretary
GARY P. GILLUM,
Assistant Secretary
J. VIRGIL MATTINGLY, JR.,
General Counsel

THOMAS C. BAXTER, JR.,
Deputy General Counsel
MICHAEL J. PRELL,
Economist
EDWIN M. TRUMAN,
Economist
LYNN E. BROWNE,
Associate Economist
THOMAS E. DAVIS,
Associate Economist

Federal Open Market Committee—Continued

WILLIAM G. DEWALD,
Associate Economist
WILLIAM C. HUNTER,
Associate Economist
DAVID E. LINDSEY,
Associate Economist
FREDERICK S. MISHKIN,
Associate Economist

LARRY J. PROMISEL,
Associate Economist
CHARLES J. SIEGMAN,
Associate Economist
LAWRENCE SLIFMAN,
Associate Economist
DAVID J. STOCKTON,
Associate Economist

PETER R. FISHER, *Manager, System Open Market Account*

During 1995 the Federal Open Market Committee held eight regularly scheduled meetings (see Minutes of Federal Open Market Committee Meetings in this REPORT.)

Federal Advisory Council

December 31, 1995

Members

- District 1—MARSHALL N. CARTER, *Chairman and Chief Executive Officer*, State Street Bank and Trust Company, Boston, Massachusetts
- District 2—WALTER V. SHIPLEY, *Chairman and Chief Executive Officer*, Chemical Banking Corporation, New York, New York
- District 3—ANTHONY P. TERRACCIANO, *Chairman, President, and Chief Executive Officer*, First Fidelity Bancorporation, Newark, New Jersey
- District 4—FRANK V. CAHOUE, *Chairman, President, and Chief Executive Officer*, Mellon Bank Corporation and Mellon Bank, N.A., Pittsburgh, Pennsylvania
- District 5—RICHARD G. TILGHMAN, *Chairman and Chief Executive Officer*, Crestar Financial Corporation, Richmond, Virginia
- District 6—CHARLES E. RICE, *Chairman and Chief Executive Officer*, Barnett Banks, Inc., Jacksonville, Florida
- District 7—ROGER L. FITZSIMONDS, *Chairman and Chief Executive Officer*, Firstar Corporation, Milwaukee, Wisconsin
- District 8—ANDREW B. CRAIG III, *Chairman, President, and Chief Executive Officer*, Boatmen's Bancshares, Inc., St. Louis, Missouri
- District 9—RICHARD M. KOVACEVICH, *Chairman, President, and Chief Executive Officer*, Norwest Corporation, Minneapolis, Minnesota
- District 10—CHARLES E. NELSON, *Chairman, Chief Executive Officer, and President*, Liberty Bank and Trust Company of Oklahoma City, N.A., Oklahoma City, Oklahoma
- District 11—CHARLES R. HRDLICKA, *Chairman and Chief Executive Officer*, Victoria BankShares, Inc., Victoria, Texas
- District 12—EDWARD A. CARSON, *Chairman and Chief Executive Officer (Retired)*, First Interstate Bancorp, Los Angeles, California

Officers

ANTHONY P. TERRACCIANO, *President* MARSHALL N. CARTER, *Vice President*
HERBERT V. PROCHNOW, *Secretary Emeritus*
JAMES E. ANNABLE, *Co-Secretary*
WILLIAM J. KORSVIK, *Co-Secretary*

Federal Advisory Council—Continued

Directors

FRANK V. CAHOUET

RICHARD G. TILGHMAN

CHARLES E. RICE

The Federal Advisory Council met on February 2–3, May 4–5, September 7–8, and November 2–3, 1995. The Board of Governors met with the council on February 3, May 5, September 8, and November 3, 1995. 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, 1995

Members

D. DOUGLAS BLANKE, *Director of Consumer Policy*, Office of the Attorney General, St. Paul, Minnesota

THOMAS R. BUTLER, *President and Chief Operating Officer*, NOVUS Services, Inc., Riverwoods, Illinois

ROBERT A. COOK, *Partner*, Venable, Baetjer, and Howard, Baltimore, Maryland

ALVIN J. COWANS, *President and Chief Executive Officer*, McCoy Federal Credit Union, Orlando, Florida

MICHAEL FERRY, *Staff Attorney*, Consumer Unit, Legal Services of Eastern Missouri, Inc., St. Louis, Missouri

ELIZABETH G. FLORES, *Senior Vice President*, Laredo National Bank, Laredo, Texas

EMANUEL FREEMAN, *President*, Greater Germantown Housing Development Corporation, Philadelphia, Pennsylvania

NORMA L. FREIBERG, *Community Activist*, New Orleans, Louisiana

DAVID C. FYNN, *Regulatory Risk Manager*, National City Corporation, Cleveland, Ohio

LORI GAY, *Executive Director*, Los Angeles Neighborhood Housing Services, Los Angeles, California

ROBERT G. GREER, *Vice Chairman*, Northern Trust Bank of Texas, N.A., Houston, Texas

KENNETH R. HARNEY, *Journalist*, Washington Post Writers Group, Chevy Chase, Maryland

GAIL K. HILLEBRAND, *Litigation Counsel*, West Coast Regional Office, Consumers Union of U.S., Inc., San Francisco, California

RONALD A. HOMER, *Chairman and Chief Executive Officer*, Boston Bank of Commerce, Boston, Massachusetts

THOMAS L. HOUSTON, *Executive Director*, The Dallas Black Chamber of Commerce, Dallas, Texas

TERRY JORDE, *President and Chief Executive Officer*, Towner County State Bank, Cando, North Dakota

EUGENE I. LEHRMANN, *President*, American Association of Retired Persons, Madison, Wisconsin

RONALD A. PRILL, *Vice President, Credit*, Dayton Hudson Corporation, Minneapolis, Minnesota

Consumer Advisory Council—Continued

- LISA RICE-COLEMAN, *Executive Director*, Fair Housing Center, Toledo, Ohio
 JOHN R. RINES, *President*, General Motors Acceptance Corporation, Detroit, Michigan
 JULIA M. SEWARD, *Vice President and Corporate Community Reinvestment Officer*,
 Signet Bank, Richmond, Virginia
 ANNE B. SHLAY, *Associate Director*, Institute for Public Policy Studies, Temple
 University, Philadelphia, Pennsylvania
 REGINALD J. SMITH, *President*, United Missouri Mortgage Company, Kansas City,
 Missouri
 JOHN E. TAYLOR, *President and Chief Executive Officer*, The National Community
 Reinvestment Coalition, Washington, D.C.
 LORRAINE VANETTEN, *Vice President and Community Lending Officer*, Standard Federal
 Bank of Troy, Troy, Michigan
 GRACE W. WEINSTEIN, *Financial Writer and Consultant*, Englewood, New Jersey
 LILY K. YAO, *President and Chief Executive Officer*, Pioneer Federal Savings Bank,
 Honolulu, Hawaii
 ROBERT O. ZDENEK, *Director, Economic Development*, New Community Corporation,
 Newark, New Jersey

Officers

JAMES L. WEST, *Chairman*
 President, Jim West
 Financial Group, Inc.,
 Tijeras, New Mexico

KATHARINE W. MCKEE, *Vice Chairman*
 Associate Director,
 Center for Community Self-Help,
 Durham, North Carolina

The Consumer Advisory Council met with members of the Board of Governors on March 23, June 29, and November 2, 1995. The council is composed of academics, state and local government officials, representatives of the financial industry, and repre-

sentatives 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, 1995

Members

- E. LEE BEARD, *President and Chief Executive Officer*, First Federal Savings and Loan Association of Hazleton, Hazleton, Pennsylvania
 JOHN E. BRUBAKER, formerly *President and Chief Executive Officer*, Bay View Federal Bank, A FSB, San Mateo, California
 MALCOLM E. COLLIER, *Chairman and Chief Executive Officer*, First Federal Savings Bank, Lakewood, Colorado
 GEORGE L. ENGELKE, JR., *President and Chief Executive Officer*, Astoria Federal Savings and Loan Association, Lake Success, New York
 BEVERLY D. HARRIS, *President*, Empire Federal Savings and Loan Association, Livingston, Montana
 DAVID F. HOLLAND, *Chairman, President, and Chief Executive Officer*, Boston Federal Savings Bank, Burlington, Massachusetts

Thrift Institutions Advisory Council—Continued

CHARLES JOHN KOCH, *President and Chief Executive Officer*, Charter One Bank, F.S.B., Cleveland, Ohio

JOSEPH C. SCULLY, *Chairman and Chief Executive Officer*, St. Paul Federal Bank for Savings, Chicago, Illinois

STEPHEN D. TAYLOR, *formerly President and Chief Executive Officer*, American Savings of Florida, F.S.B., Miami, Florida

JOHN M. TIPPETS, *President and Chief Executive Officer*, American Airlines Employees Federal Credit Union, DFW Airport, Texas

LARRY T. WILSON, *President and Chief Executive Officer*, Coastal Federal Credit Union, Raleigh, North Carolina

WILLIAM W. ZUPPE, *President and Chief Operating Officer*, Sterling Savings Association, Spokane, Washington

Officers

CHARLES JOHN KOCH, *President*

STEPHEN D. TAYLOR, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on March 10, June 2, September 15, and December 1, 1995. 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 and Branches

December 31, 1995

BANK or Branch	Chairman ¹ Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON ²	Jerome H. Grossman William C. Brainard	Cathy E. Minehan Paul M. Connolly	
NEW YORK ²	Maurice R. Greenberg John C. Whitehead	William J. McDonough Ernest T. Patrikis	
Buffalo	Joseph J. Castiglia		Carl W. Turnipseed ³
PHILADELPHIA	James M. Mead Donald J. Kennedy	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND ²	A. William Reynolds G. Watts Humphrey, Jr.	Jerry L. Jordan Sandra Pianalto	
Cincinnati	John N. Taylor, Jr.		Charles A. Cerino ³
Pittsburgh	Robert P. Bozzone		Harold J. Swart ³
RICHMOND ²	Henry J. Faison Claudine B. Malone	J. Alfred Broadbuss, Jr. Walter A. Varvel	
Baltimore	Michael R. Watson		William J. Tignanelli ³
Charlotte	James O. Roberson		Dan M. Bechter ³

Officers of Federal Reserve Banks and Branches— Continued

BANK or Branch	Chairman ¹ Deputy Chairman	President First Vice President	Vice President in charge of Branch
ATLANTA	Leo Benatar	Robert P. Forrestal	James M. McKee ³
Birmingham	Hugh M. Brown	Jack Guynn	Fred R. Herr ³
Jacksonville	Patricia B. Compton		James D. Hawkins ³
Miami	Lana Jane Lewis-Brent		James T. Curry III
Nashville	Michael T. Wilson		Melvyn K. Purcell
New Orleans	James E. Dalton, Jr.		Robert J. Musso
	Jo Ann Slaydon		
CHICAGO ²	Robert M. Healey	Michael H. Moskow	
	Richard G. Cline	William C. Conrad	
Detroit	John D. Forsyth		David R. Allardice ³
ST. LOUIS	Robert H. Quenon	Thomas C. Melzer	
	John F. McDonnell	James R. Bowen	
Little Rock	Janet M. Jones		Karl W. Ashman
Louisville	Daniel L. Ash		Howard Wells
Memphis	Woods E. Eastland		John P. Baumgartner
MINNEAPOLIS	Gerald A.	Gary H. Stern	
	Rauenhorst	Colleen K. Strand	
	Jean D. Kinsey		
Helena	Matthew J. Quinn		John D. Johnson
KANSAS CITY	Herman Cain	Thomas M. Hoenig	
	A. Drue Jennings	Richard K. Rasdall	
Denver	Sandra K. Woods		Carl M. Gambs ³
Oklahoma City	Ernest L. Holloway		Mark L. Mullinix
Omaha	LeRoy W. Thom		Harold L. Shewmaker
DALLAS	Cece Smith	Robert D. McTeer, Jr.	
	Roger R.	Tony J. Salvaggio	
	Hemminghaus		
El Paso	W. Thomas Beard III		Sammie C. Clay
Houston	Isaac H. Kempner III		Robert Smith III ³
San Antonio	Carol L. Thompson		James L. Stull ⁴
SAN FRANCISCO	Judith M. Runstad	Robert T. Parry	
	James A. Vohs	Patrick K. Barron	
Los Angeles	Anita E. Landecker		John F. Moore ⁴
Portland	Ross R. Runkel		Raymond H. Laurence
Salt Lake City	Gerald R. Sherratt		Andrea P. Wolcott
Seattle	George F. Russell, Jr.		Gordon R. G. Werkema ³

NOTE. A current list of these officers appears each month in the *Federal Reserve Bulletin*.

1. The Chairman of a Federal Reserve Bank serves, by statute, as Federal Reserve Agent.

2. Additional offices of these Banks are located at Lewiston, Maine; Windsor Locks, Connecticut; Utica at Oriskany, New York; Jericho, New York; East Ruther-

ford, New Jersey; Columbus, Ohio; Charleston, West Virginia; Culpeper, Virginia; Columbia, South Carolina; Indianapolis, Indiana; Milwaukee, Wisconsin; Des Moines, Iowa; and Peoria, Illinois.

3. Senior Vice President.

4. 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, 1995.

The members of the Executive Committee of the Conference of Chairmen during 1995 were Jerome H. Grossman, chairman; Cece Smith, vice chair; and A. William Reynolds, member.

On November 30, 1995, the conference elected its Executive Committee for 1996; it named Cece Smith as chair, A. William Reynolds as vice chairman, and John F. McDonnell 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.

Robert D. McTeer, President of the Federal Reserve Bank of Dallas, served as chairman of the conference in 1995, and Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, served as its vice chairman. Helen E. Holcomb, of the Federal Reserve Bank of Dallas, served as its secretary. David A. Saperaro, of the Federal Reserve Bank of Kansas City, served as its assistant secretary until September 18, 1995, and Esther L. George, of the same Reserve Bank, served as its assistant secretary for the balance of the year.

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.

Tony J. Salvaggio, First Vice President of the Federal Reserve Bank of Dallas, served as chairman of the conference in 1995, and

Sandra Pianalto, First Vice President of the Federal Reserve Bank of Cleveland, served as its vice chair. Joanna O. Kolson, of the Federal Reserve Bank of Dallas, served as its secretary and Martha Maher, of the Federal Reserve Bank of Cleveland, served as its assistant secretary.

On October 10, 1995, the conference elected Sandra Pianalto as its chair for 1996 and Colleen K. Strand, First Vice President of the Federal Reserve Bank of Minneapolis, as its vice chair.

Directors

The following list of directors of Federal Reserve Banks and Branches shows for each director the class of directorship, the director's principal organizational affiliation, and the date the director's term expires. Each Federal Reserve Bank has a nine-member board: 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.

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. Annually, the Board of Governors designates one of the Class C directors as chairman of the board and Federal Reserve Agent of each District Bank, and it designates 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 and Branches."

Term expires
Dec. 31

DISTRICT 1—BOSTON

Class A

Marshall N. Carter	Chairman, President, and Chief Executive Officer, State Street Bank and Trust Company, Boston, Massachusetts	1995
Vacancy		1996
Jane C. Walsh	President and Chief Executive Officer, Northmark Bank, North Andover, Massachusetts	1997

Class B

Joan T. Bok	Chairman, New England Electric System, Westborough, Massachusetts	1995
Stephen L. Brown	Chairman and Chief Executive Officer, John Hancock Mutual Life Insurance Company, Boston, Massachusetts	1996
Edward Dugger III	President and Chief Executive Officer, UNC Ventures, Inc., Boston, Massachusetts	1997

Class C

William C. Brainard	Professor of Economics and Chair, Department of Economics, Yale University, New Haven, Connecticut	1995
John E. Flynn	Executive Director, The Quality Connection, East Dennis, Massachusetts	1996
Jerome H. Grossman	Chairman, Outcomes and Health Services Research and Development Center, Boston, Massachusetts	1997

DISTRICT 2—NEW YORK

Class A

Robert G. Wilmers	Chairman, President, and Chief Executive Officer, Manufacturers and Traders Trust Company, Buffalo, New York	1995
J. William Johnson	Chairman and Chief Executive Officer, The First National Bank of Long Island, Glen Head, New York	1996
J. Carter Bacot	Chairman and Chief Executive Officer, The Bank of New York, New York, New York	1997

Class B

William C. Steere, Jr.	Chairman and Chief Executive Officer, Pfizer Inc., New York, New York	1995
Sandra Feldman	President, United Federation of Teachers, New York, New York	1996

Term expires
Dec. 31

DISTRICT 2, *Class B*—Continued

Eugene R. McGrath	Chief Executive Officer, Consolidated Edison Company of New York, Inc., New York, New York	1997
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Class C

Herbert L. Washington	Owner, HLW Fast Track, Inc., Rochester, New York	1995
John C. Whitehead	Chairman, AEA Investors Inc., New York, New York	1996
Maurice R. Greenberg	Chairman, American International Group, Inc., New York, New York	1997

BUFFALO BRANCH

Appointed by the Federal Reserve Bank

George W. Hamlin IV	President and Chief Executive Officer, The Canandaigua National Bank and Trust Company, Canandaigua, New York	1995
Louise C. Woerner	Chairman and Chief Executive Officer, HCR, Rochester, New York	1996
Mark W. Adams	Owner and Operator, Adams Poultry Farm, Naples, New York	1997
William E. Swan	President and Chief Executive Officer, Lockport Savings Bank, Lockport, New York	1997

Appointed by the Board of Governors

F. C. Richardson	President, Buffalo State College, Buffalo, New York	1995
Joseph J. Castiglia	President and Chief Executive Officer, Pratt & Lambert United, Inc., Buffalo, New York	1996
Donald L. Rust	Plant Manager, Tonawanda Engine Plant, General Motors Powertrain Division, General Motors Corporation, Buffalo, New York	1997

DISTRICT 3—PHILADELPHIA

Class A

Carl L. Campbell	President and Chief Executive Officer, Keystone Financial, Inc., Harrisburg, Pennsylvania	1995
Terry K. Dunkle	Chairman, United States National Bank, Johnstown, Pennsylvania	1996
Dennis W. DiLazzero	President and Chief Executive Officer, Minotola National Bank, Vineland, New Jersey	1997

Class B

David W. Huggins	President and Chief Executive Officer, RMS Technologies, Inc., Marlton, New Jersey	1995
J. Richard Jones	President and Chief Executive Officer, Jackson-Cross Company, Philadelphia, Pennsylvania	1996

Term expires
Dec. 31

DISTRICT 3, Class B—Continued

Robert D. Burris	President and Chief Executive Officer, Burris Foods, Inc., Milford, Delaware	1997
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Class C

James M. Mead	President and Chief Executive Officer, Capital Blue Cross, Harrisburg, Pennsylvania	1995
Joan Carter	President and Chief Operating Officer, UM Holdings Ltd., Haddonfield, New Jersey	1996
Donald J. Kennedy	Business Manager, International Brotherhood of Electrical Workers, Local Union No. 269, Trenton, New Jersey	1997

DISTRICT 4—CLEVELAND

Class A

Edward B. Brandon	Chairman and Chief Executive Officer (Retired), National City Corporation, Cleveland, Ohio	1995
Alfred C. Leist	Chairman, President, and Chief Executive Officer, The Apple Creek Banking Company, Apple Creek, Ohio	1996
David S. Dahlmann	President and Chief Executive Officer, Southwest National Corporation, Greensburg, Pennsylvania	1997

Class B

I. N. Rendall Harper, Jr.	President and Chief Executive Officer, American Micrographics Company, Inc., Monroeville, Pennsylvania	1995
Thomas M. Nies	President, Cincom Systems, Inc., Cincinnati, Ohio	1996
Michele Tolela Myers	President, Denison University, Granville, Ohio	1997

Class C

A. William Reynolds	Chief Executive, Old Mill Group, Hudson, Ohio	1995
Robert Y. Farrington	Executive Secretary-Treasurer, Ohio State Building and Construction Trades Council, Columbus, Ohio	1996
G. Watts Humphrey, Jr.	President, GWH Holdings, Inc., Pittsburgh, Pennsylvania	1997

CINCINNATI BRANCH

Appointed by the Federal Reserve Bank

Jerry W. Carey	President and Chief Executive Officer, Union National Bank and Trust Company, Barbourville, Kentucky	1995
Judith G. Clabes	Director, Special Projects, Scripps Howard, Cincinnati, Ohio	1996

Term expires
Dec. 31

DISTRICT 4, CINCINNATI BRANCH

Appointed by the Federal Reserve Bank—Continued

Phillip R. Cox	President, Cox Financial Corporation, Cincinnati, Ohio	1996
Jerry A. Grundhofer	Chairman, President, and Chief Executive Officer, Star Banc Corporation, Cincinnati, Ohio	1997

Appointed by the Board of Governors

Eleanor Hicks	President, M.I.N.D.S. International, Cincinnati, Ohio	1995
John N. Taylor, Jr.	Chairman and Chief Executive Officer, Kurz-Kasch, Inc., Dayton, Ohio	1996
C. Wayne Shumate	Chairman and Chief Executive Officer, Kentucky Textiles, Inc., Paris, Kentucky	1997

PITTSBURGH BRANCH

Appointed by the Federal Reserve Bank

Helen J. Clark	Chairman, President, and Chief Executive Officer, Apollo Trust Company, Apollo, Pennsylvania	1995
Randall L. C. Russell	President and Chief Executive Officer, Ranbar Technology, Inc., Glenshaw, Pennsylvania	1996
Wesley W. von Schack	Chairman, President, and Chief Executive Officer, DQE, Pittsburgh, Pennsylvania	1996
Thomas J. O'Shane	President and Chief Executive Officer, First Western Bancorp, Inc., New Castle, Pennsylvania	1997

Appointed by the Board of Governors

Robert P. Bozzone	Vice Chairman of the Board, Allegheny Ludlum Corporation, Pittsburgh, Pennsylvania	1995
Sandra L. Phillips	Executive Director, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania	1996
John T. Ryan III	President, Chairman, and Chief Executive Officer, Mine Safety Appliances Company, Pittsburgh, Pennsylvania	1997

DISTRICT 5—RICHMOND

Class A

Charles E. Weller	President and Chief Executive Officer, Elkridge Bank, Elkridge, Maryland	1995
Robert M. Freeman	Chairman and Chief Executive Officer, Signet Banking Corporation, Richmond, Virginia	1996

DISTRICT 5, Class A—Continued

Philip L. McLaughlin	President and Chief Executive Officer, Horizon Bancorp, Inc., Greenbrier Valley National Bank, Lewisburg, West Virginia	1997
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Class B

R.E. Atkinson, Jr.	Chairman, Dilmar Oil Company, Inc., Florence, South Carolina	1995
Paul A. DelaCourt	Chairman, The North Carolina Enterprise Corporation, Raleigh, North Carolina	1996
L. Newton Thomas, Jr.	Senior Vice President (Retired), ITT/Carbon Industries, Inc., Charleston, West Virginia	1997

Class C

Henry J. Faison	Chairman, Faison, Charlotte, North Carolina	1995
Stephen Brobeck	Executive Director, Consumer Federation of America, Washington, D.C.	1996
Claudine B. Malone	President, Financial and Management Consulting, Inc., McLean, Virginia	1997

BALTIMORE BRANCH

Appointed by the Federal Reserve Bank

Richard M. Adams	Chairman and Chief Executive Officer, United Bankshares, Inc., Parkersburg, West Virginia	1995
Morton I. Rapoport	President and Chief Executive Officer, University of Maryland Medical System, Baltimore, Maryland	1996
Thomas J. Hughes	President and Chief Executive Officer, Navy Federal Credit Union, Vienna, Virginia	1997
F. Levi Ruark	Chairman, President, and Chief Executive Officer, The National Bank of Cambridge, Cambridge, Maryland	1997

Appointed by the Board of Governors

Daniel R. Baker	President and Chief Executive Officer, Tate Access Floors, Inc., Jessup, Maryland	1995
Michael R. Watson	President, Association of Maryland Pilots, Baltimore, Maryland	1996
Rebecca Hahn Windsor	Chairman and Chief Executive Officer, Hahn Transportation, Inc., New Market, Maryland	1997

CHARLOTTE BRANCH

Appointed by the Federal Reserve Bank

David B. Jordan	Vice Chairman and Director, CCB Financial Corporation, Salisbury, North Carolina	1995
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Term expires
Dec. 31

DISTRICT 5, CHARLOTTE BRANCH

Appointed by the Federal Reserve Bank—Continued

Jim M. Cherry, Jr.	President and Chief Executive Officer, Williamsburg First National Bank, Kingstree, South Carolina	1996
Dorothy H. Aranda	President, Dohara Associates, Inc., Hilton Head Island, South Carolina	1997
J. Walter McDowell	President and Chief Executive Officer, Wachovia Bank of North Carolina, N.A., Winston-Salem, North Carolina	1997

Appointed by the Board of Governors

James O. Roberson	President, Research Triangle Foundation of North Carolina, Research Triangle Park, North Carolina	1995
Dennis D. Lowery	Chief Executive Officer and Chairman, Continental Ltd., Charlotte, North Carolina	1996
Joan H. Zimmerman	President, Southern Shows, Inc., Charlotte, North Carolina	1997

DISTRICT 6—ATLANTA

Class A

W. H. Swain	Chairman, First National Bank, Oneida, Tennessee	1995
James B. Williams	Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, Georgia	1996
D. Paul Jones, Jr.	Chairman and Chief Executive Officer, Compass Bancshares, Inc., Birmingham, Alabama	1997

Class B

J. Thomas Holton	Chairman and President, Sherman International Corporation, Birmingham, Alabama	1995
Andre M. Rubenstein	Chairman and Chief Executive Officer, Rubenstein Brothers, Inc., New Orleans, Louisiana	1996
Maria Camila Leiva	Executive Vice President, Miami Free Zone Corporation, Miami, Florida	1997

Class C

Leo Benatar	Chairman, Engraph, Inc., Atlanta, Georgia	1995
Daniel E. Sweat, Jr.	Program Director, The America Project, Atlanta, Georgia	1996
Hugh M. Brown	President and Chief Executive Officer, BAMSI, Inc., Titusville, Florida	1997

Term expires
Dec. 31

DISTRICT 6, ATLANTA—Continued

BIRMINGHAM BRANCH

Appointed by the Federal Reserve Bank

J. Stephen Nelson	Chairman and Chief Executive Officer, First National Bank of Brewton, Brewton, Alabama	1995
Julian W. Banton	Chairman, President, and Chief Executive Officer, SouthTrust Bank of Alabama, N.A., Birmingham, Alabama	1996
Marlin D. Moore, Jr.	Chairman, Pritchett-Moore, Inc., Tuscaloosa, Alabama	1997
Columbus Sanders	President, Consolidated Industries, Inc., Huntsville, Alabama	1997

Appointed by the Board of Governors

Patricia B. Compton	President, Patco, Inc., Georgiana, Alabama	1995
Donald E. Boomershine	President, The Better Business Bureau of Central Alabama, Inc., and the Counties of the Wiregrass, Birmingham, Alabama	1996
D. Bruce Carr	International Representative, Laborers' International Union, AFL-CIO of North America, Gadsden, Alabama	1997

JACKSONVILLE BRANCH

Appointed by the Federal Reserve Bank

Royce B. Walden	Vice President, Ward Bradford & Company, Orlando, Florida	1995
William G. Smith, Jr.	President, Capital City First National Bank, Tallahassee, Florida	1996
Arnold A. Heggstad	Chester Holloway Professor of Entrepreneurship, University of Florida, Gainesville, Florida	1997
Terry R. West	President and Chief Executive Officer, Jax Navy Federal Credit Union, Jacksonville, Florida	1997

Appointed by the Board of Governors

Lana Jane Lewis-Brent	President, Paul Brent Designer, Inc., Panama City, Florida	1995
Joan Dial Ruffier	General Partner, Sunshine Cafes, Orlando, Florida	1996
Patrick C. Kelly	Chairman and Chief Executive Officer, Physician Sales and Service, Inc., Jacksonville, Florida	1997

Term expires
Dec. 31

DISTRICT 6, ATLANTA—Continued

MIAMI BRANCH

Appointed by the Federal Reserve Bank

E. Anthony Newton	President and Chief Executive Officer, Island National Bank and Trust Company, Palm Beach, Florida	1995
Steven C. Shimp	President, O-A-K/Florida, Inc., Fort Myers, Florida	1996
Pat L. Tornillo, Jr.	Executive Vice President, United Teachers of Dade, Miami, Florida	1996
Carlos A. Migoya	President, Dade/Monroe Counties, First Union National Bank of Florida, Miami, Florida	1997

Appointed by the Board of Governors

R. Kirk Landon	Chairman and Chief Executive Officer, American Bankers Insurance Group, Miami, Florida	1995
Michael T. Wilson	President, Vinegar Bend Farms, Inc., Belle Glade, Florida	1996
Kaaren Johnson-Street	Vice President, Diversity Business Enterprise, Burger King Corporation, Miami, Florida	1997

NASHVILLE BRANCH

Appointed by the Federal Reserve Bank

James D. Harris	President and Chief Executive Officer, Brentwood National Bank, Brentwood, Tennessee	1995
Williams E. Arant, Jr.	Chairman, First Knoxville Bank, Knoxville, Tennessee	1996
John E. Seward, Jr.	President and Chief Executive Officer, The Paty Company, Piney Flats, Tennessee	1997
Jack J. Vaughn	President, Opryland Hospitality & Attractions Group, Gaylord Entertainment Company, Nashville, Tennessee	1997

Appointed by the Board of Governors

Frances F. Marcum	Chairman and Chief Executive Officer, Micro Craft, Inc., Tullahoma, Tennessee	1995
Paula Lovell	President, Lovell Communications, Inc., Nashville, Tennessee	1996
James E. Dalton, Jr.	President and Chief Executive Officer, Quorum Health Group, Inc., Brentwood, Tennessee	1997

Term expires
Dec. 31

DISTRICT 6, ATLANTA—Continued

NEW ORLEANS BRANCH

Appointed by the Federal Reserve Bank

Thomas E. Walker	Chairman and Chief Executive Officer, Bank of Forest, Forest, Mississippi	1995
Howard C. Gaines	Chairman and Chief Executive Officer, First National Bank of Commerce, New Orleans, Louisiana	1996
Angus R. Cooper II	Chairman and Chief Executive Officer, Cooper/T. Smith Corporation, Mobile, Alabama	1997
Kay L. Nelson	President, Nelson Capital Corporation, New Orleans, Louisiana	1997

Appointed by the Board of Governors

Lucimarian Tolliver		
Roberts	President, Mississippi Coast Coliseum Commission, Biloxi, Mississippi	1995
Victor Bussie	President, Louisiana AFL-CIO, Baton Rouge, Louisiana	1996
Jo Ann Slaydon	President, Slaydon Consultants and Insight Productions and Advertising, Baton Rouge, Louisiana	1997

DISTRICT 7—CHICAGO

Class A

Arnold C. Schultz	Chairman, President, and Chief Executive Officer, Grundy National Bank, Grundy Center, Iowa	1995
David W. Fox	Chairman and Chief Executive Officer, The Northern Trust Corporation and The Northern Trust Company, Chicago, Illinois	1996
Stefan S. Anderson	Chairman, President, and Chief Executive Officer, First Merchants Corporation, Muncie, Indiana	1997

Class B

Donald J. Schneider	President, Schneider National, Inc., Green Bay, Wisconsin	1995
A. Charlene Sullivan	Associate Professor of Management, Krannert Graduate School of Management, Krannert Center, Purdue University, West Lafayette, Indiana	1996
Thomas C. Dorr	President and Chief Executive Officer, Dorr's Pine Grove Farm Co., Marcus, Iowa	1997

Class C

Richard G. Cline	Chairman, NICOR Inc., Naperville, Illinois	1995
Robert M. Healey	Member, Illinois State Labor Relations Board, Chicago, Illinois	1996

Term expires
Dec. 31

DISTRICT 7, Class C—Continued

Lester H. McKeever, Jr.	Managing Partner, Washington, Pittman & McKeever, Chicago, Illinois	1997
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DETROIT BRANCH

Appointed by the Federal Reserve Bank

Norman F. Rodgers	President and Chief Executive Officer, Hillsdale County National Bank, Hillsdale, Michigan	1995
Charles E. Allen	President and Chief Executive Officer, Graimark Realty Advisors, Inc., Detroit, Michigan	1996
William E. Odom	Chairman and Chief Executive Officer, Ford Motor Credit Company, Dearborn, Michigan	1996
Charles R. Weeks	Chairman and Chief Executive Officer, Citizens Banking Corporation, Flint, Michigan	1997

Appointed by the Board of Governors

J. Michael Moore	Chairman and Chief Executive Officer, Invetech Company, Detroit, Michigan	1995
Florine Mark	President and Chief Executive Officer, The WW Group, Farmington Hills, Michigan	1996
John D. Forsyth	Executive Director, University of Michigan Hospitals, Ann Arbor, Michigan	1997

DISTRICT 8—ST. LOUIS

Class A

Douglas M. Lester	Chairman and President, Trans Financial Bancorp, Inc., Bowling Green, Kentucky	1995
W. D. Glover	Chairman and Chief Executive Officer, First National Bank of Eastern Arkansas, Forrest City, Arkansas	1996
Michael A. Alexander	Chairman and President, The First National Bank of Mount Vernon, Mount Vernon, Illinois	1997

Class B

Richard E. Bell	President and Chief Executive Officer, Riceland Foods, Inc., Stuttgart, Arkansas	1995
Warren R. Lee	President, United Benefit Services, Inc., Louisville, Kentucky	1996
Sandra B. Sanderson	President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi	1997

Class C

John F. McDonnell	Chairman, McDonnell Douglas Corporation, St. Louis, Missouri	1995
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Term expires
Dec. 31

DISTRICT 8, Class C—Continued

Veo Peoples, Jr.	Partner, Peoples & Hale, St. Louis, Missouri	1996
Robert H. Quenon	Mining Consultant, St. Louis, Missouri	1997

LITTLE ROCK BRANCH

Appointed by the Federal Reserve Bank

Mark A. Shelton III	President, M. A. Shelton Farming Company, Altheimer, Arkansas	1995
Vacancy		1996
James V. Kelley	Chairman, President, and Chief Executive Officer, First United Bancshares, Inc., El Dorado, Arkansas	1996
Lunsford W. Bridges	President and Chief Executive Officer, Metropolitan National Bank, Little Rock, Arkansas	1997

Appointed by the Board of Governors

Betta M. Carney	Chairman and Chief Executive Officer, World Wide Travel Service, Inc., Little Rock, Arkansas	1995
Janet M. Jones	President, The Janet Jones Company, Little Rock, Arkansas	1996
Robert D. Nabholz, Jr.	Chief Executive Officer, Nabholz Construction Corporation, Conway, Arkansas	1997

LOUISVILLE BRANCH

Appointed by the Federal Reserve Bank

Malcolm B. Chancey, Jr.	Chairman and Chief Executive Officer, Bank One, Kentucky, N.A., Louisville, Kentucky	1995
Robert M. Hall	Owner, East Fork Growers Farm, Seymour, Indiana	1996
Charles D. Storms	President and Chief Executive Officer, Red Spot Paint and Varnish Company, Inc., Evansville, Indiana	1996
Thomas E. Spragens, Jr.	President, Farmers National Bank, Lebanon, Kentucky	1997

Appointed by the Board of Governors

Daniel L. Ash	Consultant, Wenz-Neely Company, Louisville, Kentucky	1995
John A. Williams	Chairman and Chief Executive Officer, Computer Services, Inc., Paducah, Kentucky	1996
Laura M. Douglas	Legal Counsel, Louisville & Jefferson County Metropolitan Sewer District, Louisville, Kentucky	1997

Term expires
Dec. 31

DISTRICT 8, ST. LOUIS—Continued

MEMPHIS BRANCH

Appointed by the Federal Reserve Bank

Anthony M. Rampley	President and Chief Executive Officer, Arkansas Glass Container Corporation, Jonesboro, Arkansas	1995
Benjamin W. Rawlins, Jr. ...	Chairman and Chief Executive Officer, Union Planters Corporation, Memphis, Tennessee	1996
Katie S. Winchester	President, First Citizens National Bank, Dyersburg, Tennessee	1996
Lewis F. Mallory, Jr.	Chairman, President, and Chief Executive Officer, NBC Capital Corporation, Starkville, Mississippi	1997

Appointed by the Board of Governors

John V. Myers	President, Better Business Bureau, Memphis, Tennessee	1995
Woods E. Eastland	President and Chief Executive Officer, Staple Cotton Cooperative Association, Greenwood, Mississippi	1996
Carol G. Crawley	President, Mid-South Minority Business Council, Memphis, Tennessee	1997

DISTRICT 9—MINNEAPOLIS

Class A

Susanne V. Boxer	President and Chief Executive Officer, MFC First National Bank, Houghton, Michigan	1995
Jerry B. Melby	President, First National Bank, Bowbells, North Dakota	1996
William S. Pickerign	President, The Northwestern Bank, Chippewa Falls, Wisconsin	1997

Class B

Dennis W. Johnson	President, TMI Systems Design Corporation/TMI Transport Corporation, Dickinson, North Dakota	1995
Clarence D. Mortenson	President, M/C Professional Associates, Inc., Pierre, South Dakota	1996
Kathryn A. Ogren	Owner and Dealer, Bitterroot Motors, Missoula, Montana	1997

Class C

Gerald A. Rauenhurst	Chairman and Chief Executive Officer, Opus Corporation, Minneapolis, Minnesota	1995
David A. Koch	Chairman and Chief Executive Officer, Graco, Inc., Golden Valley, Minnesota	1996

Term expires
Dec. 31

DISTRICT 9, Class C—Continued

Jean D. Kinsey	Professor, Department of Applied Economics, College of Agricultural, Food, and Environmental Sciences, University of Minnesota, St. Paul, Minnesota	1997
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HELENA BRANCH

Appointed by the Federal Reserve Bank

Ronald D. Scott	President and Chief Executive Officer, The First State Bank of Malta, Malta, Montana	1995
Donald E. Olsson, Jr.	President, Ronan State Bank, Ronan, Montana	1996
Sandra M. Stash	Manager, Montana Facilities, Atlantic Richfield Company (ARCO), Anaconda, Montana	1996

Appointed by the Board of Governors

Matthew J. Quinn	President, Carroll College, Helena, Montana	1995
Lane W. Basso	President, Deaconess Medical Center, Billings, Montana	1996

DISTRICT 10—KANSAS CITY

Class A

William L. McQuillan	President, Chief Executive Officer, and Director, City National Bank, Greeley, Nebraska	1995
L. W. Menefee	Chairman and Chief Executive Officer, Union Colony Bank, Greeley, Colorado	1996
Samuel P. Baird	President, Farmers State Bank & Trust Co., Superior, Nebraska	1997

Class B

W. W. Allen	Chairman and Chief Executive Officer, Phillips Petroleum Company, Bartlesville, Oklahoma	1995
Charles W. Nichols	Managing Partner, Davison & Sons Cattle Company, Arnett, Oklahoma	1996
Jo Marie Dancik	Area Managing Partner, Ernst & Young LLP, Denver, Colorado	1997

Class C

Herman Cain	Chairman and Chief Executive Officer, Godfather's Pizza, Inc., Omaha, Nebraska	1995
Colleen D. Hernandez	Executive Director, Kansas City Neighborhood Alliance, Kansas City, Missouri	1996
A. Drue Jennings	Chairman, President, and Chief Executive Officer, Kansas City Power & Light Company, Kansas City, Missouri	1997

Term expires
Dec. 31

DISTRICT 10, KANSAS CITY—Continued

DENVER BRANCH

Appointed by the Federal Reserve Bank

Peter I. Wold	Partner, Wold Oil & Gas Company, Casper, Wyoming	1995
Peter R. Decker	President, Peter R. Decker & Associates, Denver, Colorado	1996
Clifford E. Kirk	President and Chief Executive Officer, First National Bank of Gillette, Gillette, Wyoming	1997
Richard I. Ledbetter	President and Chief Executive Officer, First National Bank of Farmington, Farmington, New Mexico	1997

Appointed by the Board of Governors

Sandra K. Woods	Vice President, Environmental Health and Safety Systems, Coors Brewing Company, Golden, Colorado	1995
Teresa N. McBride	President and Chief Executive Officer, McBride and Associates, Inc., Albuquerque, New Mexico	1996
Donald E. Gallegos	President, King Soopers, Denver, Colorado	1997

OKLAHOMA CITY BRANCH

Appointed by the Federal Reserve Bank

C. Kendric Fergeson	Chairman and Chief Executive Officer, The National Bank of Commerce, Altus, Oklahoma	1995
Dennis M. Mitchell	President, Citizens Bank of Ardmore, Ardmore, Oklahoma	1995
Gordona Duca	President and Owner, Gordona Duca, Inc., Realtors, Tulsa, Oklahoma	1996
Michael S. Samis	President and Chief Executive Officer, Macklanburg-Duncan Co., Oklahoma City, Oklahoma	1997

Appointed by the Board of Governors

Barry L. Eller	Senior Vice President and General Manager, MerCruiser, Stillwater, Oklahoma	1995
Ernest L. Holloway	President, Langston University, Langston, Oklahoma	1996
Victor R. Schock	President and Chief Executive Officer, Credit Counseling Centers, Tulsa, Oklahoma	1997

DISTRICT 10, KANSAS CITY—Continued

OMAHA BRANCH

Appointed by the Federal Reserve Bank

Robert L. Peterson	Chairman, President, and Chief Executive Officer, IBP, Inc., Dakota City, Nebraska	1995
Bruce R. Lauritzen	President, First National Bank of Omaha, Omaha, Nebraska	1996
Donald A. Leu	President and Chief Executive Officer, Consumer Credit Counseling Service, Omaha, Nebraska	1997
Thomas H. Olson	Chairman, First National Bank, Sidney, Nebraska	1997

Appointed by the Board of Governors

Gladys Styles Johnston	Chancellor, University of Nebraska at Kearney, Kearney, Nebraska	1995
LeRoy W. Thom	President, T-L Irrigation Company, Hastings, Nebraska	1996
Arthur L. Shoener	Executive Vice President—Operations, Union Pacific Railroad, Omaha, Nebraska	1997

DISTRICT 11—DALLAS

Class A

Eugene M. Phillips	Chairman and President, The First National Bank of Panhandle, Panhandle, Texas	1995
Gayle M. Earls	President and Chief Executive Officer, Texas Independent Bank, Dallas, Texas	1996
Kirk A. McLaughlin	President and Chief Executive Officer, Security Bank, Ralls, Texas	1997

Class B

Milton Carroll	Chairman and Chief Executive Officer, Instrument Products, Inc., Houston, Texas	1995
J. B. Cooper, Jr.	Farmer, Roscoe, Texas	1996
Peyton Yates	President, Yates Drilling Company, Artesia, New Mexico	1997

Class C

Roger R. Hemminghaus	Chairman, President, and Chief Executive Officer, Diamond Shamrock, Inc., San Antonio, Texas	1995
James A. Martin	Second General Vice President, International Association of Bridge, Structural, and Ornamental Iron Workers, Austin, Texas	1996
Cece Smith	General Partner, Phillips-Smith Specialty Retail Group, Dallas, Texas	1997

Term expires
Dec. 31

DISTRICT 11, DALLAS—Continued

EL PASO BRANCH

Appointed by the Federal Reserve Bank

Wayne Merritt	President, Norwest Bank Texas, Midland, N.A., Midland, Texas	1995
Veronica K. Callaghan	Vice President and Principal, KASCO Ventures, Inc., El Paso, Texas	1996
Ben H. Haines, Jr.	President and Chief Executive Officer, First National Bank of Dona Ana County, Las Cruces, New Mexico	1996
Hugo Bustamante, Jr.	Owner and Chief Executive Officer, CarLube, Inc. and ProntoLube, Inc., El Paso, Texas	1997

Appointed by the Board of Governors

W. Thomas Beard III	President, Leoncita Cattle Company, Alpine, Texas	1995
Patricia Z. Holland-Branch ..	President and Director of Design, PZH Contract Design, Inc., El Paso, Texas	1996
Alvin T. Johnson	President, Management Assistance Corporation of America, El Paso, Texas	1997

HOUSTON BRANCH

Appointed by the Federal Reserve Bank

J. Michael Solar	Managing Partner, Solar & Fernandes, L.L.P., Houston, Texas	1995
Judith B. Craven	President, United Way of the Texas Gulf Coast, Houston, Texas	1996
Walter E. Johnson	President and Chief Executive Officer, Southwest Bank of Texas, Houston, Texas	1996
Tieman H. Dippel, Jr.	Chairman and President, Brenham Bancshares, Inc., Brenham, Texas	1997

Appointed by the Board of Governors

Judy Ley Allen	Partner and Administrator, Allen Investments, Houston, Texas	1995
Robert C. McNair	Chairman and Chief Executive Officer, Cogen Technologies, Inc., Houston, Texas	1996
Isaac H. Kempner III	Chairman, Imperial Holly Corporation, Sugar Land, Texas	1997

Term expires
Dec. 31

DISTRICT 11, DALLAS—Continued

SAN ANTONIO BRANCH

Appointed by the Federal Reserve Bank

Gregory W. Crane	President and Chief Executive Officer, Broadway National Bank, San Antonio, Texas	1995
Juliet V. Garcia	President, University of Texas at Brownsville, Brownsville, Texas	1996
Douglas G. Macdonald	President, South Texas National Bank, Laredo, Texas	1996
Calvin R. Weinheimer	President and Chief Operating Officer, Kerrville Communications Corporation, Kerrville, Texas	1997

Appointed by the Board of Governors

Carol L. Thompson	President, The Thompson Group, Austin, Texas	1995
Erich Wendl	President and Chief Executive Officer, Maverick Markets, Inc., Corpus Christi, Texas	1996
H. B. Zachry, Jr.	Chairman and Chief Executive Officer, H. B. Zachry Company, San Antonio, Texas	1997

DISTRICT 12—SAN FRANCISCO

Class A

Carl J. Schmitt	Chairman, University Bank & Trust Company, Palo Alto, California	1995
Richard L. Mount	Chairman, President, and Chief Executive Officer, Saratoga Bancorp, Saratoga, California	1996
Gerry B. Cameron	Chairman and Chief Executive Officer, U.S. Bancorp, Portland, Oregon	1997

Class B

E. Kay Stepp	Principal and Owner, Executive Solutions, Portland, Oregon	1995
Gary G. Michael	Chairman and Chief Executive Officer, Albertson's, Inc., Boise, Idaho	1996
Krestine Corbin	President and Chief Executive Officer, Sierra Machinery, Inc., Sparks, Nevada	1997

Class C

Cynthia A. Parker	Executive Director, Anchorage Neighborhood Housing Services, Inc., Anchorage, Alaska	1995
James A. Vohs	Chairman and Chief Executive Officer (Retired), Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospitals, Oakland, California	1996
Judith M. Runstad	Partner, Foster, Pepper & Shefelman, Seattle, Washington	1997

Term expires
Dec. 31

DISTRICT 12, SAN FRANCISCO—Continued

LOS ANGELES BRANCH

Appointed by the Federal Reserve Bank

Steven R. Sensenbach	President and Chief Executive Officer, Vineyard National Bank, Rancho Cucamonga, California	1995
Thomas L. Stevens, Jr.	President, Los Angeles Trade-Technical College, Los Angeles, California	1996
Antonia Hernandez	President and General Counsel, Mexican American Legal Defense and Educational Fund, Los Angeles, California	1997
William S. Randall	President, First Interstate Bancorp, Los Angeles, California	1997

Appointed by the Board of Governors

Anne L. Evans	Chairman, Evans Hotels, San Diego, California	1995
Anita Landecker	Western Regional Vice President, Local Initiatives Support Corporation, Los Angeles, California	1996
David L. Moore	President, Western Growers Association, Newport Beach, California	1997

PORTLAND BRANCH

Appointed by the Federal Reserve Bank

John D. Eskildsen	President and Chief Executive Officer, U.S. National Bank of Oregon, Portland, Oregon	1995
Elizabeth K. Johnson	President, TransWestern, Inc., Scappoose, Oregon	1996
Cecil W. Drinkward	President and Chief Executive Officer, Hoffman Construction Company, Portland, Oregon	1996
Thomas C. Young	Chairman, President, and Chief Executive Officer, Northwest National Bank, Vancouver, Washington	1997

Appointed by the Board of Governors

Carol A. Whipple	Owner and Manager, Rocking C Ranch, Elkton, Oregon	1995
Ross R. Runkel	Professor of Law, Willamette University, Salem, Oregon	1996
Marvin R. O'Quinn	Chief Operating Officer, Providence Portland Medical Center, Portland, Oregon	1997

DISTRICT 12, SAN FRANCISCO—Continued

SALT LAKE CITY BRANCH

Appointed by the Federal Reserve Bank

Roy C. Nelson	President, Bank of Utah, Ogden, Utah	1995
Nancy Mortensen	Vice President—Marketing, ZCMI, Salt Lake City, Utah	1996
Daniel R. Nelson	Chairman and Chief Executive Officer, West One Bancorp, Boise, Idaho	1996
R. D. Cash	Chairman, President, and Chief Executive Officer, Questar Corporation, Salt Lake City, Utah	1997

Appointed by the Board of Governors

Richard E. Davis	President and Chief Executive Officer, Salt Lake Convention & Visitors Bureau, Salt Lake City, Utah	1995
Constance G. Hogland	Executive Director, Boise Neighborhood Housing Services, Inc., Boise, Idaho	1996
Gerald R. Sherratt	President, Southern Utah University, Cedar City, Utah	1997

SEATTLE BRANCH

Appointed by the Federal Reserve Bank

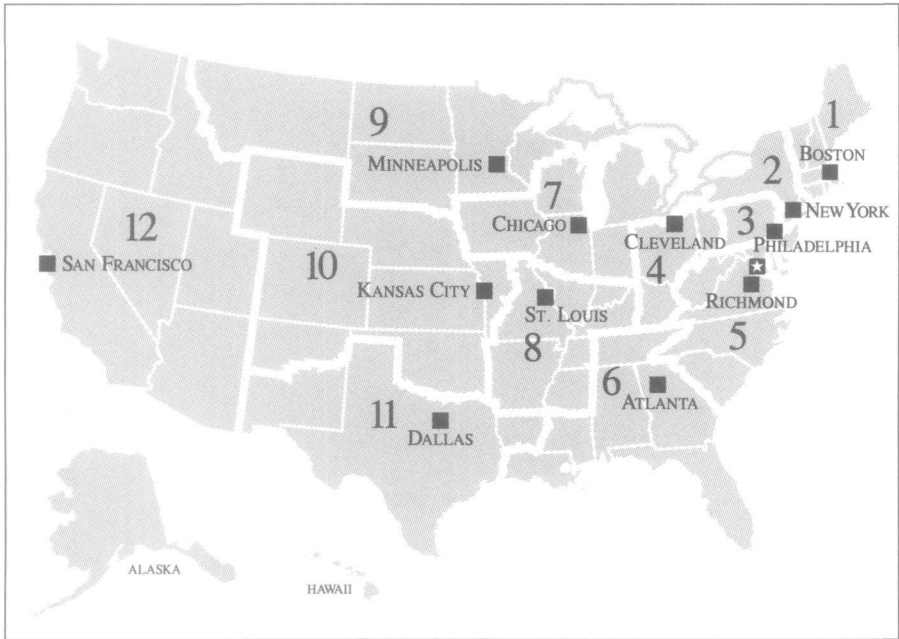
Constance L. Proctor	Partner, Alston, Courtnage, MacAulay & Proctor, Seattle, Washington	1995
Tomio Moriguchi	President, Uwajimaya, Inc., Seattle, Washington	1996
John V. Rindlaub	Chairman and Chief Executive Officer, Seafirst Corporation, Seattle, Washington	1996
Thomas E. Cleveland	Chairman and Chief Executive Officer, Enterprise Bank, Bellevue, Washington	1997

Appointed by the Board of Governors

Emilie A. Adams	President and Chief Executive Officer, Better Business Bureau Foundation, Seattle, Washington	1995
George F. Russell, Jr.	Chairman, Frank Russell Company, Tacoma, Washington	1996
William R. Wiley	Senior Vice President for Science & Technology Policy, Battelle Memorial Institute, Richland, Washington	1997

Maps of the Federal Reserve System

The Federal Reserve System



LEGEND

Both pages

- Federal Reserve Bank city
- ★ Board of Governors of the Federal Reserve System, Washington, D.C.

Facing page

- Federal Reserve Branch city
- Branch boundary

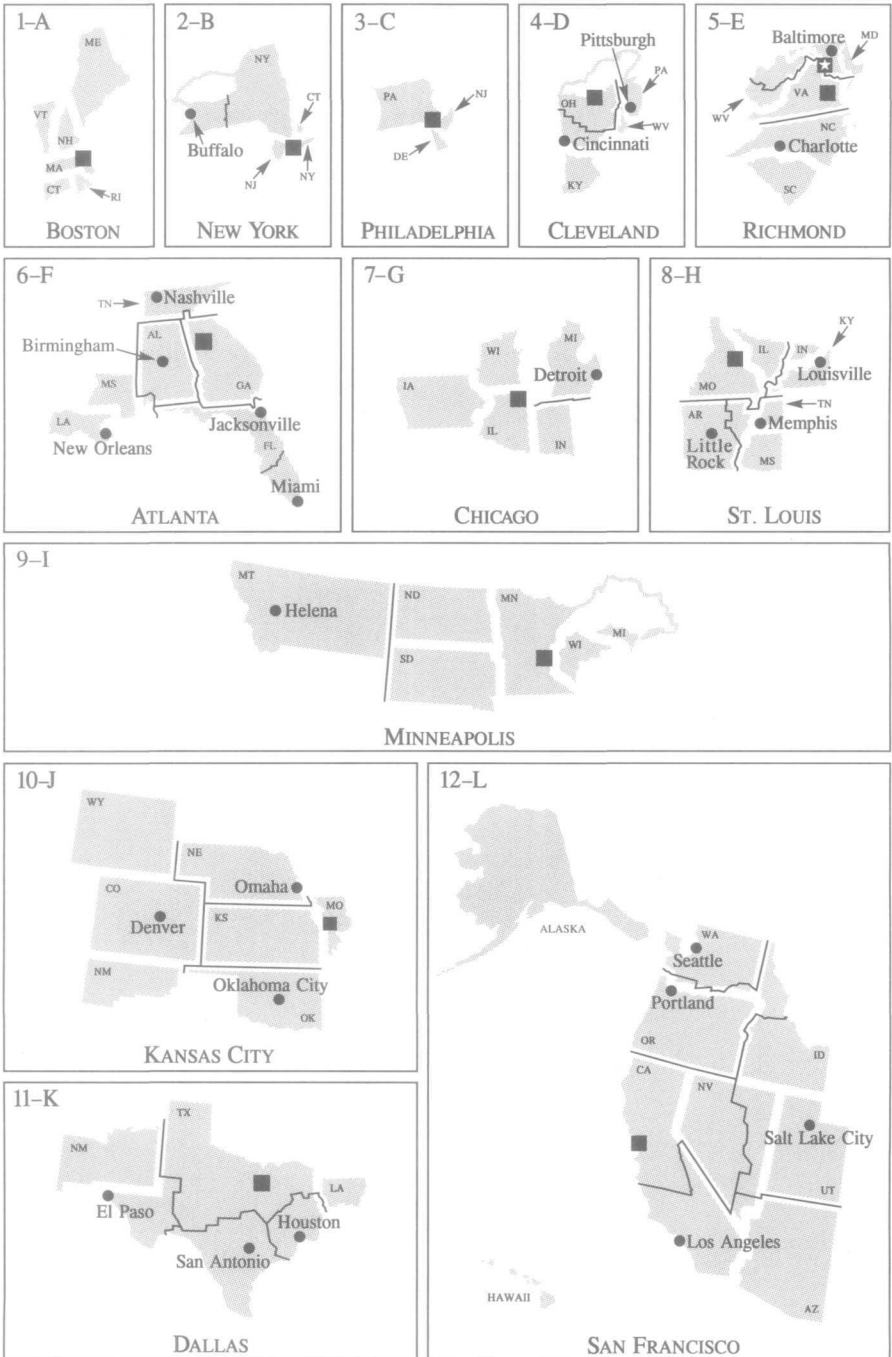
NOTE

The Federal Reserve officially identifies Districts by number and by 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 maps show the boundaries within the System as of year-end 1995.



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