

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 79-169  
October 10, 1979

Increase in Discount Rate and  
Establishment of Marginal Reserve Requirement  
On Increases in "Managed Liabilities"

TO ALL MEMBER BANKS AND  
OTHERS CONCERNED IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:

There is enclosed the text of a press release issued on October 6, 1979, by the Board of Governors of the Federal Reserve System announcing a 1-percent increase in the discount rate, from 11 percent to 12 percent, and the establishment of an 8-percent marginal reserve requirement on increases in "managed liabilities" -- liabilities that have been actively used to finance rapid expansion in bank credit. The discount rate change was effective on Monday, October 8, 1979. The change in Regulation D regarding the marginal reserve requirement will be effective on the increase in managed liabilities (over the established base) in the statement week beginning October 11, 1979, on which related reserves will be maintained in the seven-day period beginning October 25, 1979. Because U. S. Agencies and branches of foreign banks will be maintaining reserves with the Federal Reserve System for the first time, they will begin maintaining reserves the week beginning November 8, 1979.

Supplement A to Bulletin 2 has been furnished to you in a separate circular. The appropriate changes to Regulation D will be forwarded in the near future.

Any questions regarding the following material should be directed to Allan Y. Neale of the Accounting Department, Ext. 6334.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

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Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.



# FEDERAL RESERVE

press release

For immediate release

October 6, 1979

The Federal Reserve today announced a series of complementary actions that should assure better control over the expansion of money and bank credit, help curb speculative excesses in financial, foreign exchange and commodity markets and thereby serve to dampen inflationary forces.

Actions taken are:

1. A 1 percent increase in the discount rate, approved unanimously by the Board, from 11 percent to 12 percent.
2. Establishment of an 8 percent marginal reserve requirement on increases in "managed liabilities" -- liabilities that have been actively used to finance rapid expansion in bank credit. This was also approved unanimously by the Board.
3. A change in the method used to conduct monetary policy to support the objective of containing growth in the monetary aggregates over the remainder of this year within the ranges previously adopted by the Federal Reserve. These ranges are consistent with moderate growth in the aggregates over the months ahead. This action involves placing greater emphasis in day-to-day operations on the supply of bank reserves and less emphasis on confining short-term fluctuations in the federal funds rate. It was approved unanimously by the Federal Open Market Committee, which is comprised of all members of the Board of Governors and five of the 12 Presidents of the Federal Reserve Banks.

In announcing these changes, the Board issued the following statement:

"Inflation has continued at an exceptionally high rate over recent months. In part, the inflation rate reflects sharply rising energy prices, and those pressures should be subsiding in the months to come. However, appropriate restraint on the supply of money and credit is an essential part of any program to achieve the needed reduction in inflationary momentum and in inflationary expectations. Such restraint should help to avoid new uncertainties about the outlook for prices and distortions in markets that could aggravate the process of economic adjustment that is underway. It will help to restore a stable base for financial, foreign exchange and commodity pricing.

"Under the provisions of the Humphrey-Hawkins Act, the Federal Reserve sets yearly targets for the monetary aggregates and bank credit, and reports these targets to the Congress. At mid-year, the targets for 1979, encompassing the period from the fourth quarter of 1978 to the fourth quarter of 1979, were reviewed and reaffirmed at 1 1/2 to 4 1/2 percent for M<sub>1</sub>, 5-8 percent for M<sub>2</sub>, and 6-9 percent for M<sub>3</sub>. \* These targets, after allowance for the smaller shift of demand deposits to ATS and NOW accounts, still seem broadly appropriate.

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\*The M<sub>1</sub> target had assumed a shift of about 3 percent of demand deposits to automatic transfer service accounts (ATS) and NOW accounts; that shift now appears to be about 1 1/2 percent so that the equivalent adjusted target is 3-6 percent for M<sub>1</sub>.

"However, growth over recent months in these aggregates and in bank credit has been more rapid than is consistent with those targets, and if unrestrained, would clearly be excessive in terms of our basic economic objectives. Recent Federal Reserve actions, taking account of inevitable lags, should work to contain money and credit growth in the months immediately ahead, consistent with the targeted objectives. The actions announced today are designed to provide further assurance that those objectives will be reached."

The Board also stressed that banks should avoid loan activity that supports speculative activity in gold, commodity and foreign exchange markets.

#### Discount Rate

In announcing the change in the discount rate, the Board acted on requests from directors of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Richmond, Minneapolis and San Francisco.

The discount rate is the rate that member banks are charged when they borrow from their district Federal Reserve Bank. The change is effective on Monday.

The Board indicated that, within the general framework of existing policies regarding the administration of the discount window, the discount rate would be managed flexibly to discourage excessive member bank borrowing.

#### Marginal Reserve Requirement

The marginal reserve requirement adopted by the Board will apply to all increases in managed liabilities of member banks, Edge corporations, and U.S. agencies and branches of foreign banks.

This means that these institutions will be required to put up an additional 8 percent reserve against their deposits to the extent that they increase the aggregate level of their managed liabilities above a base amount. These liabilities include large time deposits (\$100,000 and over with maturities of less than a year), Eurodollar borrowings, repurchase agreements against U.S. Government and federal agency securities, and federal funds borrowings from a nonmember institution. (Federal funds borrowings from member banks, Edge corporations, and U.S. agencies or branches of foreign banks are exempt in order to avoid a double counting of reserve requirements.)

The marginal reserves will be an addition to any reserve requirement already in place for member banks and Edge corporations. Large time deposits, for example, are already subject to a supplemental reserve requirement of 2 percent that was put in place last November, plus a basic reserve ranging from 1 percent to 6 percent depending on maturity.

The current reserve requirement on Eurodollar borrowings is zero while federal fund transactions and repurchase agreements against U.S. Government and federal agency securities are currently exempt from reserve requirements. The marginal reserve will also apply to loans made by foreign offices of member banks to U.S. residents and to assets sold by member banks, Edge corporation and U.S. branches and agencies to related foreign offices.

The base for the marginal reserve will be \$100 million or the average amount of managed liabilities held by a member bank, Edge corporation or by a family of U.S. branches or agencies of a foreign bank, as of the two statement

weeks ending September 26, whichever is larger. Any increase in managed liabilities above that point will be subject to the 8 percent marginal reserve.

Since the marginal reserve will apply to the total aggregate level of managed liabilities for each bank, an increase in one component -- large CDs for example -- may be offset by a decrease in another without any overall increase in reserve requirements.

This action is directed toward sources of funds that have been actively used by banks in recent months to finance the expansion of bank credit. Member banks are presently estimated to hold over \$240 billion in such managed liabilities. They have increased by about \$17 billion over the last three months. About half of the increase in bank credit over that period has been financed by such managed liabilities.

The marginal reserve requirement will also apply to marginal increases in all repurchase agreements on U.S. Government and agency securities entered into by member banks, Edge corporations, and U.S. branches and agencies except those entered into with other member banks, Edge corporations and U.S. branches and agencies. A deduction, however, will be permitted for U.S. Government and agency securities held in an institution's trading account -- securities held for the purpose of resale. The Board expects that affected institutions will not reclassify securities held in their investment accounts to their trading accounts for the purpose of avoiding the marginal reserve requirement.

The marginal reserve requirement will be effective on the increase in managed liabilities in the statement week beginning October 11 and maintained in the seven-day period beginning October 25. Because U.S. agencies and branches of foreign banks will be maintaining reserves with the Federal Reserve for the first time, they will begin maintaining reserves the week beginning November 8.

FOMC Action

Under the new procedures adopted by the FOMC for the conduct of open market operations -- the major tool used by the Federal Reserve in its operations -- wider day-to-day or week-to-week fluctuations in the federal funds rate may occur. The federal funds rate is the rate that commercial banks pay to borrow short-term funds generally on an overnight basis.

Over recent years, the FOMC has fixed a relatively narrow range for the federal funds rate. To help achieve better control over the reserve base, it will now be necessary -- within broad limits -- to permit wider fluctuations of that rate if so determined by market forces.

In its open market operations, the Federal Reserve, through its trading desk at the Federal Reserve Bank of New York, buys or sells government securities in the open market. In simple terms, a purchase of securities increases the level of bank reserves while a sale of securities decreases bank reserves.