FEDERAL RESERVE BANK OF NEW YORK

ANNUAL REPORT 1969

FEDERAL RESERVE BANK OF NEW YORK

March 2, 1970

To the Member Banks in the
Second Federal Reserve District:

I am pleased to present our fifty-fifth Annual Report, reviewing the major economic and financial developments of 1969.

The events of the past year brought into sharp focus the problems this country faces in restoring price stability and international payments equilibrium. Despite exceptionally tight monetary policy and a surplus in the Federal budget, little visible progress was made on either front. Domestic price inflation accelerated even though real economic growth slowed and was brought to a halt by the year-end. The inflationary pressures at home prevented any significant improvement in our world trade balance, and our international payments position was clearly unsatisfactory.

The international financial system was again subjected to violent shocks. Monetary authorities were confronted with unprecedented flows of funds across national borders and responded by bolstering further their cooperative arrangements. After parity adjustments for the French franc and the German mark, the tense atmosphere in the foreign exchange markets receded.

In 1970 we must get on with the task of checking inflation and improving the country's competitive position in world markets. The achievement of these goals will be neither easy nor painless. Fiscal policy, as well as monetary policy, must play a part in convincing the general public that inflation cannot and will not be permitted to continue. Leaders in business and labor must become more acutely aware that they too have responsibilities to this end.

Alfred Hayes

ALFRED HAYES
President

Federal Reserve Bank

of New York

FIFTY-FIFTH ANNUAL REPORT

For the Year

Ended on

December 31, 1969

Second Federal Reserve District

Contents:

1969: A Difficult Year

The past year was difficult for the American economy. Monetary and fiscal policies were on balance very restrictive as inflation remained the most urgent domestic economic problem. Real economic growth came to a halt by the end of 1969, but inflationary expectations continued strong throughout the year. These expectations contributed to an acceleration of price and wage increases, making the inflation of 1969 the worst since the Korean war. Interest rates rose rapidly—in some cases to the highest levels in a hundred years—as credit demands remained heavy and the erosion of the value of the dollar intensified. At the same time, little if any progress was made in halting the deterioration of the quality of life in America. While the problems of poverty, violence, pollution, congestion, housing, and public transportation were attacked in a variety of ways, the limited gains underlined the magnitude of these problems.

The inflation of the past several years was one of the main factors responsible for the unsatisfactory United States balance of payments in 1969. Inflation has not only weakened America's competitive position in world markets but has also swollen domestic demand for foreign goods and services. Thus, the export surplus was again minuscule in 1969, and the overall liquidity deficit climbed to $7 billion. Substantial net capital outflows also contributed to the huge deficit last year. Despite the deficit, the dollar fared reasonably well in the exchange markets. Domestic monetary restraint led to massive borrowing in the Euro-dollar market by United States banks. This borrowing helped to insulate the dollar from exchange market pressures, and contributed to a surplus of nearly $3 billion in the payments balance measured on an official settlements basis. However, this surplus could disappear quickly if, for example, United States banks decided to cut back substantially on their Euro-dollar takings.

Against the background of mounting inflation and an unsatisfactory payments position, monetary policy maintained a firmly restrictive stance during 1969. All the traditional monetary instruments were utilized in an effort to bring the inflation under control. Federal Reserve Bank discount rates had been increased in December 1968 and were raised again in April 1969, bringing them to the highest level in forty years. Member bank reserve requirements on demand deposits were raised in April. Moreover, System open market operations put increasing pressure on bank reserve positions through the first half of the year, and this pressure was subsequently maintained.

These determined monetary policy measures were quickly reflected in a retardation of the growth of various banking and monetary aggregates. The growth of total bank credit (including credit extended by bank holding companies and other affiliates, partly in conjunction with operations in the commercial paper market) slowed from an annual rate of 15 percent in the second half of 1968 to 5 percent in the first half of 1969 and to 1½ percent in the second half of the year. The rate of growth of the narrowly defined money stock fell from 7 percent to 4½ percent to ½ percent during these three successive half-year periods. Throughout 1969, market rates of interest were above the ceilings on rates allowed on time deposits by the Board of Governors' Regulation Q. Moreover, the rate spreads widened during the course of the year as market rates rose almost uninterruptedly. Consequently, the banks experienced a massive time deposit outflow.

The banks responded to the pressures of monetary restraint and continued strong loan demand by liquidating securities on a major scale. By the end of 1969 the banks' holdings of United States Government securities had fallen to the lowest level in at least twenty years. And for the first time in ten years they liquidated tax-exempt state and local government issues on balance, adding to the pressures in the municipal securities market.

In order to cushion the impact of a heavy runoff of negotiable certificates of deposit (CD's), and to meet loan commitments to established customers, the large banks sought aggressively to attract nondeposit types of funds—that is, funds not covered by the System's maximum deposit rate and reserve requirement regulations. These banks, which had come to rely heavily on large CD's, experienced a $12 billion outflow of such deposits in 1969. Thus, during the course of the year a costly "cat and mouse game" developed wherein the large banks, in an effort to maintain their earning assets, sought out and exploited gaps in System regulations to secure nondeposit funds—such as Euro-dollars, the proceeds of repurchase agreements against loans, and funds derived from commercial paper sales by bank subsidiaries and affiliates. The System in turn amended, or proposed amending, its regulations to close such gaps.

The System's maintenance of noncompetitive Regulation Q interest rate ceilings in 1969 raises several important issues. There was some obvious attraction in using Regulation Q to put pressure on the banks and thereby to hold down bank credit growth. It could also be argued that the use of Regulation Q put special pressure on the large banks and that this should have made credit harder to come by for big corporate borrowers. However, these views did not fully take into account the ability of many borrowers—particularly large corporations—to bypass the banking system and obtain funds directly in the open market. Moreover, the Q effort underestimated both the ability of the banks to secure nondeposit funds through gaps in System regulations and the increasingly complex regulations needed to close these gaps. Indeed, the distortions and supervisory problems that developed during 1969 as the result of noncompetitive Regulation Q ceilings suggest that more sparing use of this type of limitation on market competition is probably desirable.

The sharp rise in market rates caused portfolio adjustments which reduced the flow of deposits into the thrift institutions. The savings and loan associations and mutual savings banks reacted by cutting back on their mortgage lending activity in the second half of the year. Nevertheless, the cutback would have been sharper if the Federal Home Loan Banks had not stepped up their support activities markedly. Moreover, conditions in the mortgage markets would have been even tighter if the Federal National Mortgage Association (FNMA) had not offset part of the decline in private mortgage commitments by substantially increasing its commitment activity. Thus, the operations of these Federally sponsored agencies served to insulate partially the mortgage markets and residential construction from special pressures arising from monetary restraint and, to that extent, helped to maintain demands on resources by this sector.

The Home Loan Banks and FNMA had to finance their mortgage support operations by borrowing heavily, adding to demands on the already hard-pressed money and capital markets. Fortunately the Federal Government's direct demands on the credit markets were nominal in 1969 as the extension of the 10 percent income surtax through the end of the year helped to maintain a budget surplus. Nevertheless, 1969 was a difficult year for the capital markets, and it is a tribute to their flexibility that on the whole they functioned efficiently in placing large amounts of securities. Demands for credit were heavy, and investors were willing to commit funds to fixed-income securities only at ever-higher yields in view of the continued decline in the purchasing power of the dollar. In this environment, "equity kickers" were often necessary in placing commercial mortgages, and corporate bonds often carried an equity conversion feature. The corporate bond market handled a near-record volume of new issues—at record rates—as corporate liquidity became increasingly strained and bank credit increasingly difficult to obtain. The municipal securities market experienced even more trying conditions, as the commercial banks, which have usually been net purchasers of municipals, became net sellers and because various tax-reform proposals opened to question the tax-exempt status of these issues until late in the year. Given these unsettled conditions, plus noncompetitive borrowing rate ceilings in many localities, the volume of new municipal bond issues dropped off sharply in 1969. But the underlying demand for funds by state and local governments remains very strong in view of the burgeoning needs for expanded and improved services in almost every sizable community in the country.

The balance of payments remains a major unresolved problem for the United States and potentially a very disturbing element in the international financial system. There were, however, a number of developments during 1969 that augured well for this system. The devaluation of the French franc and the revaluation of the German mark provided a much more realistic exchange rate structure. The emergence of a surplus in the British balance of payments also served to calm the exchanges. Moreover, the disappearance of the free market premium over the official gold price, and the agreement providing for the orderly marketing of South African gold, neutralized other destabilizing factors in the international financial system. At least as important in the long run as any of these developments was the decision by the members of the International Monetary Fund to activate the special drawing rights facility by allocating a total of $9½ billion of SDR's over a three-year period beginning in 1970. Because the SDR's represent net additions to the participants' international reserves and can be increased by general agreement, fears of liquidity shortages—resulting from inadequate flows of gold into official reserves or from restricted supplies of United States dollars—have receded. Thus, the foundations of the international payments system have been considerably strengthened.

The balance-of-payments problem and the difficulties experienced by the capital markets in 1969 were, of course, facets of the inflation that plagued the

American economy in the second half of the sixties. As the new decade opens, the most pressing economic policy problem is to bring inflation under control. While the growth of real output in the economy had come to a halt by the end of 1969, inflationary expectations still remained strong and the behavior of prices and wages had not yet responded to the weakening of real output. In the circumstances, continued restraint in both fiscal and monetary policy seems essential to put the economy back on the track of sustainable noninflationary growth. It might also be useful to attempt to reinforce these policies by moral suasion; Governmental expression of the public's interest in major wage and price decisions might well have a tempering effect on such decisions.

A restrictive Federal budget position could play a major role in breaking inflationary expectations in 1970 while assuring a reasonable balance between fiscal and monetary restraint. But a tight fiscal policy will be especially difficult to achieve in view of tax and spending legislation enacted in late 1969 and widespread demands for increased expenditures to alleviate pressing domestic problems. Although a further scaling-down of the American effort in Vietnam might ease the fiscal problem somewhat, very determined efforts will be needed to prevent the budget position from becoming insufficiently restrictive. If it proves impossible to keep spending in check, additional taxes may be necessary. With inflationary expectations still strong, a significant weakening of fiscal policy could undermine the stabilization policies of the past year and place an even greater burden on monetary policy. Certainly, the experience of the late 1960's makes clear the danger of relaxing policies of restraint before there are clear signs that inflationary expectations are being overcome.

Continued restraint, of course, involves risks and costs. As restrictive policies slow the growth of the economy, the risks of a recession increase. However, policy makers are as aware of the danger of pushing restraint too far as of relaxing too soon. Even without a recession, slower economic growth involves the costs of foregone income and output and of employment opportunities lost. But these short-run costs weigh less heavily in the balance than those associated with continued inflation. The longer the inflation continues, the greater the distortions it engenders in the economy and the more costly it becomes to correct these later.

At the same time, efforts must be made to assure that the costs of checking inflation are not borne primarily by those least able to bear them. Serious consideration should be given to some form of minimum income for families at or below the edge of poverty in our society. Action is also needed to protect workers more adequately from the effects of any significant rise in unemployment.

Not only should unemployment insurance coverage and benefits be improved, but job training programs should be expanded to provide marginal workers with the skills necessary to achieve more secure and better paying jobs. Protection of the most exposed members of society from bearing a disproportionate cost of the fight against inflation is without question both necessary and possible in an economy where the annual output of goods and services is approaching the trillion-dollar mark.

Given our unparalleled production potential, the decade of the 1970's can witness significant progress in resolving the basic problems now confronting the United States. The United States has the resources and the skills to improve the quality of life of all its citizens in this decade, provided it approaches the task with determination and provided also that the inflation which is now hobbling and distorting the economy is soon brought under control. Price stability is essential, not only to a rational attack on the problems confronting the United States at home, but also to the fulfillment of its international responsibilities.

THE UNITED STATES ECONOMY IN 1969

Business Conditions—Inflation Dominates

The economy in 1969 continued the expansion that began in early 1961, but this record-shattering performance was marred by virulent inflation. Measured at market prices, the nation's gross national product (GNP) climbed to $932 billion, $66 billion higher than in 1968 and more than had been generally expected as the year began. Prices, which rose much faster than had been hoped, accounted for a substantial part of the advance. Indeed, despite powerful efforts at economic restraint and a slowing of the growth of real economic activity, most measures of prices actually soared a good deal more rapidly last year than they had in 1968. GNP adjusted for price changes rose only 3 percent above the previous year's level—the slowest year-over-year gain since 1961—but prices moved up at the fastest rate since the Korean war period.

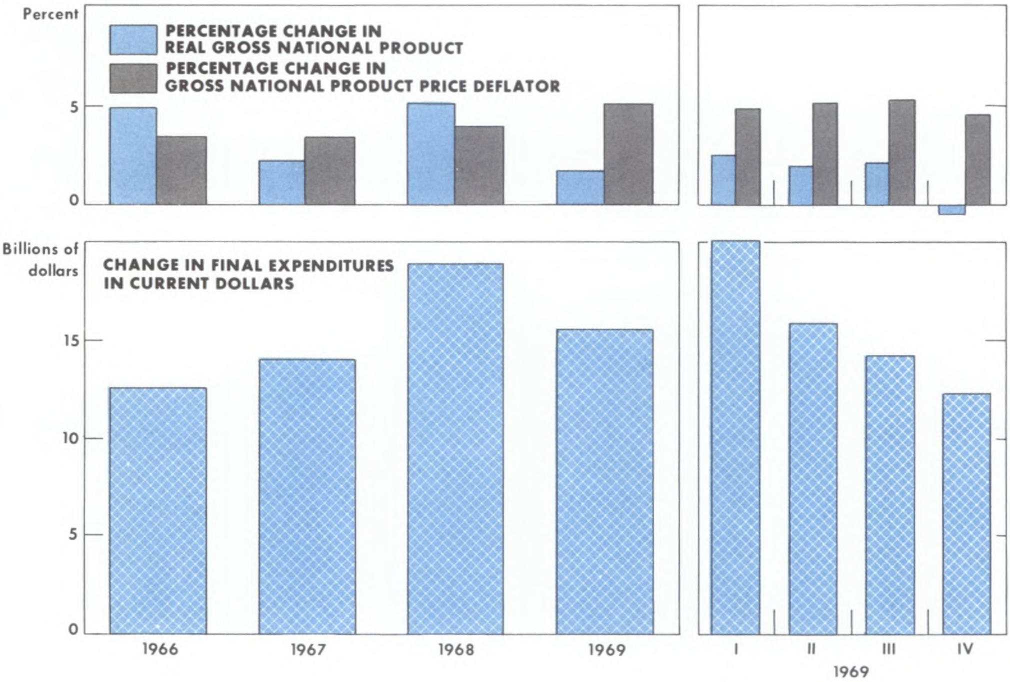
Inflation dominated the economic scene in 1969 despite restrictive monetary and fiscal policies. The Federal Reserve System sharply curtailed the rate of growth of the money supply and bank credit, and interest rates climbed to levels unprecedented in this country's modern history. The improved fiscal policy position was largely the outgrowth of the Revenue and Expenditure Control Act of 1968, which established the 10 percent surtax on corporate and individual incomes and imposed expenditure ceilings on Federal outlays through the end of fiscal year 1969. Subsequently, the surtax was extended at the full 10 percent to the end of calendar year 1969, and further limitations were placed on Federal expenditures for fiscal 1970. The persistence of strong demands despite monetary and fiscal restraint was partly the result of strong inflationary expectations throughout the economy. These expectations, the legacy of nearly four years of rapid inflation, encouraged a "buy now" attitude that worked against the restraining effects of high taxes and record borrowing costs. In addition, fears of continuing inflation in the cost of living encouraged large and growing wage demands, thus adding to the pressures on prices arising from higher production costs.

As the year drew to a close, there was increasing evidence that restrictive economic policies were limiting the rise of aggregate demand. Industrial production peaked in July and fell steadily through December, though strikes accentuated the decline. The fourth-quarter increase in GNP slowed to $9 billion, the smallest since the mini-recession of 1967, and real output fell slightly. The growth of personal income and employment also moderated in the second half of the year, and some signs of an easing of the tight labor market conditions began to emerge. At the same time, progress toward reducing this country's involvement in the Vietnam war held out the hope that military demands on the nation's resources might soon abate. However, price and wage pressures remained strong as the year ended, and it was obvious that much remained to be done in the battle against inflation.

THE PATTERN OF DEMANDS. The pattern of economic growth in 1969 reflected the distortions caused by inflation and the uneven impact of high interest rates and tight credit conditions. Inventory spending increased somewhat in the second half of the year, possibly reflecting both fears of future higher prices and, toward the year-end, a failure of sales to live up to expectations. Final expenditures—all purchases of goods and services except for inventories—accelerated at the beginning of 1969 but slowed progressively over the course of the year (see Chart 1). Toward the end of 1968, inflationary psychology had tightened its grip on the economy as it became apparent that the sharp change in fiscal policy, which occurred in mid-1968, was not having the restrictive effect that had initially been expected. Monetary policy had moved to restraint in late 1968, but in the early months of 1969 there was widespread skepticism that monetary policy could or would stem the rising tide of inflation. Thus, spending in early 1969 remained buoyant. Indeed, during the first half of 1969, final spending rose fully $36 billion, somewhat more than the sizable $33 billion gain achieved in the second half of 1968. State and local government outlays, consumption, and business expenditures for plant and equipment all contributed to this surge in final purchases of goods and services.

The great strength of credit demands in the face of a progressively more restrictive monetary policy resulted in a strong upward thrust of interest rates over the first six months of 1969. This development was to have increasingly important implications for spending in the second half of the year. Indeed, homebuilding activity began to show the effects of tight credit conditions well before the second half began; housing starts peaked at an exceptionally high level in January and began to move appreciably lower thereafter. Moreover, during the

Chart 1. GROSS NATIONAL PRODUCT: The rate of growth of real economic activity slowed in 1969 and declined slightly in the fourth quarter. Price increases were even sharper than in the previous year, however, and showed little tendency to moderate as the year moved on. The growth of final expenditures slowed progressively throughout the year in response to policies of economic restraint.



For comparability, annual dollar changes for 1966 through 1969 are averages of quarterly changes during each year. Quarterly 1969 data reflect changes in seasonally adjusted annual rate levels.

latter part of the year the usury ceilings prevailing in many states acted to limit the flow of loanable funds into home mortgages and accentuated the downward pressures on home construction. A similar limitation in credit flows to state and local governments arose, as interest rates in the badly depressed markets for tax-exempt obligations began to exceed the ceiling rates which many state and local governments could legally contract to pay.

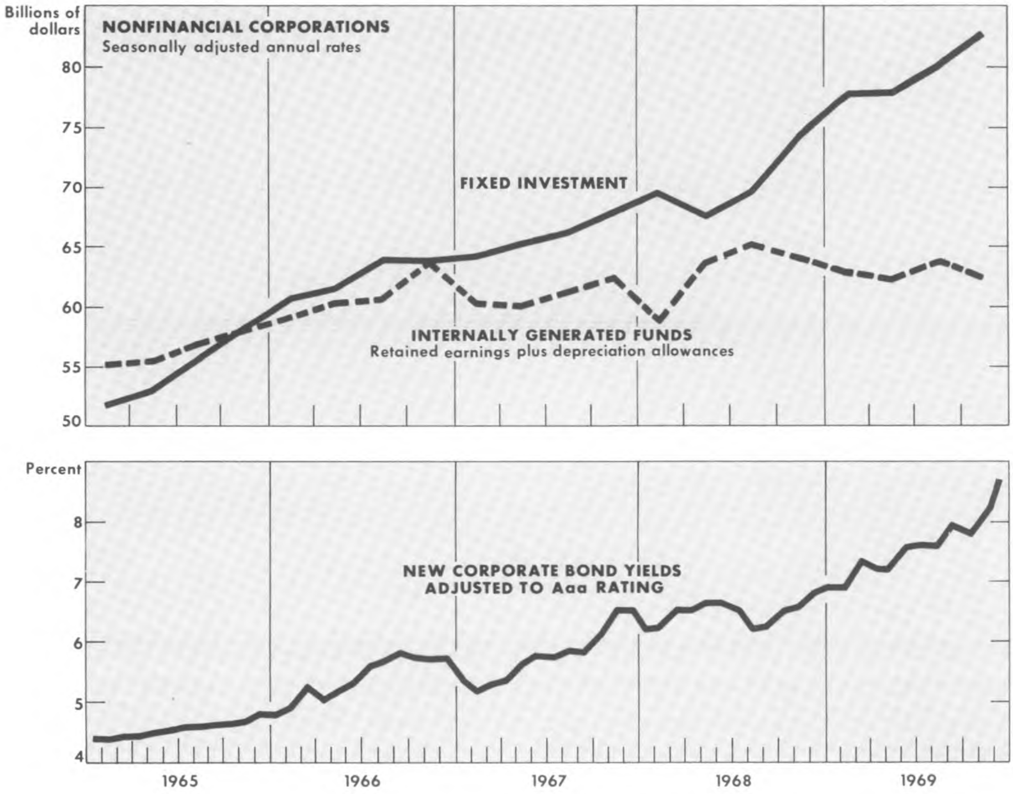
Consequently, during the second half of the year, reduced residential construction spending and a marked slowing in the growth of state and local outlays helped to limit the expansion of total final demand to $27 billion, $9 billion less than in the first half. Consumer demand also slowed during the last six months of the year, as consumers became progressively less optimistic about the economic outlook. This development resulted in sluggish retail sales, a buildup of trade inventories, and cutbacks in production of consumer goods. Thus, in the second half of the year, the continued expansion of the economy came to depend increasingly upon the strong performance of business fixed investment.

THE STRONG STIMULUS FROM BUSINESS FIXED INVESTMENT. Over the course of 1969, business spending for new structures and equipment rose by $11 billion, almost double the gain recorded during 1968. Moreover, the increase would probably have been even steeper had it not been for production bottlenecks and construction delays.

The strength of business spending for fixed investment during 1969 occurred in the face of sharply curtailed bank credit availability, record-high borrowing costs in the corporate bond market, relatively low rates of capacity utilization in most industries, and the late-April announcement that President Nixon would seek elimination of the investment tax credit retroactive to April 19. The effect of the repeal of the investment tax credit—which was not legislated until the very end of the year but was never subject to significant doubt—was to increase the cost of most capital goods ordered after April 19 by about 7½ percent. Declining corporate profits also contributed to a relative reduction in the amount of internal funds available to corporations for financing new investment (see Chart 2). Ordinarily, this combination of circumstances would have been expected to exert downward pressure on capital spending, but in 1969 the adverse factors were outweighed by other considerations.

One of the most important forces stimulating business fixed investment this past year was the widespread expectation of still further increases in the prices of capital goods. Surveys during the year found businessmen anticipating that plant and equipment prices would rise by 5 percent or more in 1969. At the year's end, there were indications that this inflationary outlook had actually intensified. The McGraw-Hill survey of investment intentions taken in November 1969 reported that by then businessmen were expecting capital goods prices to rise by an additional 7 percent during 1970. This inflationary view of future capital goods prices undoubtedly blunted the restraining effect on investment decisions that record-high interest rates would ordinarily have had. Even though business borrowing costs of 9 to 10 percent were typical in 1969, anticipations of price increases on capital goods of 5 percent reduced the incentive to postpone investments until some future time when borrowing costs might be lower. Expectations of continuing inflation apparently led to the assumption that interest rates

Chart 2. CORPORATE INVESTMENT AND ITS FINANCING: Corporations continued to raise their spending on new productive facilities in 1969 despite greater dependence on increasingly expensive external sources of funds. In the corporate bond market, offering yields on new issues rose about 1.5 percentage points.



Source: Board of Governors of the Federal Reserve System.

would, in any event, be unlikely to fall significantly over the foreseeable future.

Price and interest rate expectations were, of course, not the only factors contributing to the strength of business capital spending last year. The growing tendency of businessmen to take a longer view of the economic horizon—to look beyond a possible temporary interruption in sales growth to what might lie further ahead—was a factor tending to stabilize spending for new production facilities. Also, tight labor markets and sharp increases in wages provided an incentive for accelerated spending on labor-saving capital equipment. Moreover, in some sectors, particularly public utilities, utilization rates were placing strong pressures on existing plant capacity.

Whatever the relative importance of the several factors working to stimulate business capital spending in 1969, it seemed clear at the year-end that they were still exerting a powerful influence. In December, the Department of Commerce and the Securities and Exchange Commission reported that their latest survey of plant and equipment spending plans indicated an upgrading of intended spending in the fourth quarter and pointed to continued growth in the first half of 1970 at a rate slightly faster than had been achieved in 1969. A subsequent Commerce-SEC survey projected a full-year gain in plant and equipment spending of 10 percent during 1970.

CONSUMER SPENDING AND RESIDENTIAL CONSTRUCTION. The consumer was an important force in the rapid expansion of the economy during the first half of the year, but thereafter his growing caution limited the rise of final spending. This slower growth of consumer outlays contributed to some accumulation of inventories and, by the year-end, posed one of the major question marks in the economic outlook for 1970. The moderation of consumer demand during the second half of the year held overall gain for the year to $39 billion, one-fifth less than the previous year's increase in spite of the steeper rise in prices.

At the beginning of 1969, consumer spending was still in the process of adjusting to the 10 percent surtax which had resulted in higher tax withholdings commencing in July 1968. However, because the tax was retroactive to April, the surtax liabilities incurred for the period April to July involved large makeup payments when final tax returns were filed in early 1969. Thus, it was anticipated that consumer spending would be restrained in the first half of the year. However, as was the case when the higher withholding rates went into effect, consumers adjusted to the added tax burden primarily by reducing their savings.

Indeed, consumption spending rose by $22 billion during the first half, an acceleration of the spending rate of the second half of 1968. As a result, the savings ratio—which had dropped sharply after higher tax withholdings became effective in mid-1968—fell further to 5.3 percent of disposable income, its lowest level since early 1964.

In the second half of the year, tight credit conditions and growing economic uncertainties appeared to have weakened consumer sentiment. Surveys of attitudes and buying intentions began to outline a picture of widespread consumer restraint. Thus, consumer spending moderated after midyear, in large part because of reduced demands for durable goods, especially new automobiles and household durables. The slowing of durable goods spending relative to that for services and nondurables was typical of the more sensitive responses of large postponable purchases to tight credit conditions and economic uncertainties. Sales of domestically produced automobiles were down to an annual rate of 7.7 million units at the year-end. This represented a 9½ percent fall below the sales pace of 8.5 million that had prevailed at the end of 1968.

The steady decline of home building over the course of 1969 also cut rather substantially into purchases of household durables, particularly in the second half of the year when the weakness of spending for furniture and household equipment became apparent. Private nonfarm housing starts declined progressively from a high of 1.7 million units (annual rate) in the first quarter to 1.3 million units in the fourth quarter. Similarly, total residential construction outlays, after having increased modestly in the first quarter, declined in both the second and third quarters of the year, and would have dropped further in the fourth quarter had it not been for a surge in outlays for repair and modernization of existing homes.

The reduced volume of home-building activity during 1969 was due largely to restrictive conditions in the residential mortgage markets, particularly in the second half of the year. In the July-December period the net flow of deposits to savings and loan associations and mutual savings banks—the principal suppliers of mortgage credit—slowed appreciably, as savers moved funds to markets offering more favorable interest yields. This development was only partly offset by a substantial increase in funds provided by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Banks (FHLB). Collectively, the mortgage purchases of FNMA and the Home Loan Bank's advances to member institutions injected about $5 billion in funds into the mortgage markets in the July-December period, making them a principal source of new mortgage funds during this interval. Usury ceilings on mortgage rates in some states also had a dampening impact on the volume of new housing starts, particularly in the Northeast where such laws tend to be quite restrictive. The depressing influence of tight mortgage credit conditions during 1969 was accentuated by sharp increases in home prices, thus requiring many potential home buyers to secure a larger mortgage than would otherwise have been needed. In addition, many institutions which supply mortgage credit increased the amount that buyers are required to make as downpayment. Thus, for many families, higher savings accumulation became a necessary prerequisite for home ownership, and this also may have limited spending on consumer durable goods.

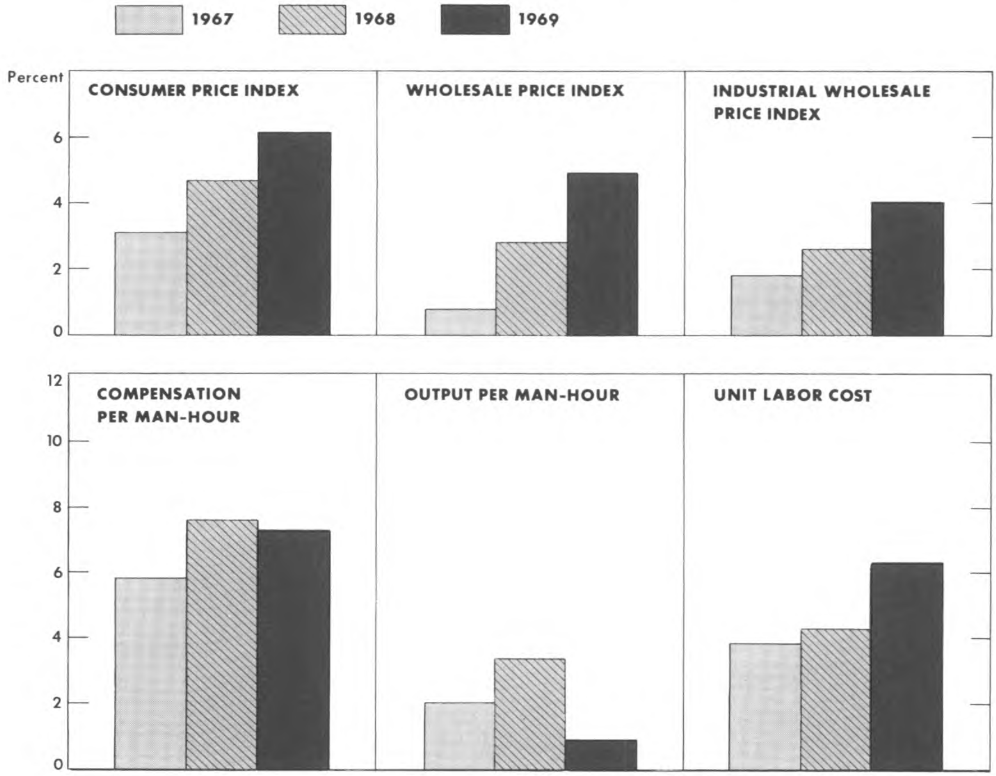
GOVERNMENT EXPENDITURES. The Federal Government's expenditures for goods and services increased by less than $½ billion in 1969. Moreover, except for the third quarter when a Federal pay raise of $3 billion took effect, outlays declined slowly within the year. This trend contrasted with a rise of $8.4 billion in 1968. Defense spending, net of the military portion of the pay increase, dropped during 1969, aided by the moderation of Vietnam war costs, and the growth of other expenditures was held down in line with the overall program of fiscal restraint. However, Federal transfer payments, including interest on the Federal debt and the various social insurance programs, continued to expand, a trend which will persist into 1970 particularly in view of the large social security benefit increase legislated at the end of 1969. For that matter the degree of restraint provided by fiscal policy was already lessening by the end of the year, and tax and spending legislation passed at the close of the year will make it very difficult to maintain continued budgetary restraint in 1970.

The rise of outlays at the state and local level also moderated somewhat, mostly because of difficulties in financing still higher expenditures particularly in the second half of the year. State and local government expenditures rose by $11.2 billion in 1969, slightly less than the gain registered in 1968. However, about two thirds of this increase was recorded in the first half of the year. State and local spending has exerted a strong expansionary influence on the economy throughout the decade of the 1960's, expanding at an average annual rate of 10 percent. This trend has exceeded the growth in Federal outlays by an average of 3 percentage points per year. The gain in state and local expenditures in 1969 would have been even larger had it not been for the adverse conditions that developed in the market for state and local bond issues.

PRICES, EMPLOYMENT, AND COSTS—INFLATIONARY PRESSURES INCREASE. The price increases recorded in 1969 were as pervasive as they were excessive, as most measures of prices recorded their largest gains since the Korean war period. The GNP deflator, perhaps the broadest indicator of price movements, rose by 5 percent during 1969, while consumer and wholesale prices were up 6 percent and 5 percent, respectively. Virtually all the components of these indexes registered their largest increases in recent years. At the consumer level, especially large price advances were recorded for housing (6.7 percent), services (7.4 percent), and food (7.2 percent). At the wholesale level, the 7.4 percent growth in farm products and processed foods, the 8.5 percent rise in crude materials, and the 21.5 percent gain in nonferrous metals prices led the overall performance of the wholesale price index. These rapid price increases reflected relatively strong demands in both product and resource markets during much of the year and the growing pressure on prices arising from the higher costs of production which combined in a classic price-wage-price spiral (see Chart 3).

The nation's labor force grew at a record rate in 1969, but the huge increase in the supply of new workers was readily absorbed and the unemployment rate was little changed over the year. The sizable growth of the labor force last year, which amounted to 2.2 million persons, was accentuated by higher labor force participation rates among women and teen-agers. This, in turn, was probably the result of the continuing shift in the age distribution of the population toward the younger age groups. However, employment gains kept close pace with the large increase in the number of workers throughout most of the year. Indeed, during the first six months of 1969, payroll employment expanded at an exceptionally high average monthly rate of 238,000, and in the second half the overall gain in employment remained relatively strong as the rise in jobs in the trade and service sectors more than offset a leveling of employment in construction and a modest decrease in the number of manufacturing jobs. Thus, despite some slowing in the economy during the second half, labor market conditions remained tight, and the unemployment rate which had averaged 3.3 percent in the first quarter was only moderately above that level at the year-end. However, the unemployment rate was characterized by an erratic pattern during the last third of the year, reaching a high of 3.8 percent in September and October and then declining to 3.5 percent in November and December. Moreover, some of the sensitive indicators of labor market conditions such as the average workweek and initial claims for unemployment insurance suggested a softening in labor demands. On

Chart 3. PRICE AND COST PRESSURES ACCELERATE: Consumer and wholesale price increases accelerated further during 1969, recording their steepest gains since the Korean war period. Moreover, the continued strong rise in compensation per man-hour, combined with the sluggish performance of productivity, gave rise to a sharp increase in unit labor costs of output.



The percentage price changes shown in the upper panel are computed on a December-to-December basis, while the figures in the lower panel are year-over-year changes for the private economy.

balance, however, even at the close of the year conditions in many segments of the labor market, particularly in the more skilled labor grades, remained very tight.

Spurred by strong competition among employers, high consumer prices, and the expectation of still further increases in living costs, wages continued to soar in 1969. Compensation per man-hour in the private economy averaged 7.3 percent above the 1968 level. Moreover, the gain in 1969 would have been larger had it not been for the fact that fewer new labor contracts were negotiated in 1969 than in 1968. The contracts signed in years prior to 1969 typically provided larger wage gains in the first year and smaller ones subsequently. Therefore, the 1969 rise in average compensation benefited from the fact that contracts signed in earlier years had been "front-end loaded". For new collective bargaining agreements reached in 1969, the negotiated wage and benefit increases over the life of a contract jumped to 7.4 percent from 6.0 percent in 1968, and this foreshadowed heavy wage demands during 1970 when many existing contracts expire.

The behavior of wages in 1969 was, of course, inflationary, but the pressure on the price level originating from this source was worsened by the retarded growth of productivity. Output per man-hour in the private economy actually dropped during the first half of the year, although this decline was offset by an improvement in productivity in the second half. However, for the year as a whole, the advance in output per man-hour was well below its long-term trend. The poor performance of productivity in the private economy during 1969 resulted from several factors; one of these was the less than proportionate slowing in the growth of labor inputs which often accompanies a slowing in the growth rate of real output. On the other hand, the sluggish behavior of productivity may have been exaggerated by a possible statistical underestimate of output growth in the nonmanufacturing sector of the economy as well as by outright labor hoarding after years of labor shortages. Also, much of the expansion in employment and man-hours occurred in the service and trade sectors, which are typically lower productivity industry groups.

The combination of sizable increases in compensation and the retarded growth of productivity gave rise to substantial increases during 1969 in labor costs per unit of real output. On average, unit labor costs in the private economy rose by more than 6 percent, far in excess of the 4.3 percent increase registered in 1968 (see Chart 3). Even in the manufacturing sector where productivity gains were stronger, unit labor costs expanded nearly 4 percent, almost three times the rise in 1968. The acceleration that appeared to be developing in labor costs increased the likelihood of a stronger push on prices from the cost side and continued pressures on profit margins.

Monetary Policy and Credit Market Developments

Even before 1969 began, it was clear that the primary task confronting monetary policy would be to restrain the strong and growing inflationary pressures in the economy. During the year the Federal Reserve System, applying all the major instruments of policy, sharply curtailed the rate of growth of bank credit and the money supply, and financial conditions tightened to a degree not experienced in many decades. Nevertheless, because of widespread inflationary psychology, which had grown deep roots during the previous years of rapidly accelerating prices, the attainment of reasonable price stability proved to be a more difficult task than had been expected when the year began. Thus, at the year-end, monetary policy remained in a posture of active restraint.

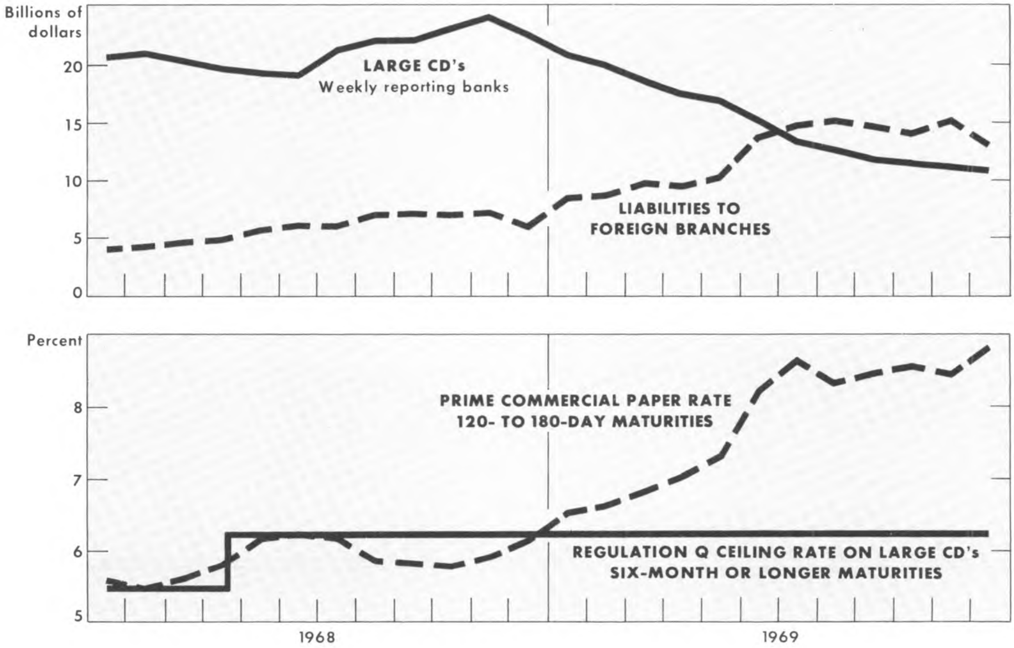
The initial moves to a policy of renewed restraint were made in late 1968. The Federal Reserve discount rate was raised ¼ percentage point to 5½ percent in mid-December 1968, and open market policy was firmed simultaneously. In announcing its approval of the discount rate increase, the Board of Governors of the Federal Reserve System stated that the action was being taken in light of the resurgence of inflationary expectations and in furtherance of a policy of restraint. These moves were quickly felt, as bank credit growth—which had been at a 15 percent annual rate in the second half of 1968—dropped significantly in the first quarter of 1969. The rate of expansion of the money supply also slowed considerably, and interest rates soared. Indeed, by late March many interest rates, including the bank prime rate, were a full percentage point above the levels of November 1968. Additional restrictive moves in the form of an increase in reserve requirements on demand deposits and an increase in the discount rate were taken in early April. These actions, together with greater restrictiveness in open market operations, led to a pronounced further reduction in the rate of growth of the money supply and bank credit. In the last half of the year the narrow money supply and bank credit grew little, though both strengthened a bit toward the year-end.

Early in 1969, rates of interest on short-term securities which compete with large bank certificates of deposit (CD's) had moved well above the Regulation Q ceilings limiting interest rates payable on the latter (see Chart 4). This development, combined with the decision to leave Regulation Q ceilings unchanged, gave rise to large losses of these deposits at member banks. Consequently, banks became increasingly dependent on sales of securities and nondeposit liabilities as sources of loanable funds. Among the latter, Euro-dollar borrowings, commercial paper sales by bank affiliates, and the sale of existing loans became major sources of funds used to offset deposit drains and meet outstanding loan commitments.

Despite the use of these nondeposit funds, particularly by the large banks, the net increase in credit forthcoming from the banking system during 1969 was drastically reduced. Moreover, the pressures on the banking system were rapidly transmitted to the securities markets, as banks reduced their securities holdings sharply and borrowers were forced to rely more heavily on nonbank sources of funds. Thus, interest rates throughout the financial markets were at or near all-time highs by midyear and remained under upward pressure thereafter.

MONETARY POLICY—A YEAR OF INTENSIVE RESTRAINT. During the fourth quarter of 1968, the Federal Reserve System had moved in the direction of restraint through progressively more restrictive open market operations and the December increase in the discount rate. Moreover, against the background of mounting inflationary pressures, open market operations tightened substantially further in the first quarter of 1969. The volume of nonborrowed member bank reserves—those supplied largely through open market operations—actually declined in the first three months of the year, and member bank borrowings at the Federal Reserve Banks increased rapidly. Furthermore, net borrowed reserves, which had averaged less than $250 million per month during the second half of 1968, rose to an average of $701 million in March. Pressures in the Federal funds market intensified, and the Federal funds rate moved upward to a daily average of 6.8 percent during March. Bank lending, supported by securities sales and the growth of nondeposit liabilities, continued to expand at a rapid rate, and inflationary pressures in the economy remained intense. Then, in a further move against inflation, the Board of Governors announced on April 3, 1969 its approval of actions by eleven Federal Reserve Banks increasing the discount rate ½ percentage point, an increase which took effect at all twelve Federal Reserve Banks by April 8. This brought the discount rate to 6 percent, the highest in forty years. Simultaneously, the Board of Governors also announced an increase of ½ percentage point in reserve requirements against demand deposits at all member banks, to take effect in the reserve computation period beginning on April 17. As a result, member banks were required to set aside an additional $650 million in their required reserve accounts, with about $375 million of that total occurring at large city banks where pressures from CD drains were already causing strains on liquidity positions.

Chart 4. THE CD DRAIN AND BANK LIABILITIES TO FOREIGN BRANCHES: As a result of the widening spread between market interest rates and the ceiling rates on large certificates of deposit, banks experienced a sharp runoff in the volume of CD's. Consequently, some banks borrowed large sums in the Euro-dollar market through their foreign branches.



In the second quarter, these developments, along with a restrictive open market position and a continuation of strong bank credit demands, led to further interest rate advances and sizable increases in member bank borrowings at the discount window. In May and June, member bank borrowings were at an average level of more than $1.4 billion, compared with $918 million in March, and net borrowed reserves exceeded an average of $1 billion in May through July. The mounting pressures on bank reserves were also reflected in a rise in the Federal funds rate from a daily average of 7.4 percent in April to 8.9 percent in June. Thus, by midyear, monetary policy had substantially increased the pressures on bank reserves and sharply reduced the liquidity of the banking system. The cumulative impact of these developments continued to be felt in the financial markets throughout the remainder of the year.

REGULATION Q AND THE GROWTH OF NONDEPOSIT LIABILITIES. The decisive move to restraint by the Federal Reserve System during the first half of 1969 was accompanied by the decision to leave Regulation Q ceilings on large CD's and other time deposits unchanged and thus below competing market rates. Moreover, as the year wore on, market interest rates continued to increase, thereby progressively widening their advantage over the time deposit ceiling rates. Consequently, banks experienced a sharp runoff in these deposits (see Chart 4). During the first half of the year, the loss of large-denomination CD's (those of $100,000 or more), which amounted to $7.5 billion, was concentrated at large banks in New York and Chicago. However, after midyear the losses of large CD's became more widespread, and sizable drains also began to occur in small denomination CD's and in savings deposits.

In an attempt to offset their time deposit losses, banks turned increasingly to nondeposit sources of funds, mainly Euro-dollar borrowings, commercial paper sales by bank parent companies, affiliated companies or subsidiaries (the proceeds of which are largely channeled into the banks by the bank-related company's purchase of existing bank loans), and loan sales made under repurchase agreements. Of the three, Euro-dollar borrowings by United States banks were quantitatively the most important. During the first nine months of the year, these borrowings grew by $8.7 billion, though they tapered off in the fourth quarter.

The leveling-out of Euro-dollar borrowings toward the year-end was partly the result of amendments in Regulation D (reserve requirements) and Regulation M (foreign activities of member banks), which were announced by the Board of Governors on July 24 and August 13. The amendment to Regulation D required that member banks, effective July 31, count outstanding checks or drafts arising out of Euro-dollar transactions as demand deposits subject to reserve requirements—an action which increased the required reserves of the largest banks in the country by almost $600 million. Euro-dollar borrowings were also made more expensive when, on August 13, the Board of Governors amended both Regulation D and Regulation M to limit the special advantage that banks with access to Euro-dollars had in adjusting to domestic credit restraint. Essentially, these amendments placed a 10 percent marginal reserve requirement on net borrowings of banks from their own foreign branches to the extent that such borrowings exceed the amount outstanding in a base period.

Reserve requirements were also placed on direct bank borrowings from foreign sources, that is, borrowings from other than their own foreign branches. Following these regulatory changes, Euro-dollar borrowings became relatively less attractive, but banks showed little inclination to reduce their borrowings appreciably below the levels attained in September. Thus, despite their high cost—the borrowing rate on three-month Euro-dollars generally averaged from 10 to 11 percent during the last six months of the year—these funds continued to play an important role in the domestic credit market.

Aside from its broader implications for bank reserves and bank credit availability, the change in the treatment of Euro-dollar transfers also permitted a significant corrective revision of the money supply data in the summer of 1969. Euro-dollar payments, which are effected through so-called "bills payable" checks or "London drafts", are carried on the books of the payee banks as cash items in the process of collection until the reserves associated with the transfer become available. Such cash items are deducted from gross deposits to derive the demand deposit component of the money supply. Thus, until the July 31 change in Regulation D, which requires the payor banks to include in their deposits subject to reserve requirements checks issued to transfer Euro-dollars, the money supply was understated by the amount of Euro-dollar payments outstanding. At the end of July, these uncollected Euro-dollar payments totaled $3.3 billion, and their inclusion in net demand deposits raised the statistics on the narrow money supply by that amount.

The second major source of nondeposit funds for banks that developed during the year took the form of commercial paper sales by bank holding companies, affiliates, or subsidiaries. Under this arrangement commercial paper is sold by the bank-related company, and the proceeds of these sales are then transferred to the commercial bank, generally through the purchase of existing bank loans. The volume of commercial paper issued by bank-related corporations increased from $810 million at the end of May to $4.2 billion by the end of the year. During the latter part of the year, commercial paper sales displaced Euro-dollars as the major source of additional nondeposit funds. Against this background the Board of Governors, late in the year, began to consider placing commercial paper sources of bank funds under interest rate ceilings and/or reserve requirements. However, action on these proposals had not been taken at the close of the year.

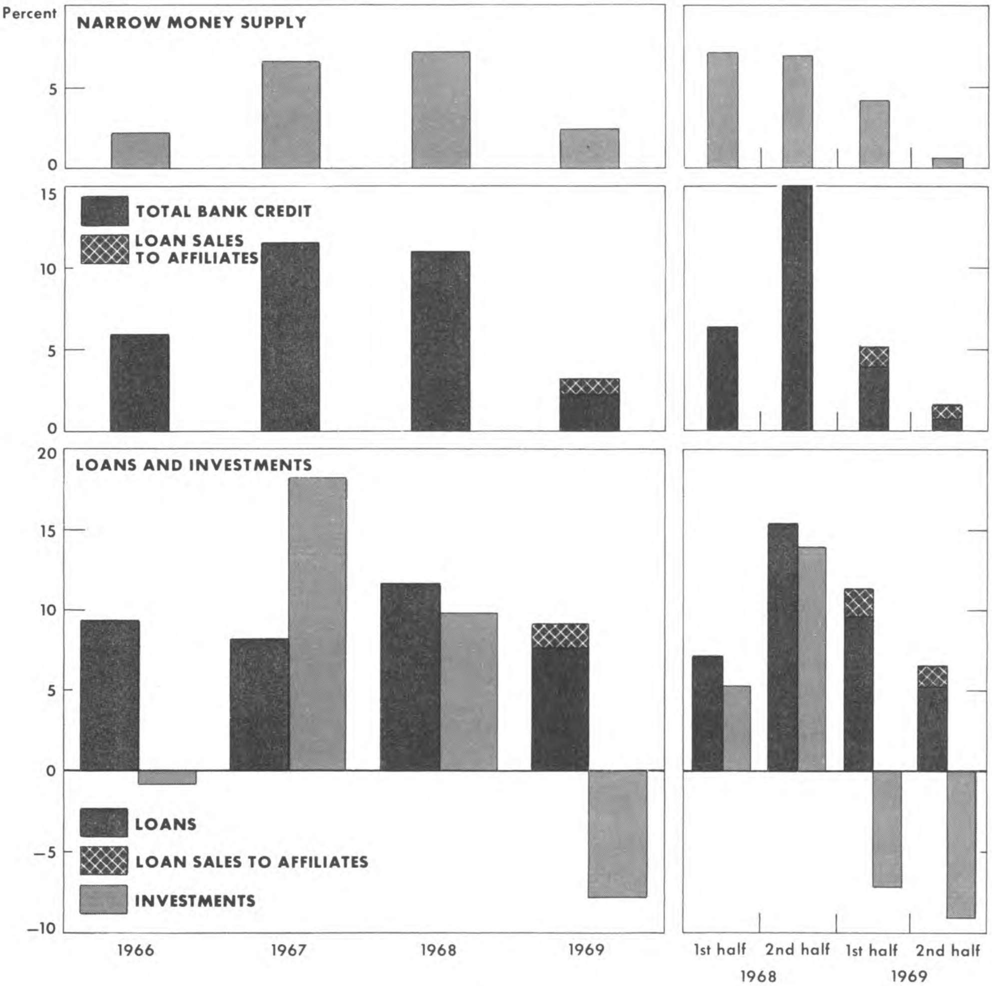
Banks also secured nondeposit funds during the year by the sale of loans to affiliates and to nonbank investors under repurchase agreements. By mid-July, outstanding liabilities of this type totaled $1.7 billion, but then declined to $0.8

billion at the end of the year. The decline reflected the amendments to Regulations D and Q put into effect on July 25 by the Board of Governors. These changes stipulated that all such liabilities arising out of transactions with nonbank institutions or from the sale of assets, other than Federal Government securities (including agency obligations), would be considered deposit liabilities subject to reserve requirements and interest ceilings.

The trend toward reliance on nondeposit liabilities as sources of funds by commercial banks gave rise to some serious problems in interpreting movements in many of the monetary indicators. For example, the bank credit proxy, which measures the daily average of member bank deposits subject to reserve requirements, tended increasingly to understate trends in total bank credit since a growing share of the total credit supplied by banks was being financed by nondeposit liabilities.

The thrust of monetary policy was essentially unchanged during the second half of the year. The retention of the restrictive position was necessitated by the continued strength of demand in many sectors of the economy and the perseverance of inflationary expectations. Thus, borrowed reserves measured as a monthly average of daily figures were in excess of $1.0 billion during the second half of the year, while net borrowed reserves fluctuated in a relatively narrow range of $800 million to $1.1 billion. Similarly, the Federal funds rate remained in the neighborhood of 9 percent. The continuation of the heavy pressure on bank reserve positions already achieved by midyear led to a further slowing of the money supply and bank credit during the July-December interval, as the cumulative effects of that pressure worked its way through the financial system (see Chart 5). The daily average money supply, which had increased at a 7 percent annual rate in the second half of 1968 and slowed to a 4.3 percent rate of growth in the first half of 1969, advanced by less than 1 percent per annum during the July-December interval, with all that gain occurring in the fourth quarter. Thus, for the year as a whole, the rate of growth in the money supply was a modest 2.5 percent, well below the 6.6 percent and 7.2 percent increases recorded in 1967 and 1968, respectively. The sharply reduced rate of growth in the money supply, coupled with the continued inflationary expansion of the economy, necessarily involved a large increase in income velocity—the ratio of GNP to the money supply—and rising interest rates.

Chart 5. THE MONEY SUPPLY AND TOTAL BANK CREDIT: Reflecting restrictive monetary policy, the rate of growth in the narrowly defined money supply slowed gradually but appreciably during 1969. Total bank credit growth also slowed in 1969, even when allowance is made for loan sales to affiliated corporations. The composition of bank credit underwent a significant shift, as banks liquidated investments in order to finance loan expansion.



The money supply growth rates are computed from daily average levels in the final month of the preceding period and the final month of the period covered. The bank credit growth rates are based on levels for the last Wednesday of the period covered and the last Wednesday of the preceding period. Semiannual figures are expressed at seasonally adjusted annual rates.

THE GROWTH AND COMPOSITION OF TOTAL BANK CREDIT. For the year as a whole, bank credit increased by 2.3 percent, compared with 11.0 percent in 1968. However, because of the rise in loan sales to bank-affiliated corporations, the bank credit data understated the actual volume of credit originally supplied by the banking system during the year. Adjusted for loan sales to affiliates, the growth rate of bank credit approximated 3.3 percent. Reflecting the restrictive posture of monetary policy, the composition of total bank credit underwent a significant shift during the year, as banks reduced their securities holdings in order to obtain funds for loan expansion (see Chart 5). Thus, during the first half of the year when total loans increased by $12.5 billion, banks liquidated some $5.2 billion of United States Government securities. In this interval, the dominant factor in the expansion of bank loans was the $6.4 billion rise in business loans, a gain which approximated that in the second half of 1968. The strength in business loan demand was, to a large extent, a reflection of the continued rapid expansion of business investment spending. Real estate and consumer loans also advanced by sizable margins during the first half of 1969, growing at annual rates of 10.5 percent and 8.0 percent, respectively.

During the second half of the year, the liquidation by banks of their securities holdings accelerated. However, despite the rundown of investments, including municipal and agency issues, the expansion of bank loans was sharply curtailed, as deposit outflows continued and nondeposit sources of funds were closed off or made less attractive by Federal Reserve regulatory actions. The increase in total bank loans in the July-December period slowed to $7 billion. Virtually all major components of bank loans expanded at reduced rates, including business loans which experienced a pronounced slowing in the fourth quarter.

When viewed in the context of total credit flows, the volume of funds supplied by the commercial banking system during the second half of 1969 and for the year as a whole was drastically reduced. Indeed, of the $86 billion in funds advanced directly in credit markets during 1969, only a net total of $10 billion or 11 percent was provided by commercial banks, as borrowers—particularly corporations—turned increasingly to nonbank sources of funds (see Chart 6). In contrast, during 1967 and 1968 commercial banks accounted for 45 percent and 40 percent, respectively, of the net funds advanced in credit markets. Moreover, even in 1966—the year of the "credit crunch"—approximately one fourth of the $68.5 billion advanced that year in the credit markets was supplied by the banking system.

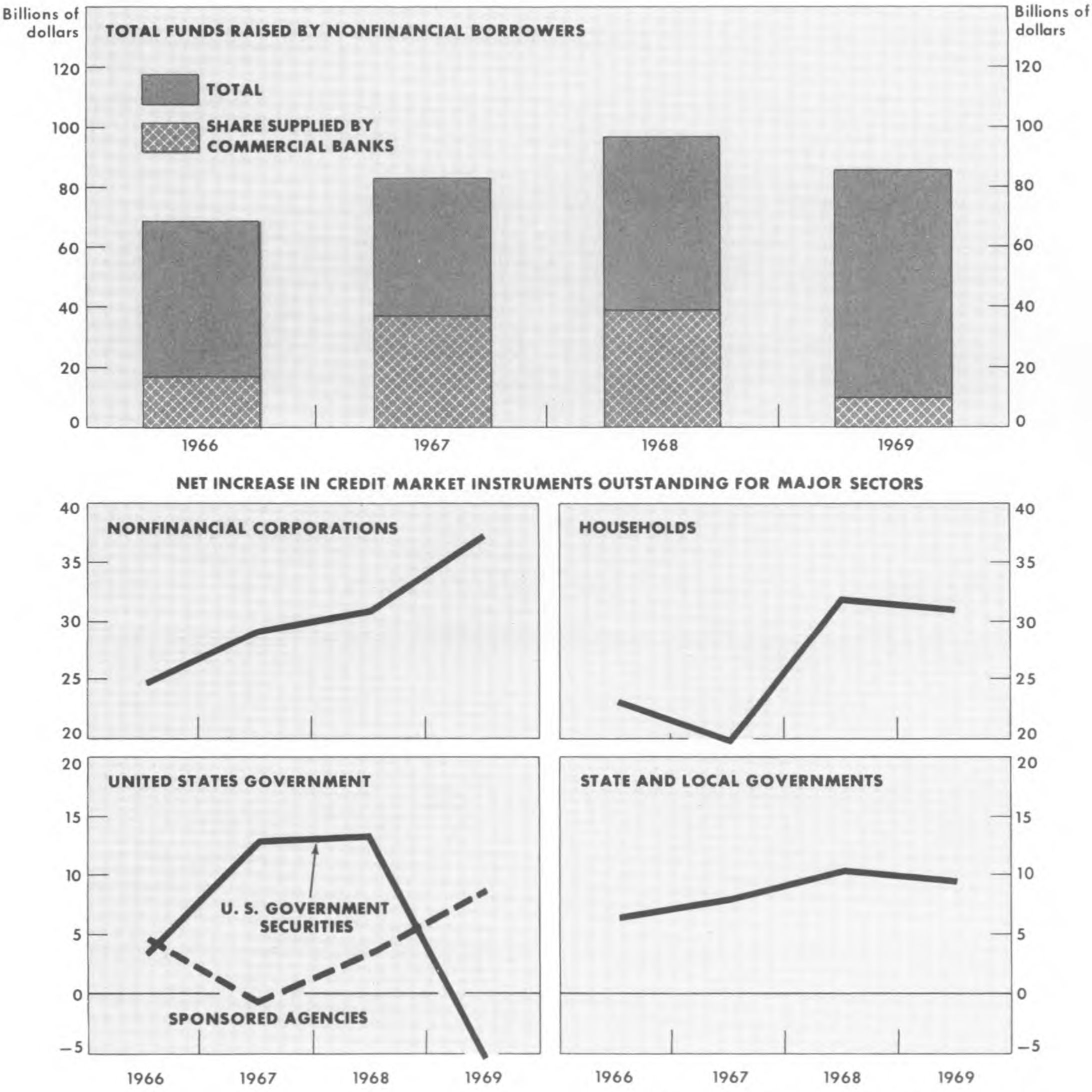
FLOW OF FUNDS AND CAPITAL MARKET DEVELOPMENTS. The total volume of funds raised by all nonfinancial borrowers declined in 1969, as higher borrowing costs and the reduced availability of funds cut into net borrowings. On balance, however, the demands for funds relative to supplies remained strong throughout the year, and at the year-end interest rates on virtually all market instruments were at or near their all-time highs.

Corporate demands for external funds were strong throughout 1969, as the spread between investment expenditures and internal cash flows widened. Thus, the net increase in credit market instruments outstanding for nonfinancial corporations was $37 billion, $6 billion more than in 1968. The growth was centered in short-term borrowing from banks, finance companies, and the commercial paper market. The increase in the amount of corporate bonds outstanding held at the 1968 pace despite record-high offering rates on new issues. Pressures in the corporate bond market were so great that offering rates approximating 9 percent on top-quality issues became commonplace late in the year. Corporate demands for short-term funds were heavy throughout the year, as bank credit availability declined and commercial paper financing accelerated. For the year as a whole, the amount of outstanding dealer-placed commercial paper increased by $4.9 billion, exceeding by a wide margin the previous record increase of $2.5 billion which occurred in 1968.

The flow of funds to the household sector was at a slightly reduced rate during 1969, following the sharp increase registered in 1968. For the most part, this slowing was a reflection of the general moderating of consumer durables outlays in the second half, which contributed to the slower growth of consumer instalment credit and bank loans.

The financing needs of the United States Treasury were substantially decreased during 1969, as the Federal budget registered a slight surplus. For calendar 1969 as a whole, United States Government securities outstanding declined in contrast to the $13 billion increases recorded in each of the two preceding years. Nevertheless, yields on Government securities also moved up sharply during 1969, and in two refinancing operations the Treasury had to offer the highest yields since the Civil War. In sharp contrast to the reduced credit needs of the Treasury in 1969, the borrowings of the five Federally sponsored agencies reached record levels. These agencies, including FNMA and the FHLB, are considered to be privately owned and, as a result, their operations are not included in the Federal budget totals. For the year as a whole, the net increase in the level of outstanding securities of these five agencies was $9 billion,

Chart 6. CREDIT FLOWS IN 1969: The total amount of funds raised in the financial markets declined in 1969, and the share supplied by commercial banks was down significantly. A sharp increase in borrowing by business corporations offset much of the large drop in Treasury borrowing and the modest decreases in credit flows to households and state and local governments. Federally sponsored credit agencies expanded their role as financial intermediaries largely in support of the mortgage market.



Source: Board of Governors of the Federal Reserve System.

with more than two thirds of the gain arising from the mortgage support activities of FNMA and the FHLB.

To a large extent the increased activities of these agencies arose because of the tight conditions prevailing in the mortgage markets and at the nation's thrift institutions. Deposit flows to mutual savings banks and savings and loan associations slowed appreciably in 1969, as the continued increases in market rates of interest attracted more personal savings into securities investments. For the year as a whole, thrift deposits grew by $6.9 billion or 3.6 percent. During the second half of the year, the annual rate of deposit growth at these institutions slowed to 1.4 percent, as yields on market instruments moved further above rates paid on these deposits. Nevertheless, largely as a result of the sizable growth in FHLB lending to its member associations, the mortgage holdings of thrift institutions increased by 6.8 percent over the year and, during the second half, grew at a 4.9 percent annual rate.

At the state and local government levels, credit market borrowings increased by $9 billion, a somewhat smaller gain than was recorded in 1968. This slowing was in large part the result of the climb of market rates on tax-exempt bonds over the ceiling rates legally imposed on many such issues. In part, these higher rates were a result of market pressures aggravated by bank sales, but uncertainty concerning the future tax status of income earned on these issues also contributed to the rise in market rates during the second half of the year. At the year-end, there was a sizable backlog of state and local issues that had been postponed because of congested market conditions and inability to borrow at legal rate ceilings, a factor which was tending to exert considerable downward pressure on the market.

THE INTERNATIONAL ECONOMY

The two major influences dominating the international monetary scene in 1969 were the clear need for, and eventually the fact of, adjustments in major currency parities and the unprecedented demand for funds in the Euro-dollar market. The German mark, long labeled a candidate for revaluation and subjected to heavy speculative buying on numerous occasions, was raised to a higher par value in the fall; thereafter, Germany experienced a reversal of previous massive inflows of funds. Pressure on the French franc and French international reserves continued unrelenting into early August, when the franc parity was lowered; by the year-end, after temporary setbacks, France's international position showed clear evidence of improvement. Many other European countries struggled against reserve losses during the course of the year. On the other hand, the pound sterling, long under a cloud, began to gather strength late in the year as improved trade and payments figures for Britain emerged during 1969. European developments alone would have led to considerable churning in the Euro-dollar market, but the upsurge of United States commercial bank borrowing in that market tightened it considerably. Euro-dollar rates rose to record levels, drawing funds not only from many European sources but also from the United States. In the summer the Federal Reserve moved to diminish the banks' incentive to borrow Euro-dollars, through changes in Regulations D and M,[1] but the banks maintained a heavy indebtedness to the market and rates remained high through the year-end. The demand for Euro-dollars by United States banks helped keep the dollar in a strong position on the exchange markets despite a massive United States balance-of-payments liquidity deficit.

Looking beyond these events, several steps were taken to strengthen the international monetary system. The vast majority of member nations in the International Monetary Fund (IMF) agreed to participate in the special drawing rights (SDR's) facility, with an initial allocation of the new assets in January 1970; agreement was reached on a general quota increase within the IMF also for 1970, and the IMF and South Africa entered into an accord over the

[1] *For details, see page 25.*

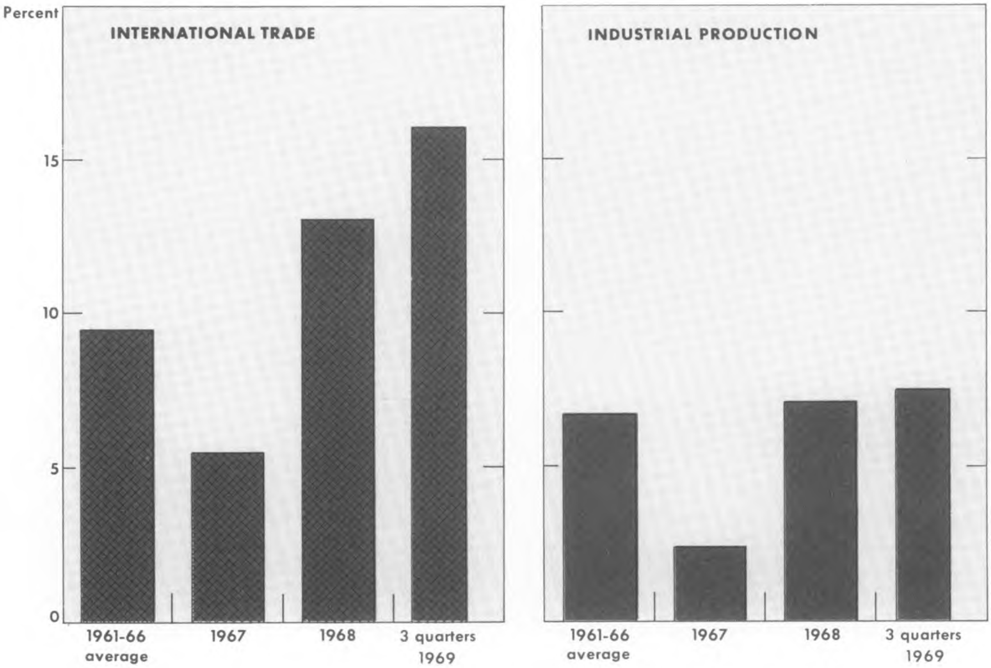
disposition of new gold production, tying up the major remaining loose end of the two-tier gold market established in March 1968. For the future, formal discussions began within the Fund over the possible need for, and feasibility of, increased exchange rate flexibility within the IMF system.

Strains on the International Economy

The speculative atmosphere in the exchange markets, which had developed over the course of 1968, continued through the first months of 1969. The November 1968 decisions of the German government not to revalue the mark, and of the French government not to devalue the franc, had brought some temporary relaxation of exchange market tensions through the year-end. But Germany continued to be in large current-account surplus, reflecting a strong international competitive position built up over the years, and France remained in sizable payments deficit, attributable in part to the inflationary wage hikes that were the cost of ending the widespread strikes of May-June 1968. Moreover, the prospects for sterling were still uncertain, as the British trade and payments position had yet to show clear improvement after the November 1967 devaluation. Thus, the markets had ample reasons for new speculative rushes into marks or out of currencies whose parities were under suspicion. Recognizing this potential and the sizable amounts of funds the market seemed able to generate for such flows, the major central banks moved to bolster their defensive arrangements. Following up discussions initiated at the Bonn conference in November 1968, they agreed in February 1969 to facilities for the recycling of short-term capital flows back to central banks suffering large reserve losses as a result of speculation. These arrangements, while not formalized in the manner of existing central bank credit facilities, were nevertheless to prove highly useful later in the year.

Underlying the exchange market uncertainties were problems generated by other economic and financial developments. Aggregate demand was very strong in most industrial countries and, in some cases, was reflected in uncomfortably high rates of wage and price rises (see Charts 7 and 8). As a result, many countries were adopting or contemplating more restrictive fiscal and monetary policies solely on the basis of domestic conditions. Moreover, international interest rate

Chart 7. TRADE AND ECONOMIC ACTIVITY: International trade rose sharply last year. Primarily, this reflected expanding economic activity in the major Western industrial countries and Japan, but price inflation was also a factor.

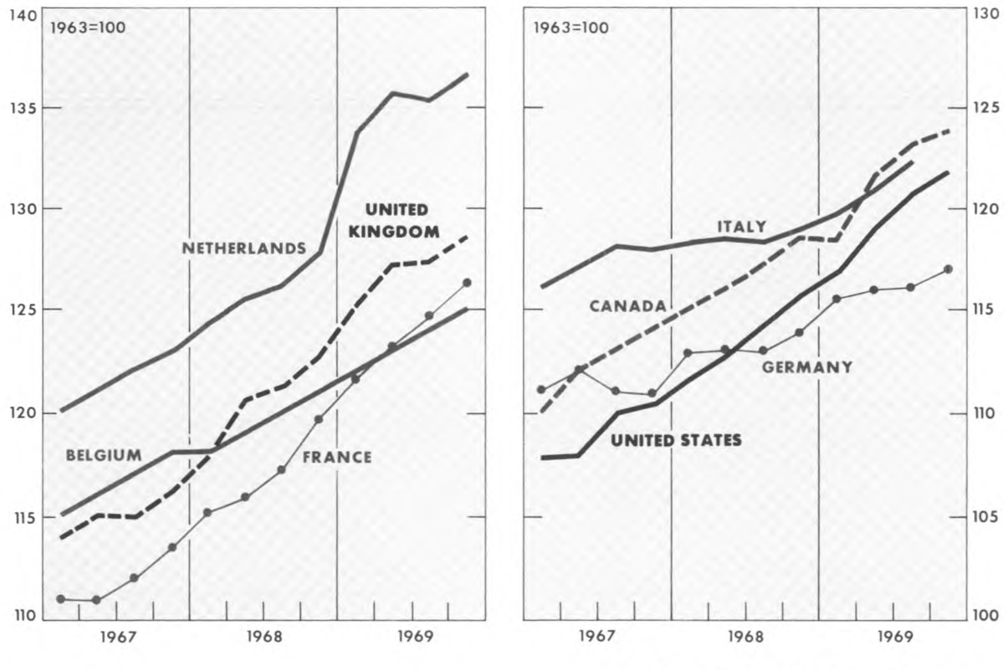


Data represent year-to-year growth rates for all OECD countries combined. The increases shown for the first three quarters of 1969 are measured relative to the same period in 1968.

considerations became increasingly important, especially as United States banks began to bid aggressively in the Euro-dollar market for funds. These banks were seeking alternative sources of funds, following an increase in monetary restraint within the United States which—in the context of unchanged Regulation Q interest rate ceilings—made the purchase of large certificates of deposit unattractive to United States investors. In the first three months of 1969, United States banks borrowed over \$3 billion from their foreign branches, mainly in London, lifting total borrowings to \$9.2 billion or almost \$2 billion above their 1968 peak. Euro-dollar rates were bid up substantially during the first quarter of the year, with the three-month deposit rate moving from 7 percent to 8½ percent. The attraction of high Euro-dollar rates induced foreign investors to demand dollars for the purpose of making Euro-dollar investments, thereby depleting the liquid dollar holdings of several foreign central banks.

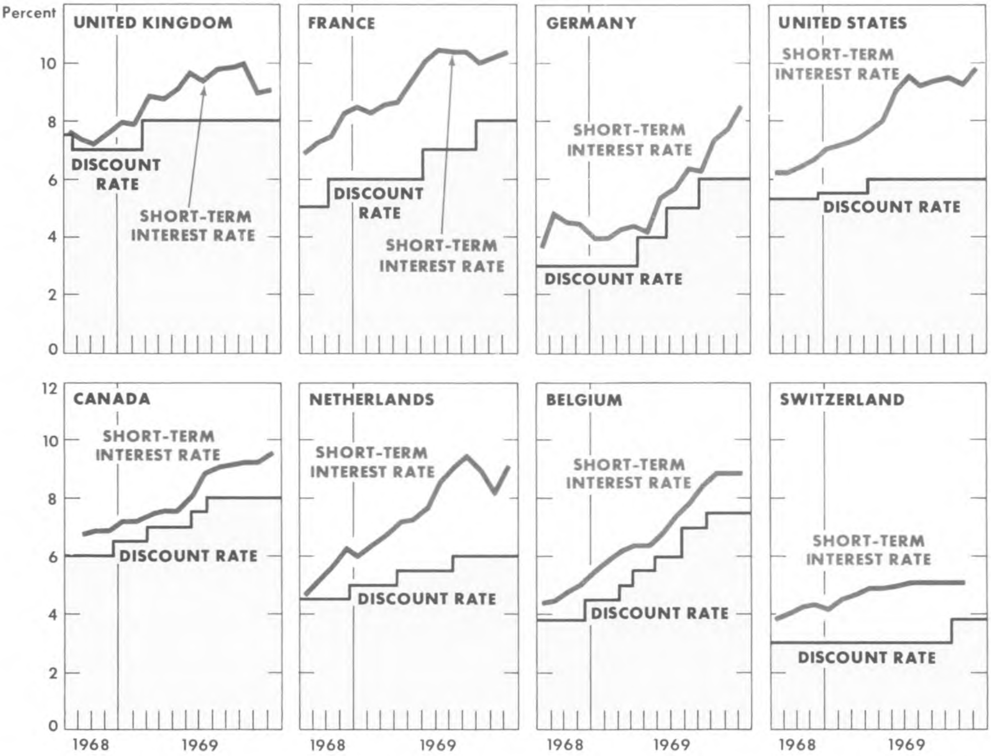
Thus, continuing domestic price pressures, high and rising international interest rates, and the running-down of liquid dollar reserves—all during a period of general apprehension over the existing parity structure—led national authorities to take a number of restrictive measures during March and early April. Discount rate increases or other restrictive monetary policy actions were taken in Belgium, Canada, Denmark, Germany, Italy, the Netherlands, Sweden, and the United Kingdom (see Chart 9). Fiscal policy was tightened in the United Kingdom and the Netherlands. The Dutch government also decreed a price freeze on all goods

Chart 8. **CONSUMER PRICE INCREASES: Inflation continued to be a widespread problem internationally. As demand pressed against productive capacity, many countries experienced domestic price increases as great or greater than those of 1968.**



Fourth-quarter 1969 data are preliminary.

Chart 9. DISCOUNT RATES AND SHORT-TERM INTEREST RATES: Faced with inflationary domestic economic conditions and rising interest rates at home and abroad, monetary authorities took a number of restrictive credit measures, including increases in central bank discount rates.



The interest rates shown for the foreign countries are their domestic short-term rates which are the most competitive with dollar-denominated rates abroad. The United States rate is the market yield on prime four- to six-month commercial paper.

and services. In Italy and Belgium the authorities requested banks to reduce their net foreign asset positions. The freedom of Italian banks to participate in underwriting new Euro-bond issues was restricted, while in Germany the number of new foreign bond issues in marks was limited.

Despite these defensive measures, the underlying nervousness of the exchange markets came to the fore in late April. The defeat of a national referendum in

France prompted President de Gaulle to resign from office, leaving an uncertain political situation in France. At about the same time, reports that the German authorities might be willing to consider a mark revaluation as part of a multilateral realignment of parities unleashed a new speculative rush into that currency in late April and early May. The subsequent massive flow of funds into Germany was the heaviest in international financial history, reaching about $4 billion in seven trading days. The flow into marks came from many countries, but those most severely hit were France, the United Kingdom, Italy, and smaller European countries such as Belgium and Denmark. The outflow from the United States was also large. As in previous cases, a large part of the inflow was in terms of payments leads and lags, but there was ample evidence of outright speculation not tied to normal commercial transactions.

When the German government clearly rejected the revaluation of the mark on May 9, the speculation immediately subsided. Nevertheless, much of the previous inflow remained in Germany. Georges Pompidou's election as France's president in mid-June led to a smooth governmental transition which slowed, but did not reverse, the steady drains on French reserves. Many traders were awaiting the German elections, scheduled for late September, to see how the parity issue would ultimately be resolved. A sizable portion of the reflow that did develop moved into the Euro-dollar market rather than into other foreign countries. Foreign branches of United States banks absorbed a substantial part of this flow and, between mid-May and the end of July, the branch borrowings rose by another $4.9 billion to $14.4 billion. Euro-dollar deposit rates reached record levels, and at one point in June the three-month deposit rate was quoted as high as 13 percent.

In such circumstances, national authorities took further measures to limit the short-term outflow and/or to counteract the inflationary pressures at home. By the end of July, exchange controls had been tightened in Denmark and Belgium, ceilings had been placed on domestic credit expansion in France and Belgium, and Canadian and Dutch banks had been requested to limit or to reduce their net foreign asset positions. Various measures to tighten fiscal policy were taken in Canada, Denmark, France, and Germany, while further monetary restrictions were imposed in Belgium, Canada, Denmark, France, Germany, Italy, the Netherlands, Norway, and Sweden. In addition, the Federal Reserve System, in order to moderate the flow of liquid funds to the United States, took a series of measures placing reserve requirements on banks' Euro-dollar liabilities that slowed down bank borrowings abroad.

Progress Toward Adjustment

On August 8, the French government announced an 11.1 percent devaluation of the franc to $0.180044 per franc. Exchange reserves had been seriously depleted, and the only economic policy alternative would have been a severe deflation, which the new government felt would be harmful to the long-term development of the economy. To support the devaluation, the government immediately instituted a temporary price freeze. By early September, it had presented a broad program which included further strengthening of the curbs on consumer credit, substantial cuts in public spending, a balanced budget for 1970, and a policy of strict official surveillance of domestic prices once the temporary price freeze expired. In addition, the government announced that it had credits totaling $2.6 billion available from the IMF and various central banks, and it quickly drew $1.3 billion from the IMF.

The exchange markets accepted the French devaluation rather calmly. The French reserve position slowly improved during late August and early September, but this was temporary as the focus of attention shifted to Germany. Throughout September, funds moved into Germany in steady and sizable amounts, bringing German reserves to almost $11½ billion by the fourth week of September. In order to forestall an even more massive buildup immediately prior to the September 28 election, the German authorities announced after the close of business on Wednesday, September 24, that the exchange market would be closed until after the weekend election.

The election results pointed to a change of government. As the political arrangements were being worked out, the interim government authorized the German Federal Bank to suspend its defense of the official intervention limits beginning Tuesday, September 30. The mark immediately jumped to a premium of more than 5 percent above the $0.25 parity. The premium continued to increase slowly through the following three weeks, and by October 24 it was almost 8 percent. During this period, the Federal Bank regularly offered dollars to the market at a price just under the currently quoted market price and sold over a billion dollars. Finally, in the third week of October, the new government was formed, and on October 24 it announced a revaluation of the mark. A new parity of $0.273224 was set, 9.3 percent above the old.

Once the new mark parity had been set, there was a brief flurry of speculation that some other currencies—notably the Dutch guilder, the Swiss franc, the Belgian franc, and possibly the Japanese yen—might follow, but this soon faded.

Outflows from Germany continued on a very large scale, however, and by the year-end a total of over $5.2 billion had flowed out of German reserves. While a portion of the funds moved into the Euro-dollar market, substantial amounts returned to other countries' reserves. To bolster its liquid reserves, Germany withdrew the equivalent of $1.1 billion from the IMF, sold $500 million in gold to the United States Treasury, and cashed in $200 million of its holdings of mark-denominated Treasury notes.

The unwinding of the earlier speculative flows to Germany led to a significant improvement in the atmosphere on the foreign exchange markets which was reinforced during this period by favorable developments in the United Kingdom. In September, it was reported that the British payments balance had registered a surplus during the second quarter, and in the third quarter the trade balance alone moved into surplus for the first time since 1966. The basic balance also remained in surplus for the duration of the year and was running ahead of the magnitude indicated by the British government in its letter of intent to the IMF. This long-awaited development, together with the general calming of the exchange markets, strengthened sterling and permitted Britain to repay sizable amounts of short-term debt, including $450 million to the Federal Reserve System in the fourth quarter. By the year-end the French trade position also was showing signs of improvement, and the government announced foreign exchange gains of $660 million since devaluation.

The reduction of pressure on the exchange markets and the decision taken at the IMF annual meeting in October to implement the SDR facility were sufficient to reduce speculative activity and to change near-term expectations in the gold market. From its peak of over $43 an ounce, the price of gold on the free market in London had eased marginally during the summer months, under the pressure of high yields available in the Euro-dollar market and sizable sales by South Africa in order to finance a substantial balance-of-payments deficit. During the fourth quarter the price dropped precipitously, and by mid-December reached the official price level of $35 an ounce.

Steps to Strengthen the International Financial System

In order to help achieve a more orderly growth of international liquidity, the members of the IMF gave final approval during 1969 to the creation of a new reserve asset: SDR's. After many years of complex negotiations, an outline of the basic principles underlying SDR's had been accepted by the board of governors of the IMF in September 1967. An amendment to the Articles of Agreement of the IMF establishing the facility was submitted to member governments for legislative approval in early 1968. By late July 1969 the required number of Fund countries had ratified the amendment and it entered into force.

SDR's are assets that can be used unconditionally for the purchase of convertible currencies to settle payments deficits. They have a fixed value in terms of gold and are allocated to participating members according to their respective Fund quotas. The transfer of SDR's can be accomplished either by direct agreement between participants or through the IMF which is empowered to designate countries to supply convertible currency to another in exchange for SDR's. To safeguard confidence in the new facility, certain limits are placed on its use: a participating country can use SDR's only to meet balance-of-payments or reserve needs but not to change the composition of it reserves; a country has to meet certain reconstitution provisions if it utilizes on the average more than 70 percent of its cumulative allocation of SDR's over any five-year period; and no participating country can be required to hold more than three times its cumulative allocation, though it can do so if it chooses. The participating members agreed in October 1969 that the initial three-year allocation of SDR's would be $9½ billion, with $3½ billion to be distributed in 1970 and $3 billion in each of the next two years. After that, further allocation would be made for subsequent basic periods, normally for five years at a time, depending on international liquidity needs.

Additional steps were taken to meet other liquidity needs. IMF members acted to approve a proposed overall increase of 35 percent in the Fund's quotas during 1970. The proposed increase would add $7.6 billion to the Fund's current resources of $21.3 billion and would be accompanied by significant quota realignments—with Japan, France, Italy, and Canada getting the largest relative quota increases among major countries.

Further, an accord was reached between South Africa and the IMF on the marketing of South African gold. The accord calls for South African gold sales on the free market, which would keep prices on that market orderly and would reduce purely speculative interest in gold. The accord also allows for sales of gold by South Africa to the IMF whenever certain price and balance-of-payments conditions are met. The agreement thus permits some expansion of the amount of gold held in world reserves, but in limited amounts and under specific conditions.

In view of the exchange market difficulties that have accompanied changes in parities of major currencies in recent years, there has been increasing discussion of the adequacy of the present IMF rules in regard to exchange practices. A wide variety of proposals for increased exchange rate flexibility have been made. At the annual meeting of the IMF held in Washington last fall, it was decided that the exchange rate question—which raises a number of broad policy issues as well as many technical considerations—would be studied in depth within the Fund.

Finally, as in previous years of the decade of the 1960's, there was further development of central bank cooperation. The agreement in February 1969 on a joint central banking facility for the recycling of hot money flows was a major innovation. The Federal Reserve swap network, which grew by another $475 million to $10,980 million, was again instrumental in meeting a variety of short-term exchange and reserve situations. In fact, use of the System's swap lines was in greater volume in 1969 than the total of IMF drawings and official gold settlements during the year. The events in the exchange markets in 1969 could easily have been so disruptive as to generate chaos, either in the form of market breakdowns or in the form of official retrenchment behind "beggar-my-neighbor" policies. The lines of communication among governments, and between central banks and their exchange markets, remained open throughout the year. The relative calm at the end of 1969 could not have been achieved without this broad international effort to communicate, and as much as possible to cooperate, on means to relieve the strains on the international monetary system.

The United States Balance of Payments

The two principal measures of the United States international payments performance gave sharply divergent readings in 1969. The measure on a liquidity basis swung to a massive deficit of $7 billion, after achieving approximate balance in 1968, while the official settlements measure showed a surplus of $2.8 billion.[2] However, neither measure gave a realistic indication of this country's international payments position. Both measures were distorted by heavy flows of short-term capital and by other special factors. In general, this country's basic international position remained unsatisfactory in 1969 and, in some respects, may actually have deteriorated further.

The recent trend in the trade account has been particularly worrisome. The trade surplus was virtually unchanged in 1969 from the previous year at just over $600 million. In contrast, in the five years previous to 1968, the trade surplus had averaged almost $5 billion. The trade account was in actual deficit in the first half of the year when the Atlantic and Gulf coast dock workers' strike cut more deeply into exports than imports. The net loss to the United States trade account as a result of the strike, which lasted at some ports throughout the first quarter, has been estimated at $300 million to $400 million. Then, as the effects of the dock strike faded, a trade surplus of about $700 million was achieved in the last six months of the year. Foreign demand, especially for machinery and other capital goods, remained high. For the year as a whole, exports expanded by 8.3 percent to $36.4 billion, even though sales abroad of agricultural products dropped because of improved grain crops abroad, particularly in the large importing countries. Rising prices and buoyant demand in the United States continued to spur imports, notably of automobiles, other consumer goods, and capital equipment. Imports at $35.8 billion were 8.5 percent higher for the year, though the pace of expansion appeared to ease slightly in the second half of the year as domestic economic pressures became somewhat less intense.

The surplus in the service account also narrowed last year. A moderate rise in military expenditures abroad more than offset a small increase in the sale of

[2] *The balance on the "liquidity basis" is measured by changes in United States reserve assets and in liquid dollar liabilities to all foreigners, while the balance on the "official reserve transactions basis" is measured by changes in United States reserve assets and in liquid and certain nonliquid liabilities to foreign official institutions, mainly monetary authorities.*

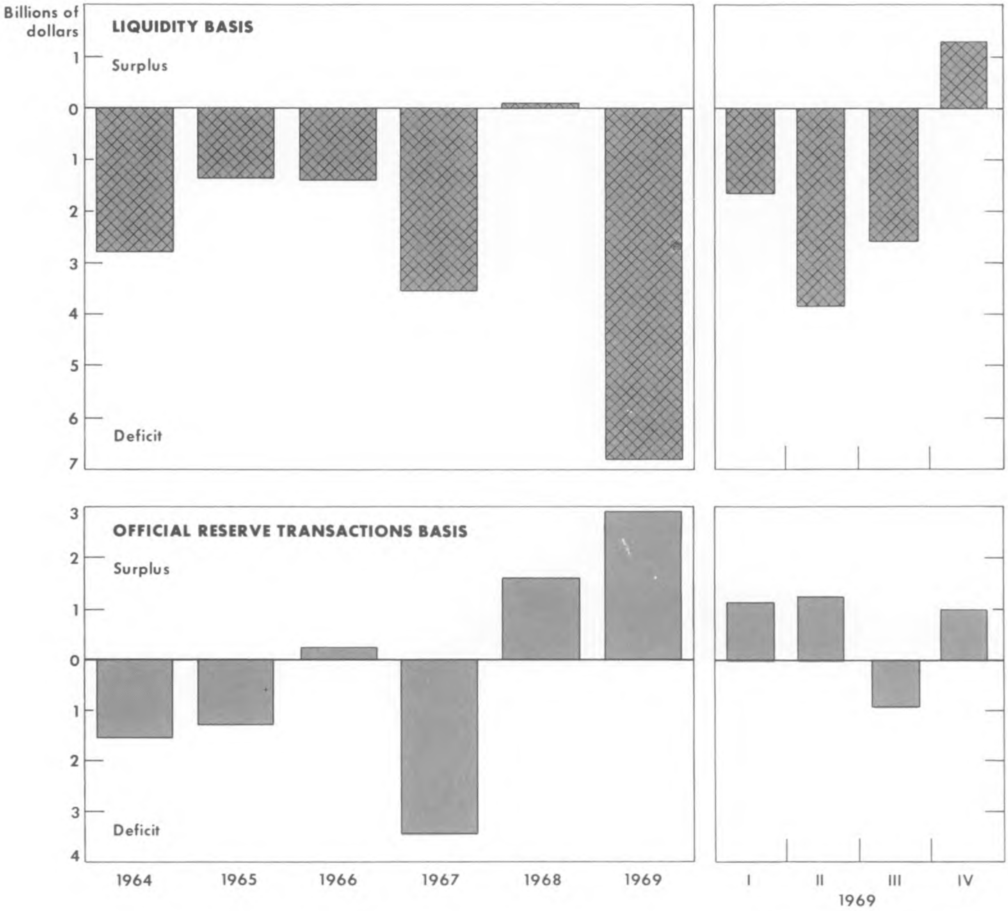
military equipment, and the surplus on investment income declined rather substantially. Higher domestic interest rates, together with increased United States indebtedness abroad, gave rise to a substantial increase in interest payments to foreigners, while dividend payments abroad also rose in response to the exceptionally large amount of common stocks of United States corporations purchased by foreigners in recent years. Receipts on United States investments abroad grew somewhat less rapidly. These adverse developments, along with the poor merchandise trade performance, led to a deterioration in the overall balance on goods and services of approximately $500 million for the year as a whole.

A large net outflow of private United States and foreign capital followed the unusually favorable inflow of the previous year. Direct corporate investment abroad continued to be sizable in 1969, as United States head offices financed substantial foreign expansion. Additional foreign investments were also made with funds borrowed abroad both directly from banks and through the issue of new corporate securities. Despite remaining at levels well above their pre-1968 norm, net foreign purchases of domestic securities were down markedly from their extraordinarily high 1968 rate, primarily as a result of a sharp fall in United States corporate bond issues abroad and a large decline in foreign purchases of United States equities.

The aggressive bidding for funds in the Euro-dollar market by United States banks both contributed to the massive liquidity deficit last year and provided the principal avenue by which it was financed. The high rates bid on liquid Euro-dollar deposits—higher than those generally available on short-term domestic investments—apparently induced many United States investors to place funds in the Euro-dollar market which were then absorbed by branches of United States banks and channeled to their head offices. This circular flow of liquid capital was reflected primarily in a large increase in the "errors and omissions" line in the balance-of-payments accounts during the first three quarters of the year. Nevertheless, banks' Euro-dollar demands exceeded the outflow of dollars abroad this past year. Consequently, foreign official holdings of dollars were drawn down as private foreigners purchased those holdings in the exchange markets for placement in attractive Euro-dollar investments. This decline in foreign official dollar holdings was a major factor in the official reserve transactions surplus achieved in 1969.

The decision of the new Administration to discontinue the earlier policy of encouraging foreign official institutions to shift their liquid claims against the United States into technically nonliquid claims also added significantly this past

Chart 10. UNITED STATES BALANCE OF PAYMENTS: The payments position measured on a liquidity basis was in deep deficit in 1969 despite a fourth-quarter surplus resulting from year-end capital inflows. Measured on an official reserve transactions basis, the payments position was in substantial surplus. This divergence in the two payments measures largely reflected the sizable increase during 1969 in United States banks' Euro-dollar borrowings.



Quarterly data are seasonally adjusted.

year to the recorded payments deficit on a liquidity basis. In 1968, over $2 billion of such nonliquid placements had been made by foreign authorities.

During 1969, however, there was a substantial reversal of these claims from nonliquid to liquid, especially in the second and third quarters of the year.

The divergence between the liquidity measure and the official reserve transactions measure of the balance of payments was most marked in the first half of the year (see Chart 10). During that time, domestic banks' borrowings from their foreign branches rose by $7.3 billion, while the shift of nonliquid liabilities to official foreigners into liquid liabilities added over $400 million to the recorded liquidity deficit. Thus, the United States payments position on a liquidity basis showed a deficit of over $5 billion in the first half of the year, while on an official reserve transactions basis it showed a surplus of over $2 billion.

The increase in banks' Euro-dollar borrowings took place entirely in the first seven months of the year. Thereafter, total outstanding Euro-dollar liabilities to foreign branches remained about unchanged on balance until the closing days of December, when they dropped quite sharply in response to massive year-end repatriations of dollars by United States corporations. In part, the cessation of the growth of United States banks' borrowings after July reflected the imposition of a 10 percent marginal reserve requirement on these liabilities and the developing use of the domestic commercial paper market as an alternative source of bank funds free of Regulation Q rate restrictions.

Thus, in the third quarter, both the liquidity and the official settlements accounts showed large deficits. The speculative outflows of dollars into German marks, and the accumulation of large dollar reserves by the German monetary authorities, added to the third-quarter deficits. Then, in the fourth quarter the official settlements balance moved back into surplus, as speculative positions in German marks were unwound and the liquidity balance moved into surplus largely on the strength of the massive—and mainly temporary—year-end capital flows to the United States.

Despite the wide swings in other settlement items, United States official reserve assets—the gold stock, holdings of foreign convertible currencies, and the reserve position in the IMF—improved notably during the year. The gold stock alone rose by almost $1 billion, reflecting primarily large sales to the United States by France and Germany. This improvement and the decline in the premium on the private gold market were signs of continuing confidence in the stability of the dollar, at least in the near term. The retention of this confidence, however, and the eventual elimination of the present restrictions on capital outflows will depend to a great extent upon progress toward a stronger trade position.

THIS BANK'S OPERATIONS

Volume and Trend of the Bank's Operations

The volume of operations in many departments of the Bank expanded in 1969, reflecting both continued economic growth and increased activity in the financial markets.

Money transfers processed by this Bank increased sharply in 1969. The number of wire transfers rose almost 14 percent to 1.5 million, while the dollar volume (excluding Treasury transfers between Federal Reserve Districts) advanced 25 percent to $3,569 billion. These gains were considerably larger than those recorded in 1968 of 11 percent and 19½ percent, respectively. A good part of the growth this past year resulted from increased activity in both the interbank Federal funds market and the Government securities market.

The number and the dollar amount of total checks processed by this Bank reached record levels in 1969. Over 888 million checks other than Government checks were handled—an increase of approximately 5 percent, about the same gain as that in each of the previous two years. Moreover, the dollar volume of these checks processed during 1969 jumped 29 percent to $1,285 billion. The number of United States Government checks handled actually decreased by 3 percent from a 1968 high of 74 million, but the dollar amount of such checks climbed 7 percent to almost $34 billion.

During 1969, coin receipts (other than receipts of new coin from the Mint) increased substantially, after a significant decline in 1968. This Bank received 1,726 million pieces of coin, almost 14½ percent more than in 1968, and the dollar volume reached $220 million. Most coins were available in adequate quantities with the exception of one-cent coins, the shipments of which had to be limited during several short periods of time.

Reflecting the Federal Reserve System's restrictive monetary policy during 1969, discount-window loan disbursements to Second District member banks reached a postwar high of $42.5 billion. This was almost 37 percent above the previous postwar high of $31.1 billion recorded in 1966 and 43 percent more than in 1968. The number of discounts and advances rose about 80 percent,

SOME MEASURES OF THE VOLUME OF OPERATIONS OF THE FEDERAL RESERVE BANK OF NEW YORK (including Buffalo Branch)

Number of pieces handled (in thousands)★	**1969**	**1968**
Currency received	1,648,335	1,692,055
Coin received†	1,725,617	1,508,125
Gold bars and bags of gold coin handled	169	461
Checks handled:		
United States Government checks	71,440	73,728
All other	888,011	846,895
Postal money orders handled	24,644	27,458
Collection items handled:		
United States Government coupons paid	3,187	3,238
Credits for direct sendings of collection items	254	309
All other‡	43,809	30,642
Issues, redemptions, exchanges by fiscal agency departments:		
United States savings bonds and notes§	33,751	32,678‖
All other obligations of the United States	10,739	9,350‖
Obligations of Federal agencies	2,033	1,422‖
Obligations of international organizations	80	178‖
Custody of securities:		
Pieces deposited in and withdrawn from unissued stock held by this Bank as fiscal agent	40,444	— ¶
Pieces received and delivered for safekeeping accounts	1,021	1,170‖
Coupons detached	4,276	4,468
Wire transfers of marketable securities	379	325
Wire transfers of funds★★	1,541	1,354
Amounts handled (in millions of dollars)		
Discounts and advances††	42,548	29,690
Currency received	11,816	11,401
Coin received†	220	177
Gold bars and bags of gold coin handled	2,290	6,072
Checks handled:		
United States Government checks	33,846	31,583
All other	1,285,116	995,479
Postal money orders handled	597	606
Collection items handled:		
United States Government coupons paid	3,514	3,113
Credits for direct sendings of collection items	771	1,331
All other‡	4,283	4,569‖
Issues, redemptions, exchanges by fiscal agency departments:		
United States savings bonds and notes§	1,886	1,768‖
All other obligations of the United States	862,416	800,885‖
Obligations of Federal agencies	95,709	54,831‖
Obligations of international organizations	1,543	2,111
Custody of securities:		
Par value pieces deposited in and withdrawn from unissued stock held by this Bank as fiscal agent	929,146	787,021
Par value pieces received and delivered for safekeeping accounts	376,011	282,233‖
Par value wire transfers of marketable securities	312,891	245,320
Wire transfers of funds★★	3,569,025	2,857,456

★ Two or more checks, coupons, etc., handled as a single item are counted as one "piece".
† Excludes shipments of new coin from the Mint.
‡ These figures include food stamps redeemed.
§ Savings notes are not eligible for redemption until one year after issue date.
‖ Revised.
¶ Figure not available due to revised method of reporting.
★★ Excludes Treasury transfers between Federal Reserve Districts.
†† The number of discounts and advances handled in 1969 was 3,947, compared with 2,194 in 1968.

to 3,947 from 2,194. Almost half of the member banks in the Second District (49 percent) borrowed at least once during the year.

This Bank's fiscal agency operations expanded greatly in 1969. The dollar amount of all obligations handled for the United States Government (other than United States savings bonds and notes), Federal agencies, and international organizations increased by 12 percent to $960 billion, while the number of such items handled rose more than 17 percent to 13 million.

The volume of telegraphic transfers of marketable Government securities among Federal Reserve offices rose moderately in 1969 as compared with the previous year. In the same period, however, the volume of such transfers between New York City banks participating in this Bank's Government securities clearing arrangement rose by 83 percent over 1968. In addition, the par amount of such securities held in custody by this Bank on a book-entry basis reached $78 billion just after the year-end, $56 billion of which was attributable to the conversion of the System Open Market Account. These new securities clearing and custody techniques should go far to help alleviate the mounting problems involved in the physical delivery and custody of Government obligations.

Average employment at the Bank climbed for the third consecutive year to 4,303 persons, 5 percent above 1968. By the end of the year, employment—including the officers and staff at the Buffalo branch—totaled 4,367.

Public interest in the Federal Reserve remained strong. During 1969, 13,621 visitors were received for tours, 171 speeches were delivered by members of the Bank's staff to various financial, business, and educational groups, and over 755,000 copies of the Bank's publications (other than periodicals) were distributed.

Total holdings of gold, dollar balances, and other assets for foreign and international accounts declined by $3.6 billion during 1969 to a year-end level of $26.3 billion, the lowest since October 1961. Total assets held for foreign accounts fell by $2.6 billion, while those for international organizations dropped by $1.0 billion. Of the total funds held at the year-end for both foreign and international accounts, $12.3 billion was in gold ($0.7 billion less than a year earlier), $10.9 billion was in United States Government securities (a $3.3 billion decline), and $3.1 billion was in other assets, largely denominated in dollars (an increase of $0.4 billion).

Financial Statements

STATEMENT OF CONDITION

In thousands of dollars

Assets	DEC. 31, 1969	DEC. 31, 1968
Gold certificate account	2,325,038	2,812,519
Federal Reserve notes of other Banks	159,433	162,261
Other cash	7,888	20,431
Total cash	2,492,359	2,995,211
Discounts and advances	51,532	74,425
Acceptances bought outright	63,914	57,715
United States Government securities bought outright★	13,920,970	12,687,264
Total loans and securities	14,036,416	12,819,404
Other assets:		
Cash items in process of collection	2,494,160	2,663,115
Bank premises	8,997	9,702
All other†	828,356	877,161
Total other assets	3,331,513	3,549,978
Total Assets	**19,860,288**	**19,364,593**

★ Includes securities loaned — fully secured by United States Government securities pledged with the Bank	44,400	0

† Includes assets denominated in foreign currencies and IMF gold deposited.

STATEMENT OF CONDITION
In thousands of dollars

Liabilities	DEC. 31, 1969	DEC. 31, 1968
Federal Reserve notes	11,263,763	10,511,438
Deposits:		
Member bank reserve accounts	5,826,603	5,897,265
United States Treasurer — general account	302,780	681,157
Foreign★	36,628	52,506
Other†	538,713	516,138
Total deposits	6,704,724	7,147,066
Other liabilities:		
Deferred availability cash items	1,397,727	1,291,836
All other	140,976	94,107
Total other liabilities	1,538,703	1,385,943
Total Liabilities	**19,507,190**	**19,044,447**
Capital Accounts		
Capital paid in	176,549	160,073
Surplus	176,549	160,073
Total Capital Accounts	**353,098**	**320,146**
Total Liabilities and Capital Accounts	**19,860,288**	**19,364,593**
Contingent liability on acceptances purchased for foreign correspondents‡	37,107	28,062

★ After deducting participations of other Federal Reserve Banks amounting to	96,980	163,460
† Includes IMF gold deposit.		
‡ After deducting participations of other Federal Reserve Banks amounting to	108,841	81,136

STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1969 AND 1968 (In thousands of dollars)

	1969	1968
Total current earnings	848,842	696,373
Net expenses	60,432	50,213
Current net earnings	788,410	646,160
Additions to current net earnings:		
Profit on sales of United States Government securities (net)	0	192
Profit on foreign exchange transactions (net)	1,487	2,069
All other	31	16
Total additions	1,518	2,277
Deductions from current net earnings:		
Loss on sales of United States Government securities (net)	1,494	0
All other	4	10
Total deductions	1,498	10
Net additions or deductions (—)	20	2,267
Net earnings available for distribution	**788,430**	**648,427**
Dividends paid	10,237	9,473
Payments to United States Treasury (interest on Federal Reserve notes)	761,717	633,195
Transferred to surplus	16,476	5,759

SURPLUS ACCOUNT

	1969	1968
Surplus — beginning of year	160,073	154,314
Transferred from net earnings for year	16,476	5,759
Surplus—end of year	**176,549**	**160,073**

Changes in Membership

During 1969 the total number of member banks of the Federal Reserve System in this District declined from 374 to 362. The decrease was the net result of the merger of thirteen member banks, the conversion of one national bank into a state nonmember bank, and the organization of two new member banks. The 362 banks constitute 79 percent of all commercial banks and trust companies in this District and hold 97 percent of the total assets of all such institutions in this District.

NUMBER OF OPERATING MEMBER AND NONMEMBER BANKS IN SECOND FEDERAL RESERVE DISTRICT AT THE YEAR-END

Exclusive of savings banks, private banks, and industrial banks

	DECEMBER 31, 1969			DECEMBER 31, 1968		
Type of Bank	**Members**	**Non-members**	**Percent members**	**Members**	**Non-members**	**Percent members**
National banks★	257	0	100	265	0	100
State banks and trust companies	105	96	52	109	90	55
Total	**362**	**96**	**79**	**374**	**90**	**81**

★Includes one national bank located in the Virgin Islands.

CHANGES IN FEDERAL RESERVE MEMBERSHIP IN SECOND DISTRICT DURING 1969

Total membership at beginning of year	**374**
Increases:	
New state banks	2
Decreases:	
Member banks merged into other members	11
Member banks merged into nonmembers	2
National bank converted into state nonmember	1
Total membership at the year-end	**362**

Changes in Directors and Officers

CHANGES IN DIRECTORS. In November, member banks in Group 3 elected Arthur S. Hamlin a Class A director and reelected Maurice R. Forman a Class B director, each for a three-year term beginning on January 1, 1970. Mr. Hamlin, President of The Canandaigua National Bank and Trust Company, Canandaigua, N. Y., served as a director of the Buffalo Branch of this Bank from May 1963 through December 1968. As a director of this Bank, he succeeded Eugene H. Morrison, President of the Orange County Trust Company, Middletown, N. Y., who served for the three-year term that ended on December 31, 1969. Mr. Forman, Chairman of the Board of B. Forman Co., Inc., Rochester, N. Y., has been a Class B director since January 1967. Mr. Forman previously served as a director of the Buffalo Branch from January 1963 through December 1966 and as *Chairman* of the Branch Board of Directors in 1965.

In December, the Board of Governors of the Federal Reserve System reappointed Albert L. Nickerson a Class C director for the three-year term beginning on January 1, 1970 and redesignated him *Chairman* of the Board of Directors and *Federal Reserve Agent* for the year 1970. Mr. Nickerson, former Chairman of the Board of the Mobil Oil Corporation, New York, N. Y., has been serving as *Chairman* and *Federal Reserve Agent* since January 1969. He formerly served as a Class B director of this Bank from August 1961 to the end of 1966.

At the same time, the Board of Governors reappointed James M. Hester *Deputy Chairman* for the year 1970. Dr. Hester, President of New York University, has been serving as a Class C director since January 1965 and as *Deputy Chairman* since January 1969.

At the Buffalo Branch, the Board of Governors in December appointed Morton Adams a director of the Branch for a three-year term beginning on January 1, 1970. Mr. Adams, who is General Manager of Pro-Fac Cooperative, Inc., Rochester, N. Y., succeeded Gerald F. Britt, President, L-Brooke Farms, Inc., Byron, N. Y., who had been a Branch director since January 1967, serving as *Chairman* of the Branch Board in 1969. Also in December, the Board of Directors of this Bank appointed David J. Laub a director of the Branch for a three-year term beginning on January 1, 1970. Mr. Laub, who is President of the Marine Midland Trust Company of Western New York, Buffalo, N. Y., succeeded E. Perry Spink, Chairman of the Board, Liberty National Bank and Trust Company, Buffalo, N. Y. Mr. Spink had been a Branch director since

January 1967 and had previously served in that capacity from January 1958 through December 1960. At the same time, the Board of Directors of this Bank designated Robert S. Bennett as *Chairman* of the Branch Board for the year 1970. Mr. Bennett, who is General Manager of the Lackawanna Plant of the Bethlehem Steel Corporation, Buffalo, N. Y., has been a director of the Branch since January 1965 and served as *Chairman* of the Branch Board for the years 1967 and 1968.

CHANGES IN OFFICERS. Since March 1, 1969, three officers have resigned and one has retired:

Bruce K. MacLaury, Vice President assigned to Foreign, resigned effective March 31, 1969 to accept appointment as Deputy Under Secretary of the Treasury for Monetary Affairs. Mr. MacLaury joined the Bank's staff in July 1958 and became an officer in July 1963.

Edward J. Geng, Assistant Vice President assigned to Open Market Operations and Treasury Issues, resigned effective November 3, 1969 to accept appointment as Special Assistant to the Secretary of the Treasury for Debt Management. Mr. Geng joined the Bank's staff in February 1957 and became an officer in July 1964.

Betty Jean Shea, Assistant Counsel, resigned effective January 19, 1970. Mrs. Shea joined the Bank's staff in March 1960 and became an officer in October 1965.

Kenneth E. Small, Assistant Vice President assigned to Cash and Collections (Cash and Cash Custody Departments), retired effective March 1, 1970. Mr. Small joined the Bank's staff in October 1941 and became an officer in July 1951.

The following additional changes in the official staff, including the appointment of ten new officers, have been made since January 1969:

Bruce G. Alexander, formerly Employment Director, Employment Division, Personnel Department, was appointed an officer with the title of Manager on February 20, 1969, and assigned to the Personnel Department.

John T. Keane, formerly Assistant Vice President assigned to the Administrative Services function at the Head Office, was appointed Assistant Vice President at the Buffalo Branch effective April 1, 1969. Mr. Keane had been transferred from the Branch to the Head Office on a rotational assignment effective September 23, 1968.

H. David Willey, formerly Chief of the Balance of Payments Division, International Research Department, was appointed Senior Economist effective July 3, 1969. Mr. Willey had been on a leave of absence from the Bank since July 1968, serving as Director of the Reports Analysis and Policy Division of the Office of Foreign Direct Investments in the United States Department of Commerce.

John J. Clarke, Vice President and Special Legal Adviser, was assigned responsibility for the newly established Consumer Information and Securities Regulations function effective November 1, 1969. Mr. Clarke's responsibility for the Payment Systems function was continued.

James H. Booth, formerly Chief of the Accounting Division, Accounting Department, was appointed an officer with the title of Manager effective November 1, 1969 and assigned to the Bank Examinations Department.

Ralph H. Gelder, Manager, formerly assigned to the Bank Examinations Department, was assigned to the newly established Banking Studies Department effective November 1, 1969.

Edward F. Kipfstuhl, formerly Supervising Review Examiner, Examining Division, Bank Examinations Department, was appointed an officer with the title of Manager effective November 1, 1969 and assigned to the Bank Examinations Department.

James H. Oltman, Manager, formerly assigned to the Bank Examinations Department, was assigned to the newly established Consumer Information and Securities Regulations Department effective November 1, 1969.

Irwin D. Sandberg, formerly Special Assistant, Securities Department, was appointed an officer with the title of Securities Trading Officer effective November 1, 1969.

Robert G. Link, formerly Vice President, was appointed Senior Vice President on January 8, 1970, continuing in Research and Statistics as the officer in charge of that function.

David E. Bodner, formerly Assistant Vice President, was appointed Vice President on January 8, 1970 and assigned to Foreign, where he has supervisory responsibility for the operations of the function under Charles A. Coombs, Senior Vice President.

Allen R. Bivens, formerly Attorney, Legal Department, was appointed an officer with the title of Assistant Counsel on January 8, 1970.

Richard D. Coopersmith, formerly Attorney, Legal Department, was appointed an officer with the title of Assistant Counsel on January 8, 1970.

Mary J. Rodgers, formerly Attorney, Legal Department, was appointed an officer with the title of Assistant Counsel on January 8, 1970.

Charles R. Pricher, formerly Manager, was appointed Assistant Vice President on January 22, 1970 and assigned to Cash and Collections, with responsibility for the Cash and Cash Custody Departments.

Whitney R. Irwin, formerly Chief of the Sorting and Counting Division, Cash Department, was appointed an officer with the title of Manager on January 22, 1970 and assigned to the Cash Department.

Richard Vollkommer, formerly Chief of the Securities Clearance Division, Government Bond and Safekeeping Department, was appointed an officer with the title of Manager on January 22, 1970 and assigned to the Government Bond and Safekeeping Department.

MEMBER OF FEDERAL ADVISORY COUNCIL—1970. The Board of Directors of this Bank selected John M. Meyer, Jr., to serve during 1970 as the member of the Federal Advisory Council representing the Second Federal Reserve District. Mr. Meyer is Chairman of the Board of the Morgan Guaranty Trust Company of New York, New York, N. Y. He succeeded George S. Moore, Chairman of the Board of the First National City Bank, New York, N. Y., who served as a member of the Council during 1968 and 1969.

Directors of the Federal Reserve Bank of New York

DIRECTORS	Term expires Dec. 31	Class	Group
R. E. McNEILL, JR. Chairman of the Board, Manufacturers Hanover Trust Company, New York, N. Y.	1970	A	1
CHARLES E. TREMAN, JR. President, Tompkins County Trust Company, Ithaca, N. Y.	1971	A	2
ARTHUR S. HAMLIN President, The Canandaigua National Bank and Trust Company, Canandaigua, N. Y.	1972	A	3
ARTHUR K. WATSON Chairman of the Board, IBM World Trade Corporation, New York, N. Y., and Vice Chairman of the Board, International Business Machines Corporation, Armonk, N. Y.	1970	B	1
MILTON C. MUMFORD Chairman of the Board, Lever Brothers Company, New York, N. Y.	1971	B	2
MAURICE R. FORMAN Chairman of the Board, B. Forman Co., Inc., Rochester, N. Y.	1972	B	3
ALBERT L. NICKERSON, *Chairman, and Federal Reserve Agent* Former Chairman of the Board, Mobil Oil Corporation, New York, N. Y.	1972	C	
JAMES M. HESTER, *Deputy Chairman* President, New York University, New York, N. Y.	1970	C	
ROSWELL L. GILPATRIC Partner, Cravath, Swaine & Moore, Attorneys, New York, N. Y.	1971	C	

DIRECTORS—BUFFALO BRANCH

ROBERT S. BENNETT, *Chairman* General Manager, Lackawanna Plant, Bethlehem Steel Corporation, Buffalo, N. Y.	1970
WILMOT R. CRAIG Chairman of the Board, Lincoln Rochester Trust Company, Rochester, N. Y.	1970
CHARLES L. HUGHES President, The Silver Creek National Bank, Silver Creek, N. Y.	1970
NORMAN F. BEACH Vice President, Eastman Kodak Company, Rochester, N. Y.	1971
JAMES I. WYCKOFF President, The National Bank of Geneva, Geneva, N. Y.	1971
MORTON ADAMS General Manager, Pro-Fac Cooperative, Inc., Rochester, N. Y.	1972
DAVID J. LAUB President, Marine Midland Trust Company of Western New York, Buffalo, N. Y.	1972

MEMBER OF FEDERAL ADVISORY COUNCIL—1970

JOHN M. MEYER, JR. Chairman of the Board, Morgan Guaranty Trust Company of New York, New York, N. Y.	1970

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WILLIAM F. TREIBER, *First Vice President*

CHARLES A. COOMBS, *Senior Vice President*
MARCUS A. HARRIS, *Senior Vice President*
ALAN R. HOLMES, *Senior Vice President*
ROBERT G. LINK, *Senior Vice President*

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RICHARD A. DEBS, *Vice President*
PETER FOUSEK, *Vice President*
GEORGE GARVY, *Economic Adviser*
EDWARD G. GUY, *Vice President and General Counsel*
SPENCER S. MARSH, JR., *Market Adviser*
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WILLIAM H. WETENDORF, *Manager, Protection Department*
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ROBERT YOUNG, JR., *Assistant Counsel*

GEORGE C. SMITH, *General Auditor*
JOHN E. FLANAGAN, *Assistant General Auditor*

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JOHN T. KEANE, *Assistant Vice President*
RONALD B. GRAY, *Cashier*

HARRY A. CURTH, JR., *Assistant Cashier*
GERALD H. GREENE, *Assistant Cashier*
ARTHUR A. RANDALL, *Assistant Cashier*


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OGDENSBURG
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GLENS FALLS
OSWEGO
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SCHENECTADY
ALBANY
NEW YORK
BUFFALO
ELMIRA
BINGHAMTON
POUGHKEEPSIE
JAMESTOWN
BRIDGEPORT
NEW YORK
NEWARK
NEW BRUNSWICK