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FEDERAL RESERVE BANK OF NEW YORK

ANNUAL REPORT 1975

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FEDERAL RESERVE BANK OF NEW YORK

February 24, 1976

To the Member Banks in the
Second Federal Reserve District

I am pleased to present our sixty-first Annual Report, reviewing major economic and financial developments and this Bank's operations in 1975.

The past year was again a painful one for the world economy. As 1975 began, many industrial nations, including the United States, were in the throes of their deepest recessions of the postwar period. The United States economy began to recover in the second quarter and, by the year-end, recovery had spread throughout much of the world. Still, unemployment continued close to postwar peak levels, and inflation remained a serious problem.

Strains in the financial markets were also felt throughout much of the year, as the combination of inflation and recession exposed some weaknesses in both the private and the public sectors. New York City's financial difficulties were the most dramatic, but many other conspicuous problems came to light. Despite these strains, secondary repercussions in the economy proved to be of modest dimensions, and businesses and financial institutions made progress in improving their liquidity and capital positions.

In the year ahead, important tasks confront policymakers. A reduction in unemployment is clearly required. Yet we must do this without exacerbating inflation or else our efforts are likely to be thwarted. Happily, we begin the new year in the midst of an ongoing recovery with a sharply lower rate of inflation than one year ago. The challenge is to sustain the upward momentum in economic activity while continuing to make progress on the inflation front.

Paul A. Volcker

PAUL A. VOLCKER
President

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SIXTY-FIRST
ANNUAL REPORT

For the Year

Ended

December 31, 1975

Second Federal Reserve District

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Sixty-first Annual Report
Federal Reserve Bank of New York

The Economy in 1975

The industrial world began 1975 in the midst of a severe international recession and an alarmingly virulent inflation. Starting in the second quarter, however, the United States became one of the first major industrial nations to mount a substantial recovery. By the end of the year, recovery had become rather general throughout the world. Under the pressure of inventory liquidation and other factors, inflation had slowed in varying degrees. Nevertheless, both inflation and unemployment remained very serious problems. At the year-end, the staying power of the recovery was still in some doubt and the prospects for sustained growth appeared closely related to those for bringing inflation in check.

One potential obstacle to continued expansion was the financial strains faced by a wide range of the world's business and governmental units in the aftermath of the long inflationary boom, the increase in energy prices, and the subsequent steep recession. The problems of New York City were a particular focus of attention for much of the year. To be sure, these and other points of strain were contained without substantial secondary repercussions, and clear progress was achieved in strengthening the liquidity and profitability of many business and financial institutions. Yet, more cautious attitudes remained evident on the part of lenders and borrowers alike.

The pattern of the recent recession in the United States was quite unusual.

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The starting point is generally dated in late 1973, when the impact of the energy crisis curtailed growth. There was little further change until economic weakness suddenly intensified in the fall of 1974 with an almost wholly unanticipated severity. What happened in fact was that, after many months of sluggish final demand, an unexpected inventory correction of major proportions broke out and production and employment dropped sharply in the winter of 1974-75. When the worst of the inventory adjustment had spent itself, the bottom of the recession came rather quickly, sooner than generally expected. Indeed, the economy began to recover in early spring, spurred in part by a sizable tax cut and a more expansionary monetary policy. However, the drop in unemployment was limited by the rise in the civilian labor force and by the usual reluctance of firms to take on new workers in the early stages of an upturn. In December the overall jobless rate stood at 8.3 percent, only slightly below its postwar peak of 8.9 percent reached in May. To some extent, the impact of unemployment was cushioned by rising expenditures on social programs, such as unemployment compensation, food stamps, and welfare. Yet many workers had exhausted their jobless benefits by the year-end, and there could be no doubt that unemployment in 1975 constituted a source of major private and social costs.

Differences of opinion will probably persist with respect to the relative importance of various factors in generating the recent recession. However, the generally unexpected severity of the downturn undoubtedly reflected, in part, reactions to both higher oil prices and, more importantly, the unusual virulence of inflation in 1973-74. Given the absence of much postwar experience with such factors, their influence was difficult to anticipate and, in retrospect, was underestimated by most government and private sector analysts. The almost fourfold increase in the price of crude oil in late 1973 disrupted normal expenditure patterns and diverted income to the major oil-exporting nations. A more serious depressant was the strong inflation over recent years which was prompted by the worldwide boom and exacerbated by rises in the prices of both oil and food. As households became more uncertain about the purchasing power of existing income and wealth, measures of consumer confidence plummeted to record lows, and spending on new homes, automobiles, and other durables fell sharply. With corporate tax liabilities calculated on the basis of historical rather than inflated replacement costs, aftertax cash flows of firms were squeezed. Inflationary expectations helped boost inventory stocks in early 1974 to unsustainable levels, triggering the subsequent liquidation in 1975.

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Expectations of inflation also pushed up interest rates, which in turn diverted savings from thrift institutions and the housing industry. Moreover, inflation strained financial markets and liquidity positions generally. Overall, the recent experience has served to demonstrate the difficulty of maintaining steady economic expansion in an inflationary climate.

While the severity of the recent recession was certainly substantial, it nevertheless seemed to belong more closely to the family of postwar recessions than to the major economic catastrophies of the prewar period. To be sure, the 1973-75 decline in real gross national product (GNP) is estimated to have been significantly larger than the drops recorded in earlier postwar downturns. On the other hand, the percentage declines in some of the more direct measures of real activity, such as industrial production and employment, whose measurement, unlike that of real GNP, avoids the difficulties of deflating nominal expenditures, were more similar to those recorded in some previous postwar recessions (see Chart 1). By contrast, the drop in real activity during the recent recession was very much smaller than the sharp declines of 1920-21, 1929-33, and 1937-38. Capacity utilization fell significantly in the 1973-75 recession but had been so high in 1973 that the trough in early 1975 for some measures was not much different from either the 1957-58 or 1960-61 recessions. While the unemployment rate reached new postwar peaks during 1975, this measure appeared for technical reasons to overstate somewhat the amount of slack in the labor market relative to past episodes. By the end of 1975 some of the slack in the economy had already been taken up and, while a good deal of resource underutilization remained at the year-end, its extent was by no means unprecedented even for the relatively prosperous postwar period.

In one major respect, at least, the 1973-75 recession did differ markedly from its postwar predecessors: it left in its wake a still extremely high and clearly unacceptable rate of inflation. Inflation did slow during the late 1974-early 1975 period by as much if not more than in previous postwar downturns. In part, this was a normal response to sharply reduced demand. To an unknown degree, however, it also reflected the fact that the bulk of the 1974 shocks emanating from higher oil prices and food shortages, as well as from the effects of the earlier termination of domestic price controls and a major depreciation of the dollar, seem to have filtered through the cost-price structure by the end of 1974. After soaring at annual rates in excess of 30 percent during the second and third quarters of 1974, the advance in industrial wholesale prices fell by the second quarter of 1975 to a modest 2½ percent annual rate, the low-

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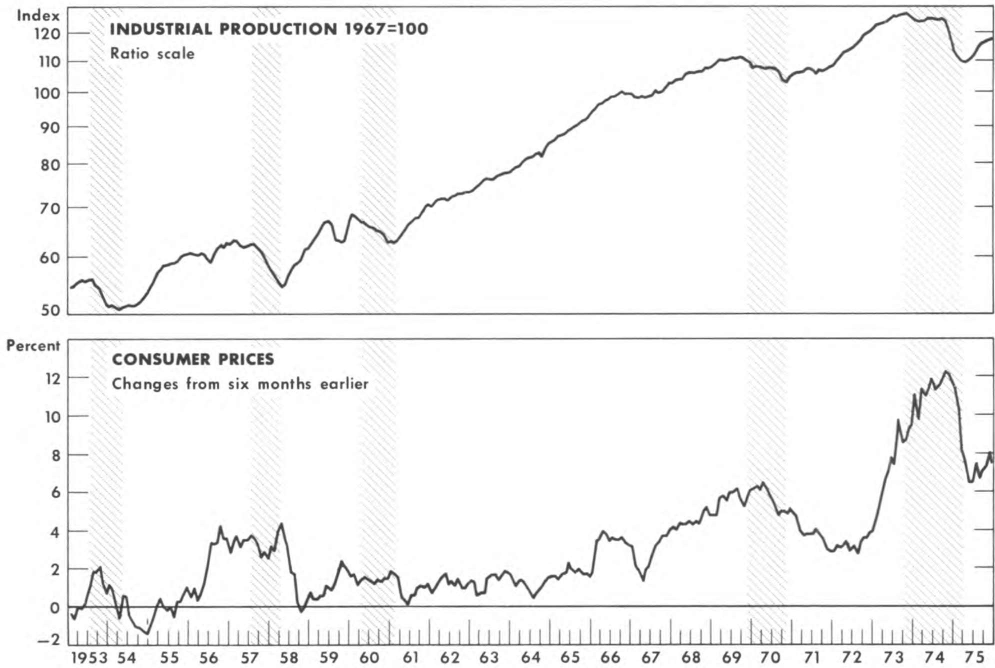
Chart 1. **PRODUCTION AND PRICES IN THE UNITED STATES**



Shaded areas represent periods of recession as defined by the National Bureau of Economic Research, except for the latest recession period where the dates are estimates. Changes in consumer prices are expressed at compound annual rates. All data are seasonally adjusted.

est pace in three years. Similarly, the increase in consumer prices slowed to about a 6 percent rate by the second quarter, sharply below the 12 percent rate prevailing in the last half of 1974. To some extent, indeed, the price picture looked deceptively favorable in the spring of 1975, when many sellers temporarily cut prices below cost in a major effort to reduce excessive inventories. Though actual price statistics were highly volatile on a month-to-month basis in 1975, as is normally the case, the underlying rate of inflation at the year-end appeared to be in the neighborhood of 7 percent. At this level, inflation was actually running above the rates experienced in most postwar periods of boom.

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The 1975 experience with continued inflation in the midst of recession provided still further evidence that in the contemporary setting, while inflation does respond to demand conditions, it does so only very gradually, creating exceedingly painful problems for economic policy. The inflationary period that reached an acute stage in 1974 was a long time in building. It was fostered by many years of intermittently excessive demand pressures and was brought to a climax in 1974 by the various adverse special factors that converged in that year. Because this experience has embedded itself in inflationary expectations, in costs, and in a seemingly endless round of catch-ups for past price rises in renewing long-term contracts, its legacy cannot be quickly overcome. At the same time, recent experience with the many ways in which inflation can generate recessionary forces strongly suggests that the restoration of price stability has become desirable not only in itself, but also as a precondition for sustainable economic expansion.

During much of the postwar period of relatively stable prosperity, inflation was modest, interest rates were lower and relatively less volatile, and the financial position of markets, firms, and governmental units remained quite comfortable. The relatively greater robustness of financial conditions reflected partly the absence of serious inflation and partly the legacy of caution left by the experience of the Great Depression of the 1930's. Under the conditions of the 1950's and 1960's, policymakers could perhaps choose to concentrate their attention either on stimulating real growth and employment or on fostering price stability. Under present conditions, however, sustainable real growth depends upon controlling inflation. Thus, the task of policy is now to seek a moderate course, one that will deal with both unemployment and inflation.

MONETARY POLICY AND FINANCIAL DEVELOPMENTS. In response to the acute dilemma of recession and continued inflation, the Federal Reserve sought to ease monetary policy enough to support recovery while not undermining the struggle to reduce inflation. Longer term System targets for the monetary aggregates were publicly disclosed for the first time when Chairman Burns announced in May growth targets covering the period March 1975 to March 1976 for several measures: 5 to 7½ percent for M_1 (the narrowest definition of money including only currency and demand deposits), 8½ to 10½ percent for M_2 (which also includes consumer-type time and savings deposits at commercial banks), and 10 to 12 percent for M_3 (which equals M_2

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plus deposits at thrift institutions). At subsequent meetings of the Federal Open Market Committee (FOMC), the one-year horizon was moved forward to encompass the June 1975 to June 1976 time span and later was changed to the period from the second quarter of 1975 through the second quarter of 1976. In October the FOMC advanced the one-year horizon to the third quarter of 1975 through the third quarter of 1976. Growth ranges remained the same as those announced earlier except that the lower bounds for expansion in the broader measures of the money stock were decreased by 1 percentage point.

The announcement of one-year targets for expansion of the aggregates did not signal any major change in the System's operating procedures. Flexibility was retained, as both the ranges and the particular aggregates for which such ranges are specified remained subject to modification as conditions might warrant. Moreover, experience suggests that it is neither desirable nor feasible to change reserve and money market conditions rapidly enough to maintain steady month-to-month expansion of the aggregates. Monthly growth rates have often fallen well outside the ranges specified for annual periods in response to short-run factors largely beyond the System's control. Finally, the announcement of target ranges was by no means intended to imply an exclusive concern on the part of policy with the monetary aggregates. The Federal Reserve still relies upon a multifaceted approach, paying close attention also to interest rates and the liquidity positions of institutions and the general public. Overall, by setting out the general dimensions of intended policies, the longer run target ranges can provide the System with a bench mark against which to evaluate shorter run movements, and announcement of the targets can help shape private decision making.

As the year began, the FOMC was seeking to promote monetary ease. This policy, which had been adopted in September 1974, was maintained throughout most of the first half of 1975. At the same time, the recession prompted weakness in demands for money and short-term credit and, consequently, interest rates on money market instruments dropped sharply. During the first quarter the Federal funds rate fell 3 percentage points to around 5½ percent in March, the lowest monthly level since December 1972 (see Chart 2), while other short-term rates posted similar declines.

On four separate occasions during the first five months of the year the directors of this Bank voted reductions in the discount rate. Similar actions were taken by other Reserve Banks and were approved by the Board of Governors. By mid-May the discount rate had been reduced to 6 percent at

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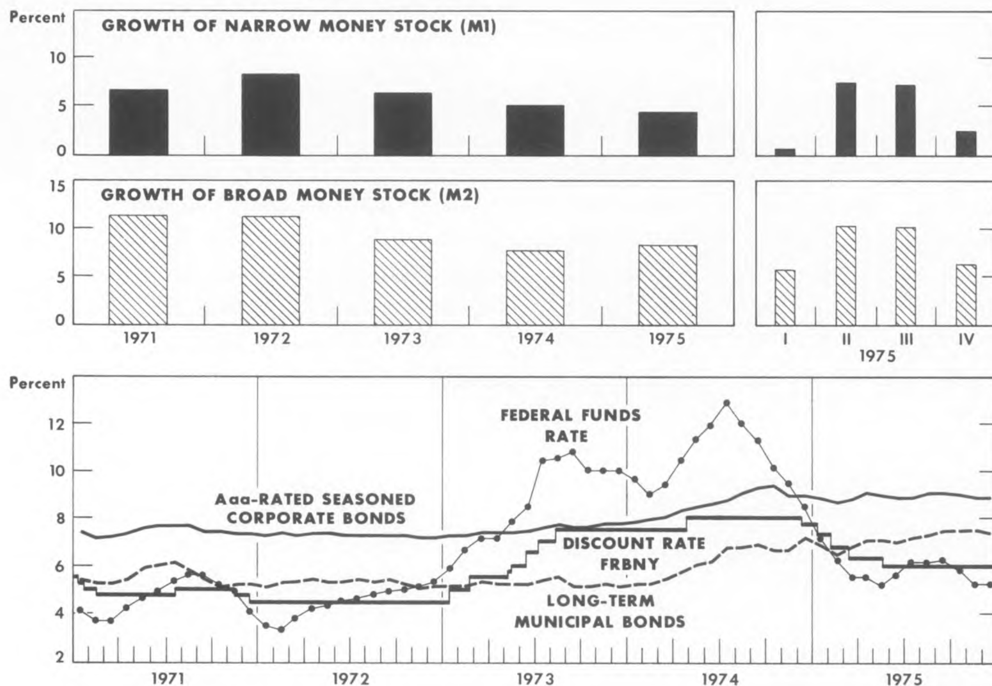
all twelve Banks. A January reduction of between ½ and 1 percentage point in reserve requirements on net demand deposits at member banks released about $1.1 billion in reserves. In early April, reserve requirements were lowered on Euro-dollar borrowings. Despite these various developments, the growth of M_1 failed to accelerate over the first four months of the year from the modest pace registered in late 1974. The growth of the broader money stock measures did pick up somewhat, however.

Chart 2. MONEY AND INTEREST RATES



The money stock growth rates are computed from daily average levels in the final quarter of the preceding period and the final quarter of the period covered. Quarterly figures for 1975 are expressed at seasonally adjusted annual rates. Rates for Federal funds and seasoned Aaa-rated corporate bonds are monthly averages of daily figures. Rates for long-term municipal bonds are monthly averages of Thursday quotations.

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The May-June period was marked by a dramatic step-up in the expansion of the aggregates. This jump reflected, in part, a temporary accumulation of deposit balances by the public following the Federal income tax rebates in May and the supplementary payments to social security recipients in June. To some extent, temporary monetary impacts from these fiscal measures were anticipated by the FOMC. At its April meeting, the April-May tolerance ranges for the growth of M_1 and M_2 were raised above the annual target bands, and at the May meeting the May-June tolerance ranges were set at 7 to 9½ percent and at 9 to 11½ percent, respectively. As it became apparent that growth rates were coming in at well above even these high ranges, the System sought some tightening of bank reserve and money market conditions. At the meeting held on June 16-17 the upper limit on the Federal funds rate was increased, as the Committee voted to achieve "moderate growth in the monetary aggregates". During most of the late-June to September period the Federal funds rate hovered between 6 percent and 6½ percent. As anticipated by the FOMC, monthly growth of the monetary aggregates slowed over this period when the higher money balances due to tax rebates and social security payments were gradually run down.

By early October, it appeared that the monetary aggregates were growing at rates well below those expected and desired by the FOMC. Taking into consideration both the weakness of the aggregates and the unsettled market for municipal securities—which was reacting to the troubled fiscal situation in New York—the Committee agreed on October 2 to decrease the lower bound of the Federal funds rate. Given the sizable overrun in monetary expansion that had occurred in May and June, the subsequent shortfall was not initially considered too serious, but it was decided to take steps to insure that it would not persist. On October 15, the Board of Governors voted to reduce reserve requirements on member bank time deposits with an original maturity of four years or more from 3 percent to 1 percent. This action was designed primarily to encourage the lengthening of the structure of bank liabilities but also to meet seasonal reserve needs and facilitate moderate growth in the monetary aggregates. On December 24, the Board of Governors announced a reduction from 3 percent to 2.5 percent in reserve requirements on time deposits maturing in 180 days to four years. In the meantime the System willingly provided reserves at lower interest rates, and the Federal funds rate and other short-term rates edged back down to the lows recorded in the second quarter. By the year-end, the Federal funds rate had fallen below 5¼ percent. Over 1975 as a whole, M_1 rose 4.4 percent as compared with 5 percent in 1974. A modest

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acceleration was recorded for M_2 growth, which increased 0.5 percentage point in 1975 to 8.2 percent, while M_3 expanded 11.1 percent, up sharply from 7.1 percent in the previous year.

In contrast to the sharp declines in short-term interest rates from their peaks in mid-1974, long-term interest rates did not drop so much as in other periods of economic slack and remained relatively high by historical standards. While the System purchased a substantial volume of coupon issues of the Treasury and Federal agencies during the year, these actions contributed only modestly and temporarily to lowering long-term rates. Indeed, such rates reflect mainly factors over which the Federal Reserve has no short-run control. Undoubtedly, a major reason for the continuing high long-term interest rates has been the persistence of inflationary expectations. In addition, during much of the year the market for long-term funds was under considerable pressure from unusually heavy offerings of corporate and Treasury securities, as well as from a substantial volume of new municipal securities.

In reaction to the financial difficulties experienced by a wide range of borrowers, interest premiums paid by those with less than the highest credit ratings rose sharply, reaching postwar record levels in the municipal bond market. The recession exposed financial problems in a number of industries and increased public awareness of the extent to which adverse trends had developed in liquidity and capital positions. These trends probably reflected, in turn, a number of factors, including gradually fading memories of the depression of the 1930's and a consequent weakening of the standards of prudence created by exposure to that trauma as well as an increasingly widespread belief that Government policy had reduced the sources of economic risk. And inflation itself contributed to a deterioration in balance-sheet positions by enlarging cash requirements at a time when market conditions made it unattractive to raise proportionate increases in equity capital. Thus, when the recession reduced revenues, some borrowers proved more vulnerable than in the past to temporary shortfalls in cash flows. Against this background, business failures increased substantially in 1975, highlighted by the bankruptcy of one of the nation's largest retailing chains. At the same time, the financial problems of the real estate investment trusts continued. As a result, some major commercial banks experienced rather sizable loan losses during the year. Nevertheless, the basic stability of the banking system remained strong. In fact, by the year-end, banks had increased their provisions for loan loss reserves and had begun to make substantial progress in improving their capital positions.

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NEW YORK'S FINANCIAL PROBLEMS. Among the most severe manifestations of credit strains were the financing problems of New York City, which came to the fore early in the year, and the subsequent problems of New York State and some of its independent agencies. New York City's financial problems had been building for a number of years. To some extent, they stemmed from long-run demographic and economic forces that have afflicted many older cities and have resulted in a declining economic base. Even as its revenue-producing powers were eroding, however, New York City's expenses kept rising rapidly as a result of the combined effects of socio-economic changes, the growth of legally mandated programs, and the provision of services and employee benefits beyond those normally available in other cities. For years the inevitable reconciliation of an eroding tax base and an escalating level of expenses was postponed by various fiscal strategems, such as pushing expenditures into the next fiscal year, borrowing at short term against anticipated revenues that were not realized, and capitalizing current expenses. The inevitable day of reckoning arrived in early 1975 when the city found itself unable to roll over maturing short-term debt.

Default by the city was averted by a number of emergency measures, such as advancing state-aid payments and the creation of the Municipal Assistance Corporation for the City of New York (MAC) to redeem maturing New York City short-term debt with the proceeds of long-term bonds. These bonds were backed by statutory provisions for the appropriation of funds for debt service out of the proceeds of earmarked state taxes collected in the city. However, amidst investors' concern that the city's fiscal problems were not going to be solved quickly, MAC experienced considerable difficulty in marketing its securities. To fill the void left by other investors, the state, various state and city employee pension funds, and the major New York City banks provided funds for the city to meet its obligations through the purchase of MAC bonds and city notes. Eventually the state legislature enacted a three-year moratorium on the repayment of certain New York City notes, with holders granted the option of exchanging their holdings into long-term MAC bonds.

These various palliatives were necessary to afford the city time to make needed budgetary adjustments in an orderly manner. Such adjustments are imperative if the city is to avoid an even larger crisis in the future. In fact, some steps toward fundamental budgetary reform were taken during the year. The state established an Emergency Financial Control Board to take control of the city's finances and to bring the city's budget into balance within three

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years. Late in the year, satisfied that the city and state were embarked upon a program of fundamental reform, President Ford proposed and the Congress approved a plan providing direct Federal loans to the city to meet its seasonal cash needs through mid-1978. To ensure that the Federal funds would not be used to finance deficits, the loans must be repaid fully by the end of each fiscal year, and their continued availability is contingent upon the city's progress in achieving a balanced budget. Even after enactment of this legislation, concern persisted over the near-term borrowing ability of New York State and its agencies. In late December, Governor Carey proposed and the state legislature passed a tax package representing a step in closing the state's own budget gap.

Thus, by the end of the year, the city and state appeared to be confronting the budgetary problems that underlay the crisis in their fiscal affairs. To be sure, much remains to be accomplished in repairing their financial condition. In particular, stringent efforts are needed to control outlays. These efforts will entail decisions in allocating scarce public resources among competing worthy objectives. The New York City fiscal crisis, however, has enhanced public awareness of the limits to which local fiscal resources can be stretched. It has become abundantly clear that the failure of a state or local government to exercise persistent fiscal discipline is a very short-sighted strategy with ultimately quite painful consequences for all its citizens.

During the course of the year, questions arose from time to time over a possible role for this Bank in particular, or the Federal Reserve generally, in resolving the financial problems of state or local governments. At one point, New York State forwarded a tentative but incomplete application for such aid to certain state agencies. In this connection, it should be understood that the Federal Reserve Act provides the System with very limited emergency powers to lend to nonbank borrowers. Among the conditions attached to the granting of such loans, which have never been made to a state or local governmental entity, are requirements that an applicant has exhausted all other sources of funds, that it is basically creditworthy and offers adequate security, and that it requires only short-term accommodation.

Apart from the statutory limitations on the Federal Reserve's ability to provide emergency credit to state and local government entities, other important policy questions could be raised by the possibility of such lending. Establishing access to Federal Reserve credit to relieve state or local financial problems could reduce the intensity of efforts to find local solutions to such problems and could impair the ability of the Federal Reserve to meet its responsibilities for

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executing general monetary policy. Moreover, such lending could inject the System into a sphere that more properly should be reserved for elected public officials.

This Bank and other elements in the Federal Reserve System did follow closely the emerging financial problems of New York City and New York State and consulted frequently with city and state officials. The System also gave considerable attention to the financial difficulties that might have occurred in the event of a city default and developed plans to limit the repercussions consistent with its clear responsibilities to assure the stability of the banking and payments system. Under these plans, loans would be made available to member banks through the Federal Reserve discount window beyond the amounts required by such banks for their normal operations. In addition to helping banks meet their temporary liquidity needs, the proceeds of such loans could also be used by the banks to assist municipalities, municipal securities dealers, and other customers temporarily short of cash because of unsettled conditions in the securities markets. System spokesmen emphasized readiness to stabilize markets, if necessary, through open market purchases of Treasury or Federal agency securities. Furthermore, the Federal Reserve and other bank regulatory agencies reviewed and publicly clarified procedures for valuing municipal securities held by banks in the event of default. Serious difficulties were not expected to be widespread, since cases of particular banks with exceptionally heavy concentrations of New York City and New York State debt relative to their capital and assets were almost entirely confined to small institutions rather widely scattered throughout the country.

INTERNATIONAL DEVELOPMENTS. Like the United States, the economies of most other industrial countries moved in 1975 from recession toward recovery, with reduced rates of inflation. Following the lead of the United States and Japan, output in other major countries began to increase in the later months of the year. However, inflation—though abating—remained generally worse abroad than here, and unemployment rose to record postwar levels. A bright spot was the spectacular improvement of the payments imbalance between the industrial and the major oil-exporting countries. With economic activity depressed, the volume of oil imports by the industrial nations declined. Simultaneously, spending under development programs adopted by the members of the Organization of Petroleum Exporting Countries (OPEC) shifted into high

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gear, and their imports soared. Most of these purchases were from the industrial countries, whose combined current-account balance shifted into surplus from the substantial deficit of the previous year. At the same time, OPEC's huge surplus was reduced by almost one half. However, this improvement in the international balance failed to encompass the oil-importing less developed countries (LDCs), whose large current-account deficits grew even bigger under the impact of high oil prices and recession.

Despite this and other serious difficulties, the year ended with a sense of purpose and even hope that had long been absent from the international economic scene. The brighter atmosphere stemmed only in part from the nascent recovery and the improved international payments balance. International financial markets, contrary to gloomy predictions, had weathered the strains stemming from inflation and recession, and exchange rate fluctuations, though wide, were no longer so erratic as they had been in the previous three years. In the field of policy, constructive initiatives were afoot. Negotiations were in progress to deal with the still growing differences in per capita wealth between the industrial and oil-producing countries on the one hand and the LDCs on the other. Steps were undertaken to help finance the deficits not only of these countries but of such industrial countries as might, in case of extreme need, require assistance. A substantial expansion in the regular financing facilities of the International Monetary Fund (IMF) was in prospect. Equally important, there were signs that international differences about exchange rate policies were being substantially narrowed. With governments working in greater harmony, there was some basis to hope that, if recovery were accompanied by a continued abatement of inflation and reasonable balance in payments, the worst of the international economic disturbances of the 1970's might now be past.

While 1975 closed on a better note, the earlier months of the year had seen production languish, especially on the European continent. In Germany, industrial production peaked in the first quarter of 1974 and then contracted until mid-1975 when a moderate upturn began (see Chart 3). The pattern in France lagged that of Germany by several months, with industrial activity declining sharply in late 1974 and the first quarter of 1975 and remaining almost flat throughout the rest of the year. In Italy, industrial production began to contract in the third quarter of 1974 and continued to fall until late in 1975. By the year-end, unemployment in the major European countries was about double the level of two years earlier.

The decline in economic activity in Europe was accompanied by a drop in

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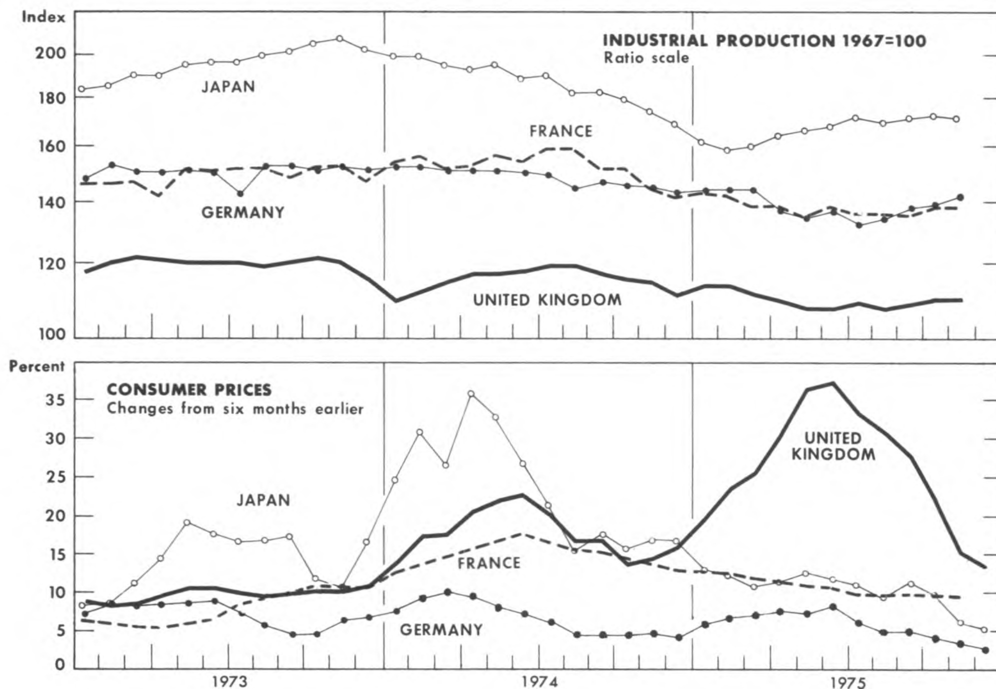
Chart 3. PRODUCTION AND PRICES IN SELECTED COUNTRIES



Industrial production data are seasonally adjusted. Consumer price data are not seasonally adjusted. Changes in consumer prices are expressed at compound annual rates.

the rate of inflation. However, price performance varied widely. The record was best in Germany and Switzerland, where consumer prices rose over the year by 4 to 5½ percent. France registered a gradual slowing in its inflation rate to about a 9 percent annual rate in the second half of 1975. Meanwhile, the rate of increase in Italy's consumer prices, which had been nearly 17 percent over the first half of the year, dropped to around 10 percent in the final six-month period. With inflation generally at intolerable levels early in 1975, initial attempts to stimulate production and employment were relatively mild. Notwithstanding some moderation, inflation continued to be regarded as a serious danger and

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these countries moved cautiously in adopting monetary and fiscal measures to counteract the recession.

Among industrial countries elsewhere, Japanese production bottomed out in the first quarter, advanced strongly through July, and then changed little over the balance of the year. At the same time, the rate of increase in consumer prices, which had climbed to over 35 percent during the first half of 1974, declined to about 5 percent by the end of 1975. The turnaround in the Japanese economy was facilitated by a shift to expansionary policies early in 1975. In the third quarter, when output faltered and the number of bankruptcies rose alarmingly, further expansionary measures were adopted. Canada's contraction, which began in early 1974, was marked by its relative mildness. Unemployment rose somewhat over the 1974 level but remained fairly constant at a level significantly below that of the United States. With inflationary pressures building, the authorities tightened monetary restraints and initiated a wage-price control program in the autumn of 1975.

The inflation-recession dilemma was most difficult in the United Kingdom. Its government had pursued accommodative policies during 1974, while other countries were adopting anti-inflationary measures. In the first half of 1975, when British inflation exceeded 35 percent on an annual-rate basis, the authorities shifted to restraint, and a comprehensive incomes policy was announced in July. The United Kingdom began to experience a recession at a time when economic conditions elsewhere were starting to stabilize. By the end of 1975, industrial production was little above its 1970 level and unemployment had increased to about 5 percent, almost double the rate of a year earlier. The inflation rate in consumer prices dropped in the final quarter of the year to the neighborhood of 15 percent.

Partly because economic activity was depressed, most industrial countries made substantial progress in redressing their external positions (see Chart 4). Imports lagged, especially those of oil and other primary commodities. At the same time, exports to OPEC members continued to surge. France, Italy, and Japan moved into approximate balance on current account from the large deficits of 1974, while Britain's huge deficit was cut by more than half. A reduction of almost half in Germany's current-account surplus also contributed to the improved international balance.

The swing in the current-account balance of the United States was as dramatic as those registered by industrial countries abroad. This nation's merchandise exports were $8.9 billion higher in 1975 than the year before,

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with exports to OPEC members increasing by nearly $4 billion. Particularly sharp gains were shown in exports of capital goods and automotive equipment (including trucks and buses), while agricultural exports remained at the record level of 1974. Simultaneously, United States imports dropped $5.5 billion. Consequently, the merchandise trade balance shifted to a record $9.1 billion surplus from the $5.3 billion deficit of 1974. At the same time, the surplus on service account was somewhat reduced. The net result was a rise in the United States current-account balance of about $13 billion, the 1975 surplus being estimated at $15 billion exclusive of government grants. This sharp swing combined with interest rate movements and growing confidence in the dollar to generate an appreciation in the exchange value of the dollar from early March until September, after which it changed little on balance through the end of the year.

Most of the 1975 improvement in the industrial countries' current-account balances arose, as already noted, from transactions with OPEC. Oil exports by OPEC members fell to approximately 27 million barrels per day in 1975 from about 30 million in 1974. This was attributable not only to the world recession but also to higher prices for petroleum products and conservation efforts. Even with the further increase in oil prices in 1975, major exporters' oil revenues, measured on a transactions basis, declined to about $100 billion, down roughly 7 percent from the previous year. On the other hand, merchandise imports of the major oil-producing countries escalated to some $60 billion from less than $40 billion recorded in 1974. Primarily for these reasons, the combined current-account surplus of these countries appears to have dropped to about $35 billion in 1975 from over $65 billion in 1974.

The decline in the major oil producers' current-account surplus was accompanied by notable shifts in the pattern of their investments. Placements in Euro-currency markets slowed considerably, as OPEC members increased their funding of international institutions, their direct loans to oil-consuming countries, and their placements in domestic capital markets outside the United Kingdom and the United States. The latter's share in the placement of OPEC funds was virtually unchanged in 1975, while the maturity of these placements lengthened considerably as funds were increasingly invested in bonds and equities rather than in time deposits and money market instruments.

In contrast to the striking improvement of the industrial countries' current-account balances, the deficits of other oil-importing countries continued to grow. The LDCs had to contend with a substantial worsening of their terms of

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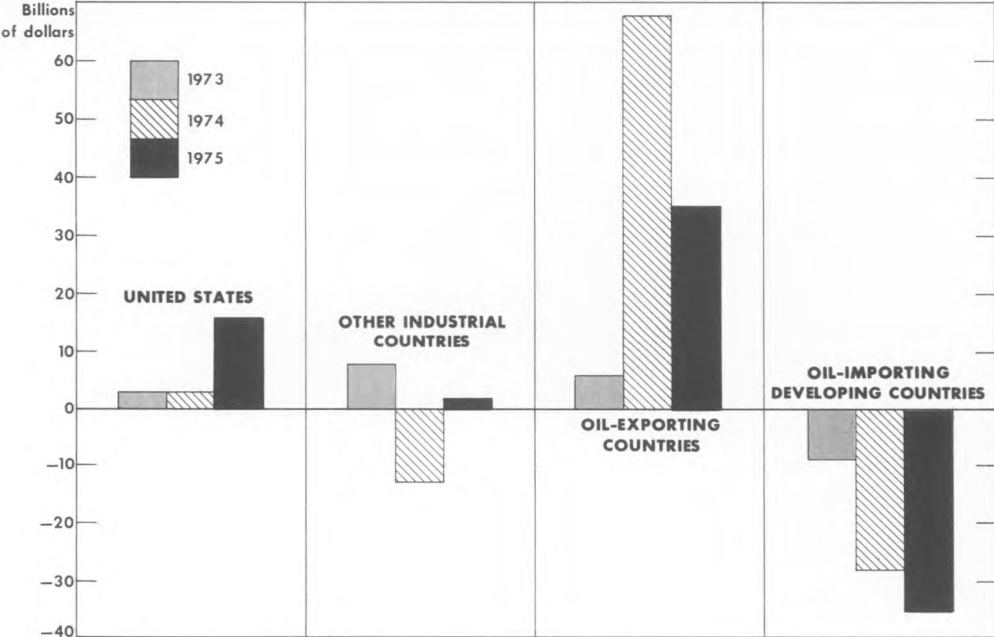
trade as well as with a decline in their exports brought about by the recession in the industrial countries. The aggregate current-account deficit of these countries widened to some $35 billion in 1975 from roughly $28 billion in 1974. They covered part of this deficit by using about $2 billion of reserves, which had risen by $10 billion during the two previous years. The bulk of the deficit was financed by increased foreign official assistance and private loans, with the Euro-currency markets remaining an important source of funds.

The plight of the LDCs highlighted the need for intensified international co-

Chart 4. CURRENT-ACCOUNT BALANCES, 1973-75



Current-account balances include goods, services, and private transfers but exclude all government transfers. More developed primary-producing countries and communist countries are not included in these groupings. Data for foreign countries are estimated by the International Monetary Fund. All 1975 figures are preliminary estimates.

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operation in financing their large external deficits. Both the industrial and the OPEC countries expanded their financial assistance to them, directly and through international institutions. The IMF Oil Facility was continued for 1975 on an enlarged basis and made $1½ billion equivalent available to the LDCs. At the close of the year, there was progress toward agreement on the establishment of the United States proposed trust fund, managed by but separate from the IMF, to provide concessional balance-of-payments assistance to the poorest of the developing countries. In addition, at the end of the year, liberalization of the IMF's compensatory financing facility was approved. This, and other arrangements adopted early in the new year, should be of substantial benefit to developing countries in 1976.

Clear progress was also made in the task of achieving consensus on the reform of the international monetary system. In September, at the IMF annual meeting in Washington, key understandings in principle were reached regarding the role of gold in the monetary system and upward revisions in Fund quotas. The understanding on gold involved abolishing the official price of gold and ending the obligation to use gold in transactions with the Fund. In addition, a sixth of the Fund's gold holdings would be returned to members in proportion to their quotas and another sixth sold, with the differential between the former official price and the selling price being used to benefit developing countries. Under an agreement subject to review after two years, the Group of Ten also barred any increase in the total stock of gold possessed by the IMF and the monetary authorities of the ten countries. Moreover, they agreed not to peg the market price of gold, which dropped in London to about $140 per ounce at the end of 1975 from the all-time high of $195 a year earlier.

The major changes in the exchange rate structure of the early 1970's facilitated much needed balance-of-payments adjustment, and the exchange flexibility of the past three years helped to cushion and absorb serious strains in the world economy. Nevertheless, swings in the exchange markets were at times very sizable. Daily fluctuations were often much larger than under Bretton Woods and, more important, changes in dollar exchange rates *vis à vis* the currencies in the European common float, the so-called "snake", cumulated to as much as 15 to 20 percent over a few months, only to be reversed in the following months. It was clear that short-term fluctuations of these magnitudes reflected not only underlying economic factors but also sharp swings in market sentiment.

Under these circumstances, the possibility of erratic and disorderly exchange market developments impeding the international economy was recognized. In

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early 1975 the dollar declined under bearish pressures, as the recession in the United States became severe and interest rates fell more steeply than those in many other countries. In February, the Federal Reserve, the Bundesbank, and the Swiss National Bank reached agreement on coordinated and more forceful intervention to counter the selling pressures on the dollar and to avoid the development of disorderly conditions. By March, the atmosphere in the exchange markets had improved and the dollar began to appreciate, as the United States trade balance moved into substantial surplus and interest rate differentials shifted in favor of New York. A desire for greater stability with major trading partners was exhibited in mid-July, when the French franc rejoined the snake. This was followed in November by the Rambouillet agreement between the United States and France, affirming the desirability of greater economic and exchange rate stability and calling for improved cooperation to counter erratic exchange rate fluctuations within the context of a system in which major countries have floating exchange rates.

It was understood of course that, while cooperative efforts could do much to improve the functioning of the exchange markets, no amount of official intervention would be useful if it ran against fundamental market forces or if intervention were viewed as a substitute for fundamental policy actions. Stability in exchange markets cannot be sought independently of stability in domestic economies. Of course, there are great difficulties in coordinating policies internationally. Dilemmas and conflicts in domestic and external policies are unavoidable. And, because the exchange market is multisided, the difficulties increase when numerous countries are involved.

Nevertheless, there is solid ground on which to build. The central problem primarily concerns a small number of major countries. If their currencies are reasonably stable, given appropriate domestic policies, the rest are likely to fall into place. Indeed, there is room for a considerable variety of exchange rate practices. These would not cause great difficulty so long as the exchange rate relationships between the United States and its major trading partners in Europe and Japan provide a reasonably stable and well-adjusted nucleus.

Already much has been done to develop informal consultative arrangements among leading countries. Acting within the framework of their economic policies, the authorities can take into account the mutual desirability of relatively stable exchange markets. This might be possible, for instance, in shaping the precise mix of fiscal and monetary policies and their timing. In some areas, a common view can emerge as to conditions and policies that are consistent with

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balance-of-payments equilibrium and adjustment as well as with internal economic stability.

Such a view must not be static and rigid if the important element of flexibility afforded by floating rates is to be retained. Basically, it is the market that determines the structure of exchange rates. But the market at times has moved erratically, and it is the fluctuations reflecting such disorderly conditions that could usefully be dampened. Expectations in the market that rates are likely to be governed in the main by fundamentals will contribute to greater stability. Those expectations, of course, will need to find support and justification in our economic policies.

THE ECONOMY IN PERSPECTIVE. The past two years were a period of painful economic readjustment in the United States and in the world as a whole. A long inflationary boom turned into a major worldwide recession and, in the process, exposed significant financial and economic weaknesses in both the private and the public sectors. At one level, the problems of inflation and the resulting recession might be traced to overly expansive economic policies throughout much of the industrial world during the early 1970's. On top of these forces had been imposed a large rise in world oil prices with associated significant impacts on the international distribution of income and wealth and on the direction of financial flows. Given this background, it indeed was fortunate that the recessionary problems of 1974 and 1975 were not even more serious than they proved to be. While there were a number of disruptive events to unsettle the domestic and international economic and financial scene, at no time did markets here or abroad show any real signs of panic or breakdown; nor was there any serious threat of a cumulative economic collapse of the sort that had marked some earlier junctures in economic history. Evidently, many of the safeguards adopted since the Great Depression of the 1930's have done their work well.

Nevertheless, the events of the past two years or so should serve as a warning. The long and relatively steady period of prosperity in the postwar period seems gradually to have loosened the bounds of prudent restraint and weakened the matching of expectations with the limits of the possible in the financial affairs of governments, businesses, and individuals. Close to home, the clearest example of this process, and of its ultimate result, was of course the fiscal crisis in New York City. Yet there were many other examples of less

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dramatic but also pervasive importance. In the business world, these included a progressive deterioration of liquidity and of balance-sheet soundness which reflected not only inflation itself, but a gradual weakening of the restraints of normal caution. In the area of government, New York City was scarcely the only example of excess, with spending outrunning levels for which taxpayers were willing directly to pay. Nor, in some instances, was labor exempt from the failure to hold demands within reasonable bounds.

There are many signs that these attitudes are undergoing reevaluation on a wide front, and in this perhaps lies the best hope that we can now build a period of stable, noninflationary prosperity. Certainly, monetary policy has a major role to play in this process. Control of the supply of money and credit has only a partial and uncertain impact over the course of economic events in the short run—and one that is sometimes exaggerated. Nevertheless, there is no doubt that a relatively steady expansion in money and credit geared to the economy's capacity to produce is a necessary condition for stable, noninflationary growth in the long run. Starting as we do with both a high level of unemployment and a high rate of persistent inflation, there will be many perplexing difficulties in working toward such a path. Moreover, monetary policy does not operate in a vacuum. It requires widespread public support and understanding of its aims, especially when they seem to run counter to some momentary objective. Given the more sober appraisals of what is economically possible generated by recent history, however, there is every reason to be hopeful that the country can make progress in solving its present problems.

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THE BANK'S OPERATIONS IN 1975

The Year in Review

During 1975, the volume of most of the Bank's operations continued to rise and overall economic and financial conditions interacted to produce strong operational pressures on a number of the Bank's organizational units. The general economic situation, along with the particular financial problems of New York City and New York State, placed further strains on financial institutions. These developments occupied much of the attention of the Bank's senior management and underscored the need for the expansion of the Bank's and the Federal Reserve System's programs relating to the examination, supervision, and regulation of banks and bank holding companies that had been initiated in 1974. At the same time, developments here and abroad combined to increase sharply the volume and complexity of open market transactions implemented by this Bank on behalf of the System Open Market Account and on behalf of foreign central banks and monetary authorities.

These special developments, together with the growth in the volume of many of the Bank's operations and continued rapid increases in the prices of goods and services purchased by the Bank, put strong upward pressure on Bank expenditures. However, the Bank was able to limit the growth in its overall expenses, net of reimbursements and recoveries, to approximately 6.5 percent and to achieve a small reduction in staffing levels. The modest rise in expenses in the face of strong volume and cost pressure was, in large part, achieved by increased employee productivity. In turn, the productivity gains were facilitated by the full implementation of the Bank's new planning and budgetary control system, discussed in last year's report, and the initiation of a formal Bankwide operations improvement program which draws upon the analytical framework of the new planning and budgetary system.

The year was also characterized by important changes in the Bank's organization. Paul A. Volcker, formerly Under Secretary of the Treasury for Monetary Affairs, was appointed the Bank's fifth chief executive officer effective August 1, 1975. He succeeded Alfred Hayes who retired after nineteen years of distinguished service as President and chief executive officer of the Bank. Earlier in the year, Charles A. Coombs and Thomas O. Waage, Senior Vice Presidents, elected early retirements after many years of service in senior management positions. The Bank's internal structure was reorganized, and Alan R.

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Holmes and Thomas M. Timlen were appointed to the newly created position of Executive Vice President. The Bank also consolidated its three principal operating areas—the Cash and Collection Function, the Check Processing Function, and the Government Bond and Safekeeping of Securities Function—into a newly created "Operations Group" and assigned overall management responsibility for the group to a Senior Vice President.

EXPANDED INITIATIVES IN THE AREA OF BANK EXAMINATIONS AND REGULATION. During 1975 the strains on the nation's banking system that had been witnessed in 1974 continued as the recession, together with special problems in certain industries, triggered sizable increases in problem credits and loan losses in the banking system. In the Second Federal Reserve District, the financial difficulties of New York City, New York State, and a number of New York State agencies posed additional problems for financial institutions. These developments served to underscore the need for new and expanded programs to examine, monitor, and supervise banks and bank holding companies. Such an effort had been initiated by this Bank and the Federal Reserve System in 1974 but was intensified in 1975.

During 1975 the Bank implemented a number of new bank examination procedures and techniques, including the development of accelerated reporting timetables, more detailed reviews of bond trading and foreign exchange trading accounts, and the expansion of programs relating to the on-site examinations of foreign branches of Second Federal Reserve District state member banks. New training programs for examining personnel were introduced, and further progress was made in the development of "early warning" techniques for anticipating problem bank situations and monitoring the performance of banks between examination dates. In addition, a comprehensive program for analyzing and monitoring the activities of bank holding companies was commenced.

These initiatives required the commitment of a sizable volume of additional resources during the year. As a result, the bank examinations and related support areas were among the few areas of the Bank that increased their work force during the year. However, the size of this increase was moderated in part by higher productivity and in part by a decline in the volume of bank and bank holding company applications work which permitted a reallocation of existing resources.

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TRADING DESK ACTIVITY AND BANK OPERATIONS. During 1975 the volume of open market transactions conducted by this Bank for its own account and for the System Open Market Account increased by approximately 20 percent, while the dollar value of such transactions nearly doubled to a level of $670 billion. Over the past decade, the dollar value of these operations has risen at a compound average annual rate of 33 percent. At the same time, the volume of transactions conducted in the domestic securities markets by this Bank on behalf of foreign central banks and monetary authorities continued to rise sharply. The number of transactions increased by approximately 16 percent in 1975, with their dollar value more than doubling to a level of $334 billion.

While the direct impact of expansion in the volume of securities trading operations occurs in this Bank's open market and foreign areas, these operations contribute in a major way to the growth in the work volume of other areas of the Bank. For example, a sizable share of the daily work flow in this Bank's Accounting, Government Bond and Safekeeping, and Data Services areas is a direct outgrowth of Trading Desk activities.

In part, the growth in the volume of open market operations during 1975 was a continuation of the trend experienced in recent years. However, during 1975, the Treasury altered its cash management policies in such a way as to produce frequent and sharp swings in its cash balances in the commercial banking system. These swings result in equally pronounced oscillations in bank reserve positions which, in many instances, must be offset by open market operations.

SERVICING THE PAYMENTS MECHANISM. The effective operation of the nation's payments mechanism, including the money and securities markets, is one of the major responsibilities of this Bank and the Federal Reserve System as a whole. The importance of these responsibilities stems in part from the fact that an efficient payments system is essential to economic growth. Beyond this, efficient money and securities markets contribute to the System's ability to conduct open market operations and to the Treasury's ability to formulate and implement effective debt management policies.

The primary responsibilities of the three functional areas of this Bank that constitute its Operations Group relate to servicing the payments mechanism and the Government securities markets. These areas account for about 45

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percent of the Bank's total staff. The activities of these areas include, among others, conventional check processing operations, the provision of currency and coin to the banking system, the electronic processing of various types of financial transactions, and the issuance, servicing, and redemption of securities as fiscal agent of the United States Government and certain Government agencies.

The volume of electronic transfers of securities and Federal funds processed by this Bank's telecommunications system rose by about 22 percent during 1975, as the daily average dollar value of such traffic reached $57 billion. Since 1970, when the Bank's telecommunications system was introduced, the daily average volume of transactions processed has risen from about 8,000 to 23,000 items, or by almost 200 percent. The continued sharp rise in the volume of traffic handled by the telecommunications system during 1975 reflected a number of developments, including a substantial increase in the amount of Treasury debt outstanding, frequent Treasury financing operations, and a further expansion of the number of Treasury and agency securities that are eligible to be held in book-entry form and to be transferred through this Bank's Government securities clearing arrangement. In this regard, by the year-end, some $285 billion, or 78.5 percent, of the Treasury's marketable public debt was in book-entry form, compared with $201.4 billion or 71.6 percent a year earlier. The amount of Federal agency obligations in book-entry form also rose sharply, reaching $40.5 billion or 54.4 percent of the total outstanding.

At times during 1975, the volume of traffic processed on the telecommunications computers strained the capacity of the system. As a result, at the year-end the Bank was actively considering steps that might be taken to insure the continued effective functioning of the system through 1980-81, when a new Systemwide facility is scheduled to become operative.

The Bank initiated or participated in a number of new programs designed to provide further efficiencies in the payments mechanism. In the area of electronic transfers of funds, the Bank implemented the Air Force payroll project in this District, which provides for the direct deposit of payrolls to the bank accounts of payment recipients. The Bank also proceeded with plans for the full implementation in 1976 of similar arrangements for processing social security payments.

The volume of conventional checks processed by this Bank during 1975 rose by 5 percent to 1.3 billion items. Overall productivity of the Bank's check operations rose sharply during the year, while the amount of holdover float generated by such operations continued to decline from the excessively high

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levels recorded in 1973. Throughout 1975 the level of holdover float remained within the Bank's and the System's holdover target. During the year detailed plans were completed for the installation of third-generation check processing systems at the Head Office, and the necessary computer hardware was in place by the year-end for testing in early 1976. Plans were also completed for the Districtwide implementation of overnight check clearing operations, which will be achieved with the commencement of operations in 1976 of two new Regional Check Processing Centers, including a new facility in the Utica, New York, area and the expansion of existing facilities in Jericho, Long Island. The Utica facility will serve banks located in thirty-four counties in the upstate region, and the expanded Jericho facility will serve the seven counties just north of New York City.

The Bank's cash and collection operations experienced a small rise in the volume of operations and a slight decline in staffing levels. Late in the year, the Bank, in connection with a Federal Reserve System project, completed arrangements for the delivery in 1976 of a high-speed automatic currency processing system. If tests of this equipment prove successful, a substantial increase in the productivity and overall effectiveness of currency processing operations should be realized.

MANAGEMENT AND STAFF SUPPORT SERVICES. By midyear the Bank's new planning and budgetary control program was installed in six additional functional areas and at the Buffalo Branch, thereby completing a process that began in mid-1973. The program involves such techniques as the setting of goals and objectives, budgeting based on productivity targets and volume projections, and the integration of project planning into the budgeting processes. The program is supported by a new budget and expense reporting system that permits Bank management to monitor and evaluate data on key volume, unit cost, and productivity measures, as well as conventional expense data.

In a separate but closely related effort, a formal Bankwide operations improvement program was initiated during 1975. The broad purpose of the program is to improve the cost effectiveness of the Bank through the selective review and analysis of its major operations. Policy direction for the program is provided by a committee of senior officers that is responsible for the Bank's overall budget and control program. Nine major studies—ranging from a review of more effective methods for processing currency deposits to a re-

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view of procedures for cleaning Bank facilities—were undertaken during the year and have resulted in substantial cost and personnel savings. Another aspect of this overall effort was the initiation of an employee suggestion program in mid-1975. Under the program, Bank employees are encouraged to submit suggestions for cost improvement opportunities and are eligible for awards for deserving suggestions.

The attainment of an improved data-processing operation has been one of the primary near-term objectives of the Bank. Plans have focused on consolidating and standardizing processing equipment, providing improved physical facilities, identifying the Bank's systems support needs, and developing comprehensive procedures for meeting those needs. During 1975 progress relative to these objectives was realized.

In January the Bank purchased two third-generation general-purpose computers and, in the process, released a multiplicity of first- and second-generation processing equipment. In addition to reducing cost, this consolidation enabled the Bank to achieve a greater degree of stability in the general-purpose processing area. Similarly, a review of alternatives for meeting the Bank's analytical and statistical processing computer needs was completed and, by the year-end, detailed plans had been completed for conversion to a new computer system by mid-1976. Also, work began on establishing improved facilities for housing computers and computer-related facilities, so that all the Bank's computer operations can be centralized in one building and provided with an adequate and stable electrical power supply.

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Financial Statements

STATEMENT OF CONDITION

In dollars

Assets	**DEC. 31, 1975**	**DEC. 31, 1974**
Gold certificate account	3,330,061,781	3,413,162,149
Special Drawing Rights certificate account	124,000,000	93,000,000
Federal Reserve notes of other Banks	275,087,350	232,852,190
Other cash	22,551,259	14,250,442
Total	3,751,700,390	3,753,264,781
Advances	78,290,000	90,750,000
Acceptances:		
Bought outright	741,485,034	578,949,486
Held under repurchase agreements	385,095,974	420,270,980
United States Government securities:		
Bought outright ★	20,810,610,000	17,783,692,000
Held under repurchase agreements	1,216,700,000	443,350,000
Federal agency obligations:		
Bought outright	1,457,196,416	1,044,519,193
Held under repurchase agreements	118,200,000	510,500,000
Total loans and securities	24,807,577,424	20,872,031,659
Other assets:		
Cash items in process of collection	1,784,801,951	1,456,275,750
Bank premises	20,107,521	11,736,752
Due from Federal Deposit Insurance Corporation†	1,125,000,000	1,723,472,055
All other‡	724,396,964	305,377,071
Total other assets	3,654,306,436	3,496,861,628
Interdistrict settlement account§	(2,609,895,974)	0
Total Assets	**29,603,688,276**	**28,122,158,068**

★ Includes securities loaned—fully secured	114,645,000	154,600,000

† In connection with the closing of Franklin National Bank.

‡ Includes assets denominated in foreign currencies.

§ Effective May 1, 1975, this account was established to reflect the settlement of interdistrict transactions.

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STATEMENT OF CONDITION

In dollars

Liabilities	DEC. 31, 1975	DEC. 31, 1974
Federal Reserve notes	19,703,279,957	17,979,728,841
Deposits:		
Member bank reserve accounts	4,717,700,951	6,139,479,997
United States Treasury—general account	2,292,381,380	1,080,151,319
Foreign ★	159,007,957	201,978,234
Other	769,063,124	812,646,165
Total deposits	7,938,153,412	8,234,255,715
Other liabilities:		
Deferred availability cash items	1,202,944,267	1,157,281,010
All other	280,699,540	281,588,702
Total other liabilities	1,483,643,807	1,438,869,712
Total Liabilities	**29,125,077,176**	**27,652,854,268**
Capital Accounts		
Capital paid in	239,305,550	234,651,900
Surplus	239,305,550	234,651,900
Total Capital Accounts	**478,611,100**	**469,303,800**
Total Liabilities and Capital Accounts	**29,603,688,276**	**28,122,158,068**
Contingent liability on acceptances purchased for foreign correspondents†	‡	248,632,059

★ After deducting participations of other Federal Reserve Banks amounting to	193,798,800	216,050,000
† After deducting participations of other Federal Reserve Banks amounting to	‡	732,186,000

‡ The guaranteeing by the Federal Reserve System of acceptances purchased for foreign correspondents was discontinued on November 12, 1974.

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STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1975 AND 1974 (In dollars)

	1975	1974
Total current earnings	1,660,070,216	1,686,669,672
Net expenses	125,660,806	118,226,676
Current net earnings	1,534,409,410	1,568,442,996
Additions to current net earnings:		
Profit on sales of United States Government securities and Federal agency obligations (net)	8,824,743	0
All other	1,024,713	1,252,160
Total additions	9,849,456	1,252,160
Deductions from current net earnings:		
Loss on sales of United States Government securities and Federal agency obligations (net)	0	10,575,644
Loss on foreign exchange transactions (net)	63,350,936★	8,661,015
All other	716,231	1,598,928
Total deductions	64,067,167	20,835,587
Net deductions	54,217,711	19,583,427
Net earnings available for distribution	**1,480,191,699**	**1,548,859,569**
Dividends paid	13,918,891	13,627,935
Payments to United States Treasury (interest on Federal Reserve notes)	1,461,619,158	1,515,542,484
Transferred to surplus	4,653,650	19,689,150

SURPLUS ACCOUNT

	1975	1974
Surplus—beginning of year	234,651,900	214,962,750
Transferred from net earnings for year	4,653,650	19,689,150
Surplus—end of year	**239,305,550**	**234,651,900**

★ Reflects revaluation of pre-1971 swap drawings.

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Changes in Directors and Senior Officers

CHANGES IN DIRECTORS. In December 1975, member banks in Group 3 elected Harry J. Taw a Class A director and reelected Jack B. Jackson a Class B director, each for a three-year term beginning January 1, 1976. Mr. Taw is President of First National Bank of Cortland, Cortland, N.Y. Mr. Jackson, President of J. C. Penney Co., Inc., has been a Class B director since January 1, 1973.

Also in December, the Board of Governors of the Federal Reserve System reappointed Frank R. Milliken a Class C director for the three-year term beginning January 1, 1976, and designated him as *Chairman* of the board of directors and *Federal Reserve Agent* for the year 1976. Mr. Milliken, President of Kennecott Copper Corporation, New York, N.Y., has been serving as a Class C director and *Deputy Chairman* since January 1, 1973; he served as a Class B director in 1972. As *Chairman* and *Federal Reserve Agent,* he succeeded Roswell L. Gilpatric, who resigned as a Class C director effective December 31, 1975. Mr. Gilpatric, a partner in the New York law firm of Cravath, Swaine & Moore, had served as a Class C director since January 1, 1969, as *Deputy Chairman* in 1971, and as *Chairman* and *Federal Reserve Agent* since January 1, 1972.

In February 1976, the Board of Governors appointed Robert H. Knight a Class C director for the remainder of Mr. Gilpatric's term ending December 31, 1977, and appointed him *Deputy Chairman* for the year 1976. Mr. Knight is a partner in the New York law firm of Shearman & Sterling.

Buffalo Branch. In December, the board of directors of this Bank appointed Avery H. Fonda, who is President of Liberty National Bank and Trust Company, Buffalo, N.Y., and Charles A. Marks, who is President of Alden State Bank, Alden, N.Y., as directors of the Buffalo Branch beginning January 1, 1976. Mr. Fonda was appointed for a three-year term and Mr. Marks for the unexpired portion of the three-year term expiring December 31, 1977. On the Branch board, they succeeded, respectively, Claude F. Shuchter, Chairman of the Board of Manufacturers and Traders Trust Company, Buffalo, N.Y., who had been a Branch director since January 1, 1973, and Stephen T. Christian, Chairman of the Board of Marine Midland Bank-Chautauqua, National Association, Jamestown, N.Y., who resigned from the Branch board effective December 31, 1975. Also in December, the board of directors of this Bank desig-

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nated Rupert Warren as *Chairman* of the Branch board for the year 1976. Mr. Warren, former President of Trico Products Corporation, Buffalo, N.Y., has been a director of the Branch since January 1, 1971 and was *Chairman* of the Branch board in 1973. At the same time, the Board of Governors reappointed Donald R. Nesbitt a director of the Buffalo Branch for a three-year term beginning January 1, 1976. Mr. Nesbitt, owner and operator of Silver Creek Farms, Albion, N.Y., has been a director of the Branch since January 1, 1973, and was *Chairman* of the Branch board in 1975.

CHANGES IN SENIOR OFFICERS. The following changes in the official staff, at the level of Vice President and above, have been made since January 1975:

Alfred Hayes, President of this Bank, retired August 1, 1975, after completing nineteen years of distinguished service in that position. Mr. Hayes, who joined the Bank as its fourth chief executive officer on August 1, 1956, had previously been a commercial banker. Immediately prior to his career with the Bank, he had been Vice President in charge of the Foreign Division of New York Trust Company.

Paul A. Volcker was appointed President, effective August 1, 1975, for the unexpired portion of the five-year term of Mr. Hayes ending February 29, 1976. Mr. Volcker held a number of positions with this Bank from 1949 to 1957, with Chase Manhattan Bank in 1957-62 and 1965-69, and with the Department of the Treasury in 1962-65. From 1969 to 1974 he served as Under Secretary of the Treasury for Monetary Affairs. During the 1974-75 academic year he had been Senior Fellow at the Woodrow Wilson School of Public and International Affairs of Princeton University.

Thomas O. Waage, Senior Vice President, elected early retirement effective April 1, 1975. He joined the Bank's staff in 1950 and became an officer in 1951. At the time of his retirement, Mr. Waage had senior management responsibility for the Cash and Collection, Check Processing, Government Bond and Safekeeping of Securities, and Public Information Functions.

Charles A. Coombs, Senior Vice President in charge of the Foreign Function, elected early retirement effective June 1, 1975. He joined the Bank's staff in 1940 and became an officer in 1953. From 1962 until February 1975, Mr. Coombs served as Special Manager of the System Open Market Account for Foreign Currency Operations. Between February 20 and June 1, 1975, he had responsibility for special studies for the President and First Vice President.

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Alan R. Holmes, formerly Senior Vice President, was appointed to the newly established position of Executive Vice President, effective February 20, 1975, and assigned senior management responsibility for the Foreign Function and the Open Market Operations and Treasury Issues Function. On February 19, 1975, the Federal Open Market Committee broadened the responsibilities of Mr. Holmes as Manager of the System Open Market Account to include foreign currency operations. At the same time, the Committee appointed Peter D. Sternlight and Scott E. Pardee, Vice Presidents of this Bank, to the positions of Deputy Manager for Domestic Operations and Deputy Manager for Foreign Operations, respectively.

Thomas M. Timlen, formerly Senior Vice President, was appointed Executive Vice President, effective February 20, 1975, and assigned senior management responsibility for the Accounting Control, Bank Supervision and Relations, Building and Planning, Data Services, Loans and Credits, Personnel, and Service Functions. In addition, effective April 18, 1975, Mr. Timlen was assigned senior management responsibility for the newly established Operations Group—consisting of the Cash and Collection, Check Processing, and Government Bond and Safekeeping of Securities Functions—and the Public Information Function.

As a result of these changes, the senior management of the Bank consists of Mr. Volcker, President and chief executive officer, Richard A. Debs, First Vice President and chief administrative officer, and Messrs. Holmes and Timlen, Executive Vice Presidents.

Edward G. Guy, formerly Vice President and General Counsel, was appointed Senior Vice President and General Counsel, effective April 18, 1975. Mr. Guy's assignment as the officer in charge of the Legal Function was continued.

Fred W. Piderit, Jr., formerly Vice President, was appointed Senior Vice President, effective April 18, 1975. Mr. Piderit's assignment as the officer in charge of the Bank Supervision and Relations Function was continued.

Thomas C. Sloane, formerly Vice President, was appointed Senior Vice President, effective April 18, 1975, and assigned as the officer in charge of the Operations Group.

Robert L. Cooper, formerly Assistant Vice President, was appointed Vice President, effective April 18, 1975, and assigned as the officer in charge of the Government Bond and Safekeeping of Securities Function.

Ronald B. Gray, formerly Assistant Vice President and Cashier, Buffalo Branch, was appointed Vice President and Branch Manager, effective April 18, 1975, in anticipation of the retirement of Angus A. MacInnes, Jr., Vice Presi-

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dent, whose assignment as the officer in charge of the Branch was terminated on that date. Mr. MacInnes joined the Bank's staff in 1934, became an officer in 1951, and was appointed Vice President in charge of the Buffalo Branch on October 1, 1966.

Leonard Lapidus, Vice President, resigned from the Bank, effective November 1, 1975, to accept the position of First Deputy Superintendent of Banks in the New York State Banking Department. Mr. Lapidus joined the Bank's staff in 1962 and became an officer in 1965.

James H. Oltman, formerly Assistant General Counsel, was appointed Deputy General Counsel, effective January 1, 1976, and assigned supervisory responsibility for the operations of the Legal Function under Mr. Guy.

Robert C. Thoman, formerly Assistant Vice President, was appointed Vice President, effective January 1, 1976, and assigned to the Check Processing Function, where he will have responsibility, under Karl L. Ege, Vice President, for the Northeastern New York Regional Check Processing Center to be located in Utica, N.Y.

MEMBER OF FEDERAL ADVISORY COUNCIL—1976. The board of directors of this Bank selected Ellmore C. Patterson to serve during 1976, for the second successive year, as the member of the Federal Advisory Council representing the Second Federal Reserve District. Mr. Patterson is Chairman of the Board of Morgan Guaranty Trust Company of New York, New York, N.Y.

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Directors of the Federal Reserve Bank of New York

DIRECTORS	*Term expires Dec. 31*	*Class*	*Group*
DAVID ROCKEFELLER Chairman of the Board, The Chase Manhattan Bank (National Association), New York, N.Y.	1976	A	1
STUART MCCARTY President, First-City National Bank of Binghamton, Binghamton, N.Y.	1977	A	2
HARRY J. TAW President, First National Bank of Cortland, Cortland, N.Y.	1978	A	3
MAURICE F. GRANVILLE Chairman of the Board, Texaco Inc., New York, N.Y.	1976	B	1
WILLIAM S. SNEATH President, Union Carbide Corporation, New York, N.Y.	1977	B	2
JACK B. JACKSON President, J. C. Penney Co., Inc., New York, N.Y.	1978	B	3
FRANK R. MILLIKEN, *Chairman, and Federal Reserve Agent* President, Kennecott Copper Corporation, New York, N.Y.	1978	C	
ROBERT H. KNIGHT, *Deputy Chairman* Partner, Shearman & Sterling, Attorneys, New York, N.Y.	1977	C	
ALAN PIFER President, Carnegie Corporation of New York, New York, N.Y.	1976	C	

DIRECTORS—BUFFALO BRANCH

RUPERT WARREN, *Chairman* Former President, Trico Products Corporation, Buffalo, N.Y.	1976
J. WALLACE ELY Chairman of the Board, Security New York State Corporation, Rochester, N.Y.	1976
DANIEL G. RANSOM President, The Wm. Hengerer Co., Buffalo, N.Y.	1976
CHARLES A. MARKS President, Alden State Bank, Alden, N.Y.	1977
PAUL A. MILLER President, Rochester Institute of Technology, Rochester, N.Y.	1977
AVERY H. FONDA President, Liberty National Bank and Trust Company, Buffalo, N.Y.	1978
DONALD R. NESBITT Owner and operator, Silver Creek Farms, Albion, N.Y.	1978

MEMBER OF FEDERAL ADVISORY COUNCIL—1976

ELLMORE C. PATTERSON Chairman of the Board, Morgan Guaranty Trust Company of New York, New York, N.Y.	1976

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Officers of the Federal Reserve Bank of New York

PAUL A. VOLCKER, *President*
RICHARD A. DEBS, *First Vice President*

ALAN R. HOLMES, *Executive Vice President*
Foreign; Open Market Operations and Treasury Issues

THOMAS M. TIMLEN, *Executive Vice President*
Operations Group; Accounting Control; Bank Supervision and Relations; Building and Planning; Data Services; Loans and Credits; Personnel; Public Information; Service

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

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

THOMAS C. SLOANE, *Senior Vice President*
Operations Group (Cash and Collection; Check Processing; Government Bond and Safekeeping of Securities)

ACCOUNTING CONTROL

A. MARSHALL PUCKETT, *Vice President*
WALTER S. RUSHMORE, *Assistant Vice President*
CATHY E. MINEHAN, *Operations Analysis Officer*
JOHN J. STRICK, *Manager, Accounting Department*
STEPHEN G. THIEKE, *Manager, Management Information Department, and Assistant Secretary*

AUDIT

GEORGE C. SMITH, *General Auditor*
JOHN E. FLANAGAN, *Assistant General Auditor*
DONALD R. ANDERSON, *Manager, Auditing Department*
W. WILLIAM BAUMGARDT, *Manager, Auditing Department*
GERALD I. ISAACSON, *Manager, Audit Analysis Department*

BANK SUPERVISION AND RELATIONS

FRED W. PIDERIT, JR., *Senior Vice President*
FREDERICK C. SCHADRACK, *Vice President*
LEON KOROBOW, *Assistant Vice President*
BENEDICT RAFANELLO, *Assistant Vice President*
JAMES H. BOOTH, *Manager, Bank Regulations Department*
FREDERICK L. FREY, *Chief Examiner*
ROBERT A. JACOBSEN, *Assistant Chief Examiner*
EDWARD F. KIPFSTUHL, *Manager, Foreign Banking Applications Department*
FRANKLIN T. LOVE, *Manager, Bank Relations Department*
DONALD E. SCHMID, *Manager, Bank Analysis Department*
BEN STACKHOUSE, *Manager, Domestic Banking Applications Department*

BUILDING AND PLANNING

ROBERT E. LLOYD, JR., *Vice President*
LOUIS J. BRENDEL, *Assistant Vice President*
A. THOMAS COMBADER, *Buildings Administrator*
MATTHEW C. DREXLER, *Manager, Building Operating Department*
RONALD E. LONG, *Manager, Planning Department*

DATA SERVICES

PAUL B. HENDERSON, JR., *Vice President*
HOWARD F. CRUMB, *Adviser*
EDWIN R. POWERS, *Assistant Vice President*
WILLIAM M. WALSH, *Assistant Vice President*
DENIS L. CONWAY, *Manager, User Operations Department*
PETER J. FULLEN, *Manager, Telecommunications Department*
GERALD HAYDEN, *Data Services Officer*
OLEG HOFFMAN, *Manager, Computer Operations Department*
ANGUS J. KENNEDY, *Data Services Officer*
HERBERT M. QUINN, *Manager, Custom Systems Department*
RALPH C. SCHINDLER, *Data Services Officer*
ISRAEL SENDROVIC, *Manager, Common Systems Department*

EQUAL OPPORTUNITY

CECIL A. SHEPHERD, *Equal Opportunity Officer*

FOREIGN

ALAN R. HOLMES, *Executive Vice President*
SCOTT E. PARDEE, *Vice President*
H. DAVID WILLEY, *Vice President*
ROBERT J. CROWLEY, *Assistant Vice President*
MARGARET L. GREENE, *Assistant Vice President*
FRED H. KLOPSTOCK, *Adviser*

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THOMAS C. BARMAN,
Foreign Exchange Officer
GEORGE H. BOSSY,
Manager, Foreign Department
ROGER M. KUBARYCH,
Foreign Exchange Officer
GEORGE W. RYAN,
Manager, Foreign Department

OPERATIONS GROUP

THOMAS C. SLOANE, *Senior Vice President*

CASH AND COLLECTION

WILLIAM H. BRAUN, JR., *Vice President*

JERRY BERKOWITZ,
Operations Analysis Officer
JOHN CHOWANSKY,
Manager, Cash Custody Department, and Manager, Collection Department
LEON R. HOLMES,
Manager, Cash Department

CHECK PROCESSING

KARL L. EGE, *Vice President*
ROBERT C. THOMAN, *Vice President (Utica Office)*

JAMES O. ASTON, *Assistant Vice President*
WHITNEY R. IRWIN, *Assistant Vice President (Cranford Office)*
JOSEPH M. O'CONNELL, *Assistant Vice President (Jericho Office)*

LEONARD I. BENNETTS,
Manager, Check Adjustment and Return Items Department
RALPH A. CANN III,
Operations Analysis Officer
FRED A. DENESEVICH,
Manager, Check Processing Department
EDWARD H. DENHOFF,
Manager, Utica Office
JOHN C. HOUHOULIS,
Manager, Payment Systems Department
JEROME P. PERLONGO,
Manager, Cranford Office
JOHN F. SOBALA,
Manager, Check Processing Department

GOVERNMENT BOND AND SAFEKEEPING OF SECURITIES

ROBERT L. COOPER, *Vice President*

MATTHEW J. HOEY, *Adviser*
WILLIAM H. WETENDORF, *Assistant Vice President*

JORGE A. BRATHWAITE,
Manager, Security Custody Department
PAUL J. CIEURZO,
Manager, Government Bond and Safekeeping Department
FRANCIS H. ROHRBACH,
Manager, Savings Bond Department
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Manager, Government Bond and Safekeeping Department
STEPHEN P. WEIS, *Operations Analysis Officer*

LEGAL

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

JAMES H. OLTMAN, *Deputy General Counsel*

LEOPOLD S. RASSNICK, *Assistant General Counsel*
ROBERT YOUNG, JR., *Legal Adviser*

RICHARD D. COOPERSMITH, *Associate Counsel, and Assistant Secretary*
ERNEST T. PATRIKIS, *Associate Counsel*
MARY J. RODGERS, *Associate Counsel*

DONALD L. BITTKER, *Assistant Counsel*
ROBERT N. DAVENPORT, JR., *Assistant Counsel*
CLIFFORD N. LIPSCOMB, *Assistant Counsel*
DON N. RINGSMUTH, *Assistant Counsel*

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CHESTER B. FELDBERG, *Vice President*

HENRY S. FUJARSKI, JR., *Assistant Vice President*

EUGENE P. EMOND,
Manager, Credit and Discount Department
HERBERT H. RUESS,
Manager, Credit and Discount Department

OPEN MARKET OPERATIONS AND TREASURY ISSUES

ALAN R. HOLMES, *Executive Vice President*

PETER D. STERNLIGHT, *Vice President*
PAUL MEEK, *Monetary Adviser*

IRWIN D. SANDBERG, *Assistant Vice President*
SHEILA L. TSCHINKEL, *Adviser*

MARY R. CLARKIN, *Securities Trading Officer*
JOHN S. HILL, *Senior Economist*
EDWARD J. OZOG,
Manager, Acceptance Department, and Manager, Securities Department

OPERATIONS ANALYSIS

KAREN J. BOPP, *Operations Analysis Officer*

PERSONNEL

JOHN T. KEANE, *Vice President*

PHILIP VAN ORMAN, *Assistant Vice President*

BRUCE G. ALEXANDER,
Manager, Personnel Department
TERRENCE J. CHECKI,
Manager, Personnel Department
ROBERTA J. GREEN,
Manager, Personnel Department

PUBLIC INFORMATION

RICHARD H. HOENIG, *Assistant Vice President*

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Officers *(Continued)*

RESEARCH AND STATISTICS

RICHARD G. DAVIS, *Vice President*
PETER FOUSEK, *Economic Adviser*
MICHAEL J. HAMBURGER, *Adviser*
ANTON S. NISSEN, *Assistant Vice President*
RUDOLF THUNBERG, *Assistant Vice President*
MARCELLE V. ARAK, *Senior Economist*
EDNA E. EHRLICH, *Manager, International Research Department*
FRED J. LEVIN, *Manager, Domestic Research Department*
CHARLES M. LUCAS, *Manager, Statistics Department*
GARY H. STERN, *Manager, Domestic Research Department*

SECRETARY'S OFFICE

E. GERALD CORRIGAN, *Adviser, and Secretary*
RICHARD D. COOPERSMITH, *Assistant Secretary, and Associate Counsel*
SUZANNE CUTLER, *Assistant Secretary*
THEODORE N. OPPENHEIMER, *Assistant Secretary*
STEPHEN G. THIEKE, *Assistant Secretary, and Manager, Management Information Department*

SERVICE

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WILLIAM M. SCHULTZ, *Assistant Vice President*
LOUIS J. CONROY, *Operations Analysis Officer*
FRANK W. LUNDBLAD, JR., *Manager, Protection Department*
RUTH ANN TYLER, *Manager, Service Department*

OFFICERS—BUFFALO BRANCH

RONALD B. GRAY, *Vice President and Branch Manager*
PETER D. LUCE, *Cashier*

ACCOUNTING; BANK RELATIONS AND PUBLIC INFORMATION; CHECK

ROBERT J. MCDONNELL, *Assistant Cashier*

BUILDING OPERATING; CASH; PROTECTION

HARRY A. CURTH, JR., *Assistant Cashier*

COLLECTION, LOANS, AND FISCAL AGENCY; PERSONNEL; SERVICE

GARY S. WEINTRAUB, *Assistant Cashier*

MANAGEMENT INFORMATION

PETER D. LUCE, *Cashier*

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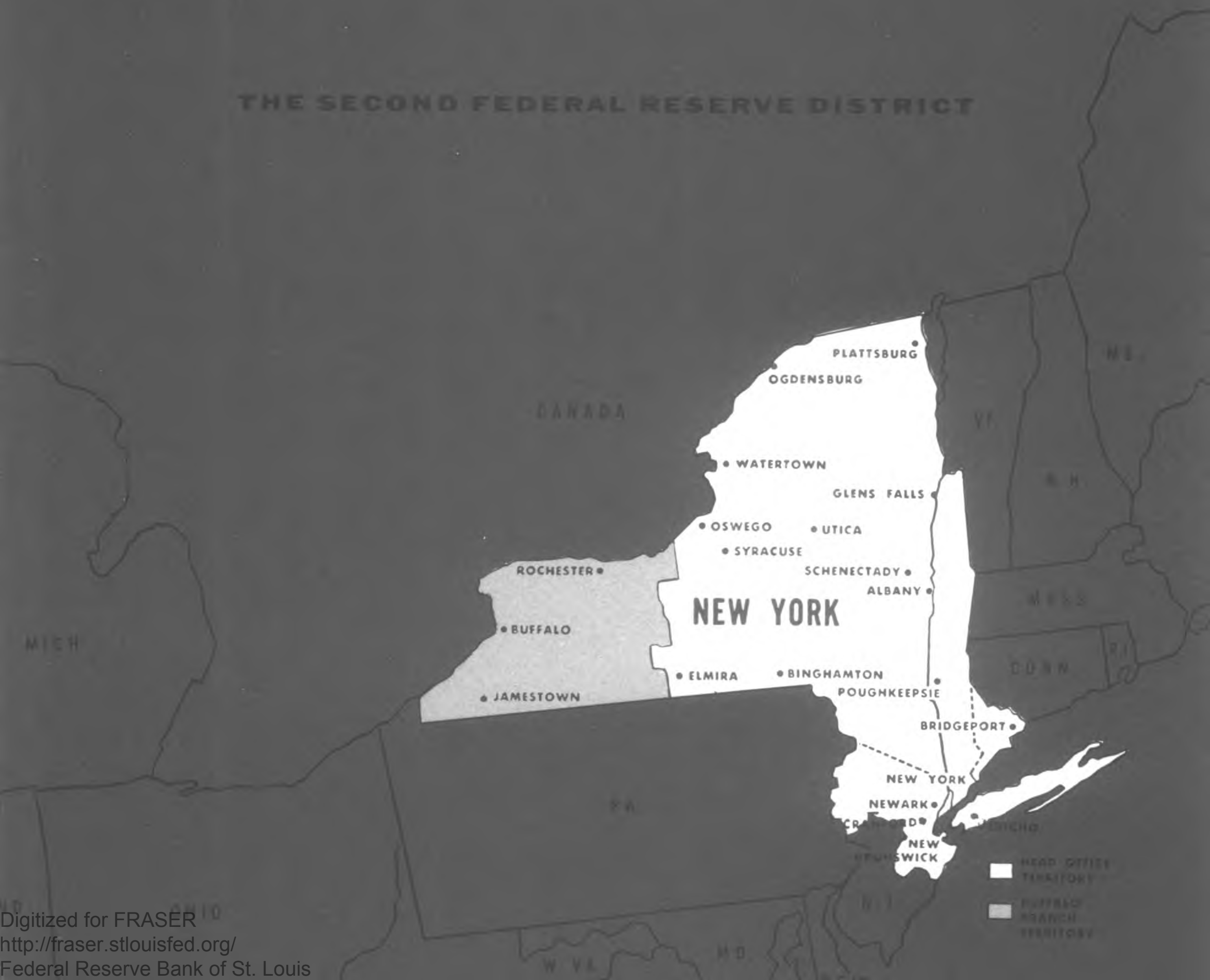

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