64th Annual Report 1977

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Letter of Transmittal

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., June 16, 1978

THE SPEAKER OF
THE HOUSE OF REPRESENTATIVES.

Pursuant to the requirements of Section 10 of the Federal Reserve Act, as amended, I am pleased to submit the Sixty-Fourth Annual Report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during the calendar year 1977.

Yours respectfully,

G. William Miller, *Chairman*

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Contents

Part 1 Monetary Policy and the U.S. Economy in 1977

3 INTRODUCTION

11 SOURCES OF ECONOMIC EXPANSION
13 Residential investment
14 Consumption
16 Income
17 Business fixed investment
19 Inventory accumulation
19 Government
21 Net exports

23 LABOR MARKET DEVELOPMENTS
24 Employment
25 Labor force and unemployment
27 Wages and collective bargaining
28 Wage and salary income

29 COST AND PRICE DEVELOPMENTS
29 Costs
30 Prices

34 MONETARY POLICY AND FINANCIAL MARKETS
34 Money and reserve aggregates
43 Interest rates
46 Aggregate flows of funds

56 INTERNATIONAL DEVELOPMENTS
59 U.S. international transactions
62 Foreign lending by U.S. banks
63 Foreign banks in the United States
63 Foreign exchange markets
66 Looking ahead

68 OFFICIAL STATEMENTS ON GROWTH TARGETS FOR MONETARY AGGREGATES

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Part 2 Records, Operations, and Organization

115 RECORD OF POLICY ACTIONS—BOARD OF GOVERNORS

152 RECORD OF POLICY ACTIONS—FEDERAL OPEN MARKET COMMITTEE

326 FEDERAL RESERVE OPERATIONS IN FOREIGN CURRENCIES

329 CONSUMER AFFAIRS
329 Introduction
332 Truth in Lending
346 Equal Credit Opportunity
358 Federal Trade Commission Act
363 Home Mortgage Disclosure

366 SECURITIES ACTS AMENDMENTS OF 1975

367 GOVERNMENT IN THE SUNSHINE

369 LEGISLATIVE RECOMMENDATIONS
369 Payment of interest on reserve balances—NOW accounts
370 Strengthened supervisory powers
371 Regulation of foreign banks
372 Financial transactions with affiliates
373 Interlocking relationships
374 Federal Reserve notes
375 Collateral for Federal Reserve notes
375 Truth in Lending Act simplification
376 Disclosure of the FOMC's domestic policy directive
376 Loans to bank examiners
377 Lending authority of Federal Reserve Banks

378 LITIGATION
378 Bank holding companies—Antitrust action
—Review of Board actions
386 Other litigation involving challenges to Board procedures and regulations

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391 LEGISLATION ENACTED
391 Emergency unemployment compensation extension
391 Depository institutions amendments
391 Tax Reduction and Simplification Act
392 Defense Production Act extension
392 Export Administration Act amendments
393 Small Business Act and Small Business Investment Act amendents
393 Congressional budget resolutions
393 Fair Debt Collection Practices Act
394 International Development Assistance Act
394 Debt ceiling extension
394 Council on Wage and Price Stability Act amendments
394 Housing and Community Development Act
395 Export-Import Bank Act amendments
396 Interest on Treasury tax and loan deposits
396 Fair Labor Standards Act amendments
397 Renewal of Federal Reserve Banks' direct purchase authority
397 Federal Reserve Reform Act
398 Securities Exchange Act amendment
399 Social Security Act amendments

400 BANK AND BANK HOLDING COMPANY SUPERVISION AND REGULATION BY THE FEDERAL RESERVE SYSTEM
400 Domestic activities and applications
409 Foreign activities and applications
412 Schools

413 CONDITION OF THE BANKING SYSTEM
413 Indexes of bank soundness
416 Potential problem areas
418 International activities
420 Improved supervision
421 Conclusion

422 FEDERAL RESERVE BANKS
422 Payments mechanism developments
422 Examination
423 Earnings and expenses
424 Federal Reserve bank premises
425 Holdings of loans and securities
426 Loan guarantees for defense production
426 Foreign accounts
427 Volume and cost of operations

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428 BOARD OF GOVERNORS
428 Income and expenses

STATISTICAL TABLES
434 1. Detailed statement of condition of all Federal Reserve Banks combined, Dec. 31, 1977
436 2. Statement of condition of each Federal Reserve Bank, Dec. 31, 1977 and 1976
440 3. Federal Reserve Bank holdings of U.S. Government and Federal agency securities, Dec. 31, 1975–77
442 4. Federal Reserve Bank holdings of special short-term Treasury certificates purchased directly from the United States, 1970–77
443 5. Open market transactions of the Federal Reserve System, 1977
444 6. Earnings and expenses of Federal Reserve Banks during 1977
446 7. Earnings and expenses of Federal Reserve Banks, 1914–77
448 8. Bank premises of Federal Reserve Banks and branches, Dec. 31, 1977
449 9. Volume of operations in principal departments of Federal Reserve Banks, 1974–77
450 10. Principal operations of Federal Reserve Banks, including total expenses, average number of employees, and ratio of total expense for each operation to total expenses, 1974–77
451 11. Number and salaries of officers and employees of Federal Reserve Banks, Dec. 31, 1977
451 12. Federal Reserve Bank interest rates, Dec. 31, 1977
452 13. Member bank reserve requirements
454 14. Maximum interest rates payable on time and savings deposits
455 15. Margin requirements
456 16. Fees and rates under Regulation V on loans guaranteed pursuant to Defense Production Act of 1950, Dec. 31, 1977
457 17. Principal assets and liabilities, and number of commercial and mutual savings banks, by class of bank, Dec. 31, 1977 and 1976
458 18. Member bank reserves, Federal Reserve Bank credit, and related items—end of year 1918–77 and end of month 1977
462 19. Changes in number of banking offices in the United States during 1977
464 20. Number of par and nonpar banking offices, Dec. 31, 1977
466 21. Description of each merger, consolidation, acquisition of assets or assumption of liabilities approved by the Board of Governors during 1977

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475 MAP OF FEDERAL RESERVE SYSTEM—DISTRICTS

FEDERAL RESERVE DIRECTORIES AND MEETINGS
478 Board of Governors of the Federal Reserve System
480 Federal Open Market Committee
481 Federal Advisory Council
482 Federal Reserve Banks and branches

507 INDEX

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Part 1

Monetary Policy and the U.S. Economy in 1977

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Introduction

The economy continued to expand at a brisk pace during 1977, and gains in employment were substantial. Although the unemployment rate was reduced significantly, joblessness remained historically quite high at year-end, in large part a heritage of the severity of the past recession. At the same time there was no progress in moderating the underlying rate of inflation.

Gross national product (GNP) rose by about 5¾ per cent in real terms from late 1976 to late 1977—somewhat more than during 1976. As in 1976, however, over-all expansion of activity was strongest early in the year. This early strength resulted in large part from a sharp rebound of inventory investment, following a small liquidation of stocks late in 1976. In addition, some special circumstances caused spending to increase in the early months of the year; the most important of these was the effect of the auto strike in late 1976 in delaying consumer and business purchases of motor vehicles.

Growth of real GNP moderated as the year progressed, reflecting smaller increases in inventory investment, as well as a sluggishness of consumer demand and an easing of capital outlays during the two middle quarters of the year. But spending for consumption picked up again in late 1977, and real final sales posted the largest gain of the year, although a sharp reduction in inventory accumulation damped the growth of real GNP.

The year 1977 witnessed the largest percentage increase in total employment in more than two decades. Although labor force growth was also rapid throughout the year, employment growth was faster, and the over-all unemployment rate fell more than 1 percentage point to less than 6½ per cent at the year-end. The improvement was concentrated among workers who had lost their last job rather than among new entrants or re-entrants to the labor force. Unemployment rates remained extremely high for young and inexperienced workers, minority groups, and those disadvantaged by lack of skills or training.

In general the expansion in 1977 was quite widely based, with most of the major sectors contributing to over-all growth. The rise in real consumption spending, while slower than it had been earlier in

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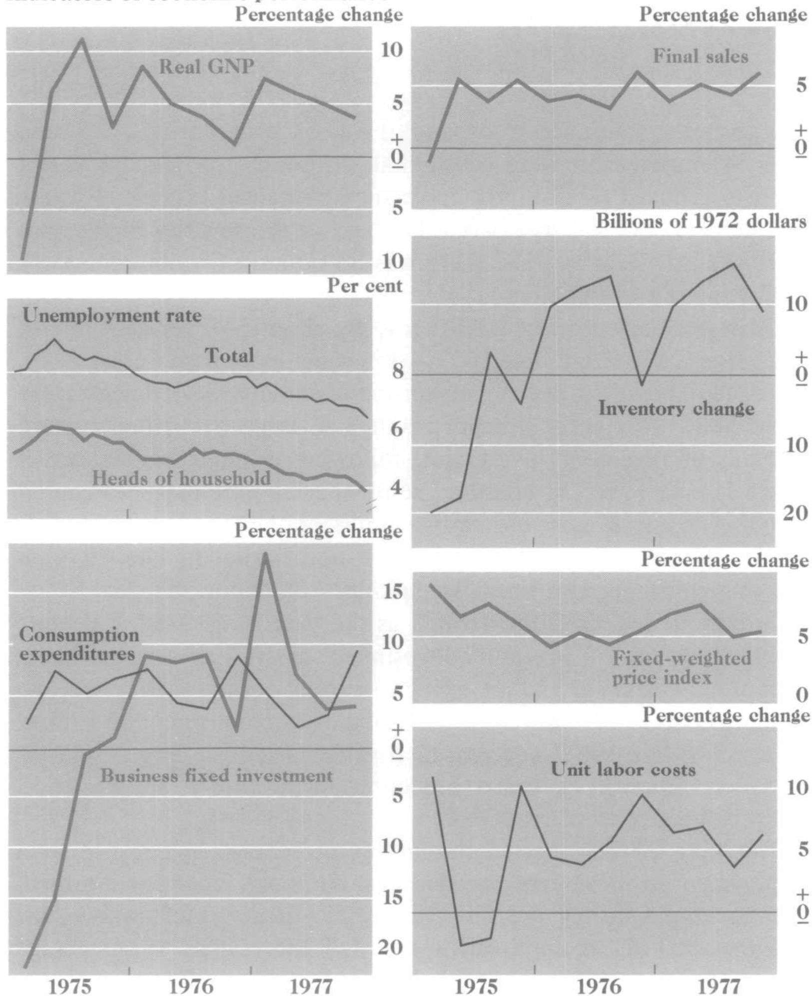

All figures for "percentage changes" are from previous quarter and are seasonally adjusted at annual rates.

Figures for the unemployment rate (seasonally adjusted monthly data) and for the change in unit labor costs are from U.S. Dept. of Labor. All other data are from U.S. Dept. of Commerce.

Fixed-weighted price index (1972 weights) is for gross domestic business product. Series designated as "real" are based on 1972 dollars.

Scales for changes in GNP, consumption expenditures, and business fixed investment are smaller than those for changes in final sales, fixed-weighted price index, and unit labor costs.

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the expansion, was still substantial by historical standards. Spearheaded by a further strong rise in purchases of durable goods, consumer purchases rose 4¾ per cent in real terms over the four quarters of 1977.

Although growth of business fixed investment moderated after the first quarter, such outlays provided support for economic expansion in 1977. Capital expenditures increased by 8.3 per cent in real terms, as compared with a rise of 7 per cent during 1976. Spending early in 1977 was concentrated on light machinery, particularly on vehicles. Outlays for commercial and industrial construction began to pick up in the spring, however, and during the remainder of the year they rose at a healthy rate. Nevertheless, business capital spending continued to lag behind its typical cyclical performance; at the year-end, after nearly 3 years of economic expansion, real business outlays were still below the pre-recession peak.

Residential construction remained a strong expansive force in 1977. A vigorous sales pace in housing markets stimulated a further, major increase in homebuilding activity during the year. Private housing starts were at an annual rate of 2.1 million units in the final quarter, and for the year as a whole they totaled nearly 2 million, the most since 1973. Including additions and alterations as well as new building, residential investment rose 15 per cent in real terms during 1977. Strength in this sector was reflected in gains in other areas such as employment in contract construction, production of construction supplies, and sales of furniture and appliances.

Growth of final demands for goods and services in 1977 also reflected larger government outlays. Federal Government purchases in real terms rose proportionately faster than total output of the economy. At the same time, outlays of States and localities were buoyed by Federal grants-in-aid for countercyclical revenue sharing, local public works, and public employment programs. These grants, together with a substantial improvement in fiscal positions of State and local governments, helped to generate a 3 per cent increase in real purchases of these governments during 1977; by contrast, such purchases had declined marginally during 1976. In another fiscal action supportive of over-all growth, personal income taxes were reduced; this helped to sustain consumption spending and to build savings flows after the unusual expansion of consumer spending during the winter.

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Higher costs of energy continued to have a strong influence on economic developments in 1977. For some time consumption of fuel had been constrained, reflecting both the reaction to the earlier quadrupling of the price of imported oil and the curtailment of economic activity during the recession. During the unusually cold winter of 1976–77, however, fuel imports rose strongly along with consumption, and as the economy expanded, they continued high. The result was a sharply increased bill for imported oil. This, in combination with rising imports of other goods and little change in demand for our exports, shifted the U.S. net balance on goods and services into a deficit (national-income-accounts basis), which persisted throughout the year. The deficit totaled $11 billion for the year as a whole—a shift of $19 billion from the 1976 surplus.

In part reflecting this deficit, the value of the dollar declined relative to the currencies of a number of our major trading partners. The initial effect was to raise the price of a wide range of imported goods, and thus add to inflation. While U.S. exports should be stimulated over the longer term by increased competitiveness, the impact to date appears to have been quite small.

Inflation continued rapid during 1977. Consumer prices rose about 6¾ per cent; during 1976 they had risen somewhat less, almost entirely because of a very small increase in food prices. Exclusive of foods, the rise in consumer prices was about 6¼ per cent during both 1976 and 1977. Wholesale prices exhibited a similar pattern; the average rise for industrial commodities remained in the neighborhood of 6½ per cent, whereas farm product and food prices, which had declined in 1976, rose during 1977, reflecting in large measure the effects of the unusually hard winter.

A variety of forces were operating to sustain price increases in 1977 in the face of continued sizable unemployment and ample productive capacity. The inflation of recent years continued to play an important role. Formal and informal indexation of wages, pensions, and welfare benefits to past price increases has mounted in the last decade, and the presence of such escalators lengthens the period necessary to unwind inflationary developments once under way. In addition, substantial cost increases arise from various government regulatory and payroll tax programs. Reflecting these and large increases in wage rates, hourly compensation in the private nonfarm business sector rose about 8½ per cent during 1977. At the same

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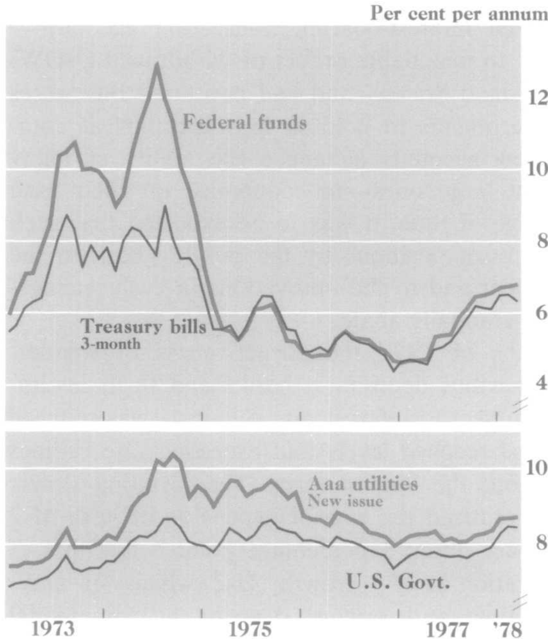
time, growth in productivity slowed from the cyclically advanced rate of 1976. As a result unit labor costs rose about 5.9 per cent; this was almost the same as in 1976, and much above the historical trend for this vital determinant of average price change. In addition, the deterioration of dollar exchange rates provided an upward bias to prices of imports and permitted larger price increases for domestically produced competitive goods.

Monetary policy in 1977 continued to be directed toward sustaining growth in the U.S. economy, while seeking to avoid additional inflationary pressures. Federal Reserve policy actions were designed to moderate the expansion in the monetary aggregates and to establish the basis for a slowing in inflation over the longer term. With demands for credit and money rising, short-term interest rates rose 1 to 2 percentage points over the year, and long-term market yields generally rose about ½ of a percentage point.

Interest rates



For notes see chart on p. 40.

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In the two previous years *M*-1, the narrow measure of the money stock (currency and demand deposits), had grown considerably less than would have been expected on the basis of the historical relationships among money, income, and interest rates. The counterpart of this comparatively limited growth had been a larger increase in the income velocity of *M*-1—GNP divided by *M*-1—than at similar stages in previous business expansions. Since the spring of 1977, however, *M*-1 has grown about in line with earlier traditional relationships and from the fourth quarter of 1976 to the fourth quarter of 1977 the rate of growth in *M*-1 exceeded 7¾ per cent, well above the upper end of the Federal Open Market Committee's longer-run range of 4½ to 6½ per cent for this aggregate for that period.

The more rapid growth of *M*-1 appeared to reflect in part a reduction in the impact of previous financial innovations and of regulatory changes on money growth. Several years earlier, in 1974, the high levels of interest rates had induced the public, especially businesses, to use a growing number of cash-management techniques and devices that tend to minimize holdings of demand balances on which no explicit interest is paid. Moreover, regulatory and legislative changes after 1974 had authorized interest-bearing transaction accounts—particularly those subject to negotiable orders of withdrawal (NOW) accounts in the New England States—and had permitted businesses and State and local governments to hold savings accounts at commercial banks. These new accounts enhanced the ability of many economic units—not just large ones—to economize on their cash balances. With the passage of time, it was to be expected that such adjustments of financial asset positions by the public—both to the new regulatory environment and to the innovations in cash-management techniques—would gradually abate.

In the last few months of 1977 the attractiveness of smaller-denomination time and savings deposits at banks and thrift institutions—all of which are subject to interest rate ceilings—was reduced as market rates of interest reached levels that exceeded rate ceilings on time deposits of all but the longest term. The resulting slower growth of such deposits reduced the rate of expansion of both *M*-2 and *M*-3 in 1977 to a pace about 1 percentage point below that of 1976, despite the acceleration in *M*-1 growth. *M*-2, which—in addition to *M*-1—includes time and savings deposits at commercial banks other than negotiable certificates of deposit (CD's) issued by

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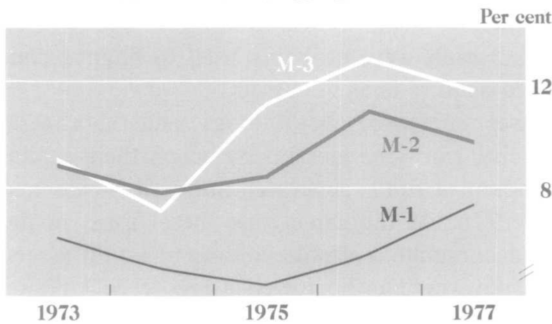
Growth rates of monetary aggregates



For definitions of these aggregates, see Table 6, p. 38.

large banks, increased about 9¾ per cent over the year; this was close to the upper end of the longer-run range of 7–10 per cent for the aggregate for the period from the fourth quarter of 1976 to the fourth quarter of 1977.

As the growth of deposits subject to interest ceilings slowed, banks and thrift institutions turned increasingly to other sources for loanable funds. In the second half of 1977 commercial banks, for example, raised more than $20 billion through time deposits in denominations of $100,000 or more, a class of deposits not subject to regulatory interest rate ceilings. By contrast, in all of 1976 such deposits had declined by about an equal amount, and in the first half of 1977 they had contracted moderately, on average. Similarly, savings and loan associations, which had made net repayments of borrowings from the Federal home loan banks in 1976, borrowed more than $4 billion from this source in 1977 and an additional $4½ billion from other sources—mainly from commercial banks and by the issuance of mortgage-backed bonds.

Total funds raised in domestic credit markets reached record proportions in 1977. Borrowing by the Federal Government—although still large by historical standards—declined appreciably, and so did that by foreigners. However, private domestic nonfinancial sectors increased their credit demands sharply. Borrowing by households reached record levels, with the largest increases occurring in the mortgage market. The amount that consumers borrowed on mort-

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gages exceeded their outlays on new and existing houses, suggesting withdrawals of equity built up in the increased value of the existing housing stock; such withdrawals were probably used to finance consumer expenditures and to acquire financial assets.

Nonfinancial businesses increased both long- and short-term borrowing as their financing gap—the amount by which their capital outlays exceeded the amount of funds generated internally—widened from the small total of 1976. At the same time these firms, in the aggregate, continued to accumulate a sizable volume of liquid assets. Finally, State and local governments borrowed a record $27 billion in 1977. However, as a result of advance refunding and of considerable budget surpluses, these units also accumulated substantial amounts of financial assets; they acquired, for example, more than one-fourth of the net issues of U.S. Government and Federal agency obligations.

Despite the considerable further increase in economic activity in 1977, resource utilization continued slack at the year-end, as indicated by the still high levels of unemployment and excess plant capacity. In order to sustain the pace of economic advance, the administration has proposed reductions in late 1978 in personal income taxes and in business taxes to encourage larger investment; such reductions are designed to offset mandated increases in payroll taxes and the effects of inflation in raising effective tax rates.

At the same time, the persistence of inflationary forces and the weakness of the dollar in foreign exchange markets suggest that public policies must be particularly sensitive to increasing pressures stemming from higher costs and higher prices. In this respect, the administration has initiated additional public and private efforts to address the cost-price problem more directly in 1978. The Federal Reserve, for its part, will pursue policies that encourage continued growth in economic activity and reduction in the unemployment rate, while seeking to attain further reduction in the rate of inflation over the longer run.

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Sources of Economic Expansion

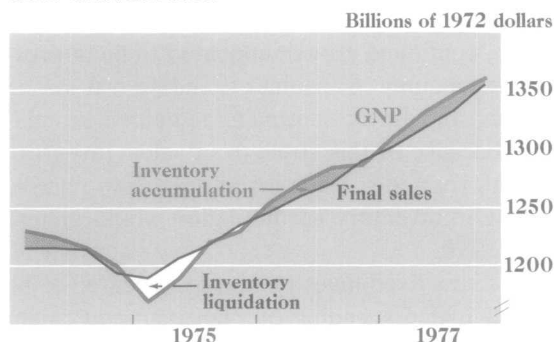
During 1977 gross national product rose by 5¾ per cent after allowance for rising prices, a larger increase than during 1976. Growth was fastest early in the year as inventory investment and consumer and business purchases of motor vehicles rebounded from the sluggish rates of late 1976. Gains in GNP slowed continuously after the first quarter. By contrast, advances in real final sales were largest late in the year.

Growth of real outlays was particularly vigorous for residential construction, business equipment, and consumer durable goods between late 1976 and late 1977. The strength of demand in these markets reflected in part a continuing recovery from the unusually depressed levels of the 1974–75 recession.

Residential building activity continued to expand briskly in 1977. Real outlays in the housing sector rose 15 per cent during the year, as total sales of homes reached a record level.

By contrast, sales of autos—a major component of consumer durable goods—jumped to a high level early in the year and then drifted lower through year-end, possibly signifying the completion of

GNP and final sales



U.S. Dept. of Commerce data, seasonally adjusted at annual rates.

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replacement buying that had been deferred during the recession and the late 1976 auto strike. As auto sales eased, however, purchases of other consumer durable goods—most notably furniture and appliances—showed renewed vigor. Consumer purchases of nondurable goods and of services each rose 4 per cent during the year.

Business fixed investment advanced 8.3 per cent in real terms during 1977, a large rise in view of the prevailing uncertainties about the effects of pending legislation and about prospects for further economic expansion in a highly inflationary environment. In addition, businesses avoided inventory imbalances for the most part by making quick adjustments in production to the uneven pace of sales during the year. A strong burst of sales at year-end, however, probably reduced stocks in some lines below desired levels.

Businesses, like consumers, increased their purchases of motor vehicles sharply early in 1977. Real purchases of other business equipment and outlays for business structures each rose about 6 per cent from late 1976 to late 1977. Industrial and commercial building activity increased markedly around midyear, but at the same time outlays for the Alaskan pipeline were reduced.

Total purchases by governments increased moderately during the year after having shown a slight decline during 1976. Much of the impetus for this rise reflected Federal fiscal initiatives, which led to a substantial increase in grants to State and local governments.

Developments in the international economy resulted in a drag on growth in domestic activity during 1977. With the economic recoveries of our major trading partners lagging behind the recovery in this country, real demands for our exports were little changed while our imports rose considerably, responding to a substantial improvement in domestic activity.

As 1977 came to a close, continued growth appeared to be in prospect for most sectors of the economy. Consumer spending was strong through the holiday season, and buyer sentiment remained at relatively high levels. In part because of this strength in sales, inventory accumulation moderated at year-end. With inventories low relative to final sales, some increase in inventory accumulation would appear to be in prospect for early 1978.

Continued growth of business fixed investment also appeared to be in prospect. Surveys of anticipated spending on plant and equipment

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1. Gross national product

Seasonally adjusted, annual rates

Measure	1976 Q4	1977 Q4	1977 Q1	1977 Q2	1977 Q3	1977 Q4
	Billions of dollars					
Gross national product	1,755	1,962	1,811	1,870	1,916	1,962
Change in business inventories	−.9	13.5	13.8	21.7	23.6	13.5
Final sales	1,756	1,948	1,797	1,848	1,892	1,948
	Percentage change from—					
	Year-earlier quarter		Previous quarter			
GNP (constant dollars)	4.7	5.7	7.5	6.2	5.1	3.8
Final sales (constant dollars)	4.4	4.8	3.8	5.1	4.4	6.1
Implicit price deflator	4.7	5.8	5.3	7.1	4.8	5.9

NOTE.—U.S. Dept. of Commerce data.

indicated that increases in such outlays in 1978 would be moderate (about 10 or 11 per cent in nominal terms) and would be somewhat less than those in 1977 (about 12½ per cent).

RESIDENTIAL INVESTMENT

Throughout the recovery housing activity has been very brisk, with especially large gains in the West and South. During 1977, record sales of new and existing homes stimulated a continuous rise in private housing starts that, together with heavy spending on additions and alterations, boosted real residential outlays 15 per cent.

The employment and product demands that were spawned by the rise in residential investment were impressive. Employment in the construction industry—including both residential and nonresidential work—increased almost 10 per cent during the year. Production of construction supplies rose 8¼ per cent, generating large gains in employment within supplier industries.

The strong showing of residential construction activity in 1977 was facilitated by developments in financial markets. Net residential mortgage debt formation is estimated to have totaled a record $100

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billion, as lending by thrift institutions was supplemented with stepped-up participation by commercial banks and with large increases in issues of mortgage-backed, "pass-through" securities.

For the year as a whole, private housing starts totaled almost 2 million units. Starts of single-family homes rose about one-fourth from the 1976 total to about 1.45 million units, reaching the highest level since 1955. Multifamily starts totaled 535,000 units—an increase of 40 per cent from 1976, and approximately half the peak reached in 1972. About a fifth of all multifamily units were started under Federal support programs—primarily under the Department of Housing and Urban Development's Section 8 Rental Assistance Program.

Market conditions facing builders of multifamily units that were not Federally supported varied considerably across the country. In some areas low vacancy rates and rising rents provided the basis for moderate increases in rental housing, whereas elsewhere rents remained too low to justify much construction.

Demands for housing were very strong in the final quarter of the year. Sales of new and existing homes were at an annual rate of 4.8 million units, and single-family housing starts were at a very rapid annual rate—1.6 million units. Outstanding mortgage lending commitments at savings and loan associations were at a record level of almost $35 billion, seasonally adjusted, at the end of 1977.

CONSUMPTION

Consumption spending rose unevenly in 1977, with especially large increases in the first and last quarters and comparatively small gains in the middle quarters. The surge in consumer spending early in the year reflected in large part two events: delayed purchases of new autos because of the strike in late 1976, and the unusually severe winter weather, which had widespread impacts on consumption of heating fuels and on prices of some foods. Later in the year the strong growth of employment and of disposable income, coupled with a high level of consumer confidence, provided support for an upturn in consumption spending in the final quarter of 1977.

During the winter of 1976–77 consumers faced larger bills for essentials. Consumption of heating fuels rose sharply in response to unusually cold weather east of the Rockies, and spending for natural

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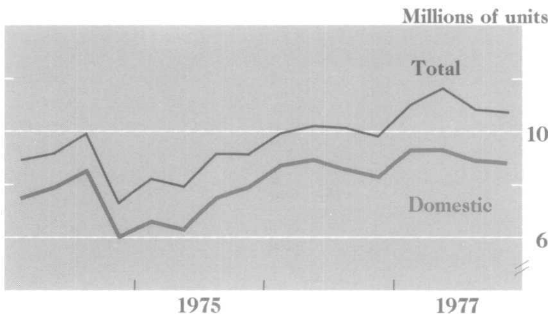
gas, fuel oil, coal, and electricity in the first quarter of 1977 was 22 per cent above that a year earlier; about half of the rise was due to higher prices.

With the return of more favorable weather, such spending declined almost 10 per cent in the second quarter. At the same time, however, consumer outlays for food rose considerably, mainly because of large increases in prices that were partially a result of weather damage to crops. With both utility and grocery bills large, spending on most other nondurable goods was apparently held down early in the year. But during the spring, as fuel bills eased and increases in food prices began to moderate, purchases of apparel moved into an upswing that continued for the remainder of the year.

Purchases of durable goods rose at a rapid pace during the first quarter of 1977, as unit sales of automobiles jumped more than 10 per cent from the prior, strike-affected quarter. Auto sales rose further to an annual rate of 11.7 million units in the second quarter—the strongest quarterly pace since 1973. During that quarter demand for autos shifted markedly in the direction of foreign models—in part, perhaps, because the administration's energy proposals stimulated renewed interest in fuel-efficient cars. Sales of foreign-model autos continued strong and for the year totaled a record 2.1 million units. Sales of domestic autos averaged about 8.9 million units (an-

Auto sales



Data from domestic manufacturers and foreign distributors, seasonally adjusted by Federal Reserve.

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nual rate) during the second half of 1977; at that level they were below the first-half rate, below manufacturers' anticipated sales, and below production rates. As a result, inventories increased rapidly late in the year, and selected downward adjustments in production rates were instituted in November and December.

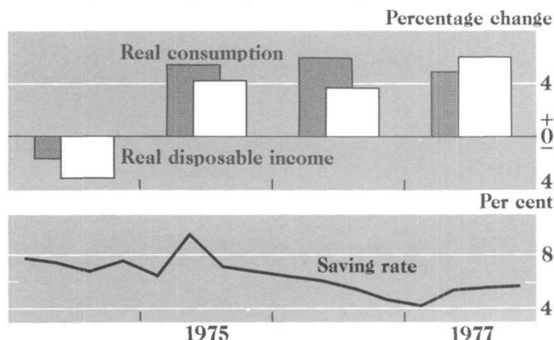
Outlays for other consumer durable goods rose strongly after mid-year. Spending for furniture and appliances, stimulated in part by record purchases of homes, rose at a 14 per cent annual rate during the last three quarters of the year. Outlays for luxury items such as jewelry and for sporting goods, as well as for a wide variety of other "nonessential" durable goods, also rose briskly late in the year.

Surveys of consumer attitudes conducted near the end of 1977 indicated that confidence remained at a relatively high level. Furthermore, substantial growth of employment and disposable income late in the year suggest good prospects for continued advances in consumer outlays during 1978.

INCOME

An acceleration in income growth supported the large increase in consumer demand in 1977. Personal income rose 11¾ per cent during the four quarters of 1977 compared with less than 10 per cent during 1976. Wage and salary disbursements in the private sector,

Income, consumption, and saving



Based on U.S. Dept. of Commerce data, seasonally adjusted at annual rates. "Real" is in terms of 1972 dollars. Changes are from Q4 to Q4.

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particularly in manufacturing and services, led the advance in payroll growth; government wages and salaries were up a modest 7½ per cent.

Transfer payments rose about 7½ per cent during 1977 as reductions in unemployment insurance payments partially offset increases in other benefits. The midyear cost-of-living increase for social security recipients bolstered transfer payments in the second half of the year. Farm income, after declining steadily in response to falling farm prices, rose sharply at year-end as wheat price-support payments were distributed.

Increases in Federal estate and gift taxes held down growth in disposable income early in the year, but such income was bolstered later in the year by a cut in Federal income taxes. Lower withholding rates, which relate directly to take-home pay, were instituted in the second quarter. Consumers used some of the increase in disposable income to increase their savings. The saving rate—which had reached a 26-year low in the first quarter, in part because of 1976 estate- and gift-tax-law revisions—rose moderately during the last three quarters.

Despite the large increase in disposable income, financial obligations of the household sector reached new highs relative to disposable income late in 1977, mainly because of the record increase in home mortgage debt. The resulting rise in debt-service requirements narrowed considerably the proportion of disposable income available for current discretionary spending.

BUSINESS FIXED INVESTMENT

By the fourth quarter of 1977 real outlays for plant and equipment had risen 8.3 per cent from a year earlier. Following sharp advances in the first half, such outlays rose only moderately in the latter half of the year as sales of transportation equipment declined and construction of the Alaskan pipeline drew to a close.

Continuing the pattern of recent years, spending on new equipment was the primary source of strength for capital outlays in 1977; over the year such spending rose 9.5 per cent. Within the equipment sector, spending on machinery rose steadily but still did not account for the share of capital spending that historical experience would suggest. Investment in structures advanced modestly during 1977—5.5 per cent, as commercial and industrial building activity strengthened in the spring, following 2 years of little change. The increase in

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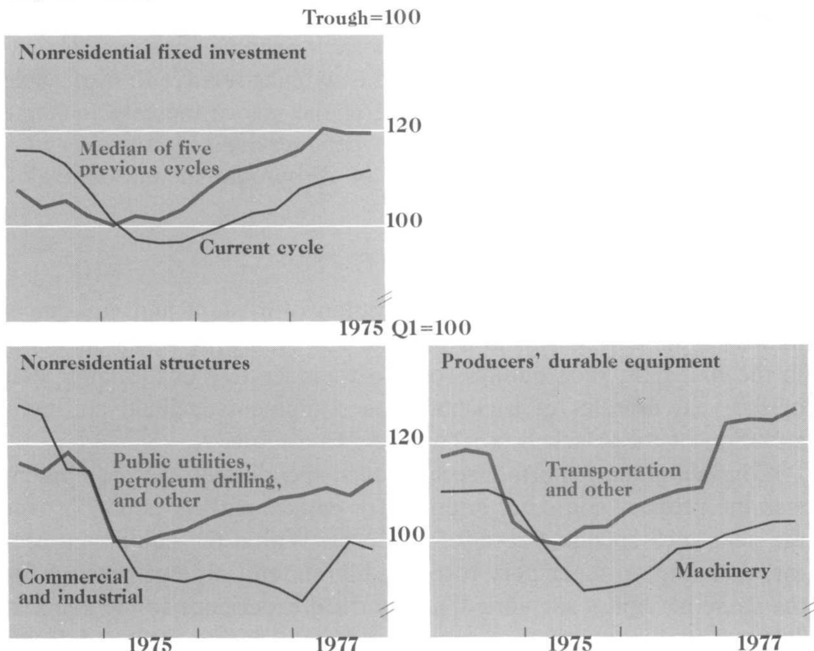
outlays for fixed capital was largest in manufacturing. Spending by producers of durable goods was particularly robust, whereas that by materials producers was damped by relatively low levels of capacity utilization and by readily available foreign supplies at competitive prices.

Despite healthy gains in the equipment sector during 1977, the total of real spending for business fixed investment in the fourth quarter was still 3 per cent below its earlier peak; a more typical cyclical experience would have seen such outlays almost 13 per cent above their previous peak. This shortfall can be attributed in part to substantial unused capacity. At the year-end capacity utilization rates in manufacturing were around 83 per cent, not much above those in late 1976 and well below the levels normally experienced after 33 months of cyclical recovery and expansion. Low-to-moderate



Based on U.S. Dept. of Commerce data in 1972 dollars, seasonally adjusted. National Bureau of Economic Research reference-cycle trough, 1975 Q1 = 100.

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utilization rates in most industries have probably had a depressing effect on growth of fixed capital throughout the recent expansion.

Other factors also contributed to the relatively modest recovery in investment spending. Continued uncertainty over tax and energy policies heightened the caution that already characterized longer-range investment plans. The weakness in stock prices pushed up the cost of equity capital and made the acquisition of existing productive capacity relatively attractive. However, financial developments outside of equity markets did not seem to affect capital spending in an adverse manner.

INVENTORY ACCUMULATION

Investment in business inventories proceeded cautiously in 1977, and inventory–sales ratios remained below historical averages in most sectors. After the abrupt shift to liquidation that had taken place in the final quarter of 1976, inventory accumulation picked up sharply in the first quarter of 1977. And in the second and third quarters there were further advances, in response to gains in final demand. At year-end, however, the pace of accumulation abated considerably, as final sales strengthened. Indeed, at the year-end stocks may have been a bit on the lean side relative to sales in some sectors; hence, there could be some pick-up in accumulation during early 1978.

GOVERNMENT

The Federal Government continued to run a substantial deficit in 1977, reflecting in part new fiscal initiatives. In particular, spending was buoyed by grants-in-aid to States and localities to implement various countercyclical spending programs, and receipts were held down by tax cuts embodied in the Tax Reduction and Simplification Act of 1977. The Federal budget deficit, on a national-income-accounts (NIA) basis, was about $50 billion during calendar year 1977—$4.5 billion less than in 1976.

Real Federal purchases rose slightly more than 7 per cent during 1977. This contrasts with the small decline during 1976. Nondefense spending was bolstered by large purchases of agricultural products by the Commodity Credit Corporation following a sharp drop in farm prices at midyear. Although the Federal civilian work force remained essentially unchanged in 1977, Federal payrolls rose 7 per cent.

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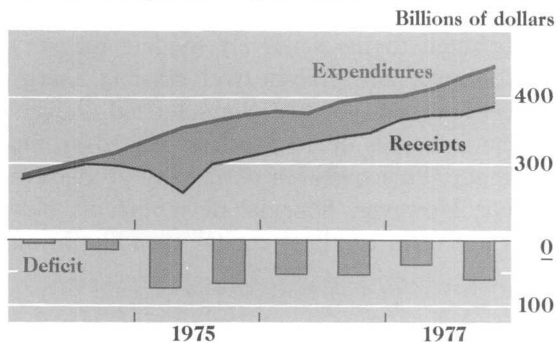
Federal receipts and expenditures



Based on U.S. Dept. of Commerce data (national income series) seasonally adjusted at annual rates.

Federal receipts rose 12½ per cent for 1977 as a whole—considerably less than in 1976. Personal tax collections increased almost 16 per cent, led by a large increase in receipts of estate and gift taxes associated with legislated changes in the method of taxing gifts. Social insurance tax collections rose about 12½ per cent, reflecting an increase in the social security taxable wage base as well as increases in payrolls.

State and local government purchases of goods and services advanced 3¼ per cent from late 1976 to late 1977, after a slight decline during 1976. Increases in Federally subsidized public service jobs accounted for a large part of the rise. Between the fourth quarter of 1976 and the fourth quarter of 1977, over-all employment in this sector increased by 337,000 jobs. This compares with an advance of 225,000 positions the previous year. Despite an infusion of countercyclical Federal aid for public works projects and a record volume of bond issues in 1977, real capital spending by State and local governments rose only marginally and at year-end was about one-fifth below the level 3 years earlier.

State and local government receipts rose about 11¼ per cent for 1977 as a whole. The advance reflected increases in local tax bases associated with the general economic expansion as well as sharply higher Federal grants-in-aid during the second half. Total spending was held below revenues throughout the year as many governmental

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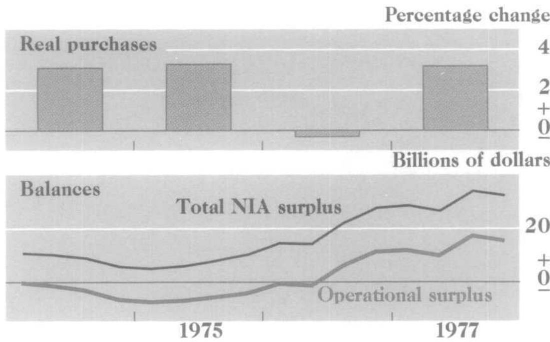
State and local government spending



Based on U.S. Dept. of Commerce data, seasonally adjusted; changes are from Q4 to Q4. Operational surplus excludes net savings by social insurance funds.

units used some of their receipts to rebuild cash balances that had been drawn down by several years of fiscal stress. As a result of such fiscal conservatism and some unspent countercyclical grants, the operational balance—which excludes net savings by social insurance funds—showed a record annual surplus of almost $14 billion.

NET EXPORTS

U.S. net exports of goods and services showed a deficit of $11 billion in 1977 on an NIA basis—a sharp reversal from the $7.8 billion surplus recorded in 1976. The swing into deficit was the result of a very large increase in the merchandise trade deficit that was only partially offset by a small rise in net investment income.

Exports of merchandise from the United States were little changed in real terms as the slow economic recovery of our major trading partners constrained expansion of demand. Slow growth of capital investment in both developing and developed countries limited increases in demand, particularly for machinery and industrial materials, which normally constitute about half of our merchandise exports. The volume of agricultural exports in 1977 continued the strong trend established in 1976, but the value of these exports declined in the latter half of the year as grain prices fell sharply.

The sharp rise in merchandise imports in 1977 reflected a broad range of developments, but the dominant factor was the substantial

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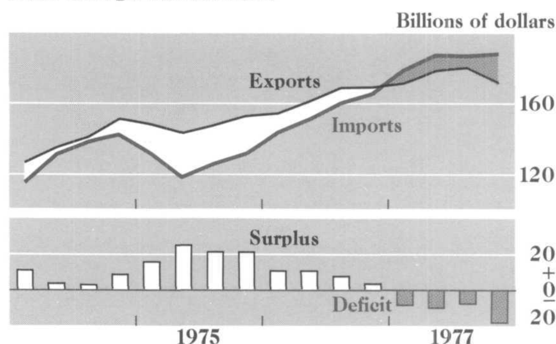
U.S. foreign transactions



U.S. Dept. of Commerce data, seasonally adjusted at annual rates. Includes both goods and services.

rise in petroleum imports. The total bill for imported oil rose about 30 per cent from its 1976 total to $45 billion, as increased consumption and substantial expansion of petroleum inventories were met almost entirely by imports. Price increases accounted for about one-third of the rise. Imports of industrial supplies, autos and related equipment, and consumer goods increased significantly, reflecting mainly demands generated by the expansion of the domestic economy. At the same time, sharply higher prices for coffee and some other imported agricultural commodities provided a significant boost to the cost of imports during the early part of the year.

Net exports of services and military transactions (NIA defined) rose $5 billion in 1977 to $22 billion. These transactions have become a large part of total exports over the past several years, as income from U.S. investment abroad and sales of military equipment to foreign governments have grown.

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Labor Market Developments

The expansion of economic activity generated a 4.4 per cent gain in total employment during 1977, the largest relative increase in more than two decades. Demands for labor exceeded the growth in the labor force, which also was at a very rapid rate, and unemployment dropped to about 6½ per cent of the labor force at year-end—a decline of 1¼ percentage points from a year earlier. Total compensation of employees rose 12 per cent during 1977, reflecting both the rapid growth of employment and large increases in wage rates.

Employment gains were concentrated in the private sector of the economy where job creation in the goods-producing industries—particularly in construction—accelerated from its lackluster pace in 1976. Increases in service-producing jobs, which had led job gains in earlier stages of the expansion, also were somewhat larger. By the year-end 3¼ million jobs had been added to nonfarm payrolls, appreciably more than the increase of about 2⅓ million during 1976.

Reductions in unemployment during 1977 were large for workers who had lost their last job, heads of households, full-time workers, and adult males. Rates of unemployment were little changed for recent labor force entrants, minority groups, and youth.

2. Selected labor market measures

Seasonally adjusted data

Measure, and unit	Levels in Q4 of—			Percentage change from year-earlier quarter	
	1975	1976	1977	1976 Q4	1977 Q4
Civilian labor force (millions of persons)	93.1	95.6	98.6	2.8	3.1
Total employment (millions of persons)	85.3	88.2	92.1	3.3	4.4
Unemployment (per cent of labor force)	8.3	7.8	6.6	....	....
Private payroll employment (millions of persons)[1]	63.0	65.1	68.0	3.4	4.3
Wage and salary disbursements[2] (billions of dollars)	654	731	822	11.8	12.5
Government employment (millions of persons)	14.8	15.0	15.4	1.3	2.3
Wage and salary disbursements[2] (billions of dollars)	181	193	207	6.2	7.5

[1] Adjusted for strike activity.

[2] Levels are at annual rates

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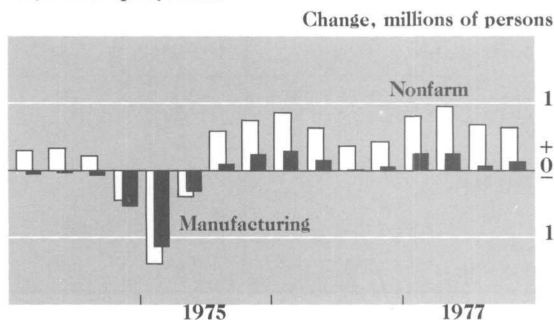
Wage rate increases were slightly larger in 1977 than the year before. Average wage rates in durable goods manufacturing were up sharply, reflecting in large part the timing of industry negotiations in the collective bargaining cycle; settlements had occurred in the auto industry late in 1976, and in the steel industry there were settlements early in 1977. Average wage increases in services, trade, and transportation and public utilities also were larger in 1977 than in 1976. By contrast, growth of wages in contract construction decelerated for the third year in a row.

EMPLOYMENT

More rapid growth of employment was evident in virtually all demographic, occupational, and industrial groups during 1977. Adult men obtained more than two-fifths of the total positions added, and their unemployment rate fell to 4¾ per cent. This reflects in part the stronger expansion of goods-producing industries—in which men hold three of each four jobs.

At the same time, continued strong growth of service-oriented industries generated job opportunities for women and youth. Nearly 2½ million additional white-collar and service jobs, which are heavily staffed by women, were created during the year. The number of women employed rose by 1⅔ million, and the proportion of their population employed reached a record high. Teenage jobholders reg-

Payroll employment



Based on U.S. Dept. of Labor data, seasonally adjusted. Changes are from previous quarter.

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istered a particularly sizable gain of more than half a million during the year—almost three times the increase during 1976.

Jobs in trade, services, and finance grew steadily during 1977, accounting for more than half of the increase in nonfarm payroll employment over the year. Demand continued strong in medical and health fields as well as in such areas as legal, educational, and business services. In view of substantial gains in residential construction activity and of a pick-up in nonresidential bulding activity, employment in contract construction posted its largest gain of the current expansion. Growth of State and local government payrolls was slow early in the year, but it accelerated following the start-up of a new round of Federally subsidized public service jobs in May. Largely due to this stimulus, government employment at the State and local level had risen almost 340,000 by the year-end—compared with a gain of about 220,000 in 1976.

Factory employment rose about 720,000 (strike adjusted) during 1977, compared with 570,000 during 1976. Producers of durable goods led the advance, with growth particularly strong in the machinery, electrical equipment, and fabricated metals industries.

In nondurable goods manufacturing, increases in employment and in the average workweek in the first half of the year were reversed between July and October as producers promptly adjusted output to slower sales in markets for soft goods. Sales improved late in the year, however, and by December employment in nondurable goods manufacturing had about regained its June peak.

At the year-end employment in manufacturing was still 2¾ per cent below its late 1973 peak, and construction jobs remained almost 4 per cent below the previous high. In durable goods manufacturing shortfalls from prior peaks were most pronounced in primary metals (11 per cent) as steel producers, faced with high costs and import competition, curtailed employment during the latter half of 1977. Employment in the apparel industry also continued to lag, and at the year-end jobs in this sector were 9 per cent below the pre-recession peak.

LABOR FORCE AND UNEMPLOYMENT

The civilian labor force increased 3 million during 1977, about one-half of which represented population growth and the other half the rise in labor force participation. The participation rate climbed to a new record—62.7 per cent of the civilian population aged 16 years

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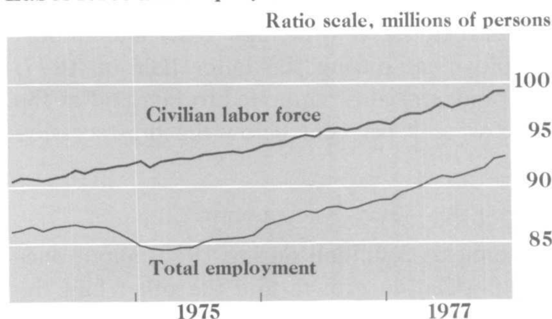
and older. Adult women continued to move into the labor market in large numbers, as an apparent preference for work outside the home was accompanied by expanding job opportunities, particularly in the service sector. By year-end an additional 1½ million women aged 20 years and over had joined the labor force.

An even sharper increase in labor force participation had occurred among teenagers, who tend to respond quickly to improvement in labor demand; the 16- to 19-year-old population was little changed over the year, but the teenage labor force expanded by 415,000. As was the case in 1976, the participation rate of adult men was relatively stable during 1977.

Growth in employment exceeded the expansion of the labor force by a considerable margin early in 1977, and by midyear the unemployment rate had dropped 0.7 percentage point. This decline was concentrated among experienced workers who had lost their last job, and it reflected in some part an acceleration of hiring in the industrial and construction sectors. After slowing slightly in the third quarter, employment growth was again strong in the final quarter of the year. As a result, the unemployment rate fell another ½ of a percentage point to just over 6½ per cent.

At the end of 1977 unemployment was almost 900,000 below the level a year earlier and was at the lowest level since late 1974. The improvement was not evenly distributed, however, as unemployment remained relatively high among less experienced workers. The high unemployment rates for teenagers and blacks remained about unchanged. For heads of families and for prime-age workers (25 to

Labor force and employment



U.S. Dept. of Labor data, seasonally adjusted.

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54 years), on the other hand, jobless rates fell 1 percentage point each during the year to 4.2 and 4.8 per cent, respectively; nevertheless, both rates remained well above pre-recession levels, which were in the neighborhood of 3 per cent for both groups.

During the year the total number of workers collecting unemployment insurance benefits declined from 4½ million to 3⅓ million. With high levels of joblessness plus the temporary extensions of benefits and expansions of coverage legislated in 1975, Federal expenditures for unemployment insurance had more than tripled between 1973 and 1976. In fiscal year 1977 these outlays fell to an estimated $13½ billion as unemployment declined and the Federal Supplemental Benefit Program, which had provided up to an additional 26 weeks of benefits, was phased out. The number of claimants under the temporary special unemployment assistance program, which had permitted previously uncovered workers to receive benefits, also fell in 1977. When the program ended in December, however, coverage for these workers was picked up by the States.

WAGES AND COLLECTIVE BARGAINING

Average pay increases in the private sector were somewhat larger during 1977 than during 1976. The average hourly earnings index for private nonfarm production workers—a broad measure of average wage-rate trends—rose more than 7½ per cent compared with about 6¾ per cent during 1976. The timing of major collective bargaining settlements, the larger increases in consumer prices, and some tightening of the labor market were important factors in the faster rise in wages.

3. Changes in adjusted hourly earnings [1]

Change from year-earlier quarter, in per cent

Category	1974 Q4	1975 Q4	1976 Q4	1977 Q4
Total	9.3	8.2	6.8	7.7
Construction	7.8	6.3	5.5	5.0
Manufacturing	10.4	8.8	7.4	8.2
Transportation and public utilities	8.1	9.8	7.4	8.0
Services	8.9	7.8	6.9	8.2
Trade	9.1	7.5	6.4	7.5

[1] Average hourly earnings index, private nonfarm production workers.
NOTE.—U.S. Dept. of Labor data.

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Larger wage increases were widespread. In manufacturing, services, and transportation and public utilities the hourly earnings index rose 8 per cent—up from a range of 7 to 7½ per cent during 1976. Among unionized workers in contract construction first-year wage adjustments averaged 6½ per cent, about in line with the 1976 average. However, growth in employment in construction in 1977 appears to have been larger at nonunion firms—where wage rates are often lower—than at union firms, and the wage index in total contract construction increased only 5 per cent over the year.

New agreements were negotiated in 1977 for about half of the 10 million workers covered by major union contracts, and key settlements were signed in the steel, metal mining, metal containers, communications, and shipping industries. Most followed the pattern set by the steel settlement—with effective wage increases of 10 to 12 per cent in the first year and about 30 per cent over the life of the contract. First-year wage adjustments for all union workers averaged about 7¾ per cent during 1977.

WAGE AND SALARY INCOME

More rapid increases in employment and in rates of pay during 1977 caused wage and salary income to rise faster than during 1976. However, prices also rose more rapidly, and the increase in real wages and salaries over the four quarters of 1977 was the same as in 1976.

Private wage and salary disbursements grew 12½ per cent over the four quarters of 1977, about the same as the year earlier. Government payrolls grew 7½ per cent—well below growth in the private sector for the second consecutive year. Larger wage and employment gains—particularly in the manufacturing and service sectors—led the growth of nonagricultural personal income over the year. At the same time, the 3-year downward trend in farm income apparently ended. Farmers received higher prices for fruits and vegetables as well as for livestock, and personal income in agriculture rose sharply early in the year. Following this spurt, a continuing erosion of crop prices pushed income down until the Congress passed legislation providing higher price-support payments and larger cash payments to farmers for certain crops. Due in large part to these Government payments, farm income in the final quarter of the year returned to levels of late 1975.

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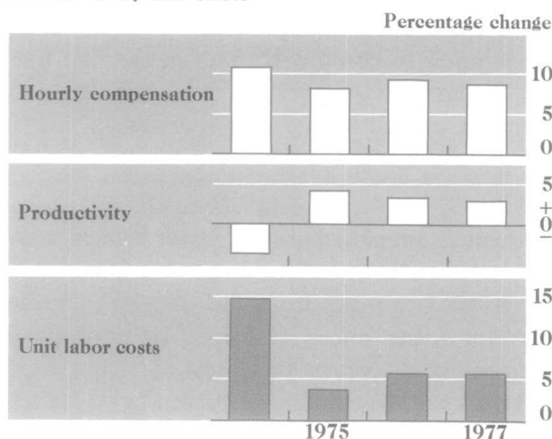
Cost and Price Developments

The dominant influence on the long-run behavior of prices in the U.S. economy has been the trend in unit labor costs. During 1977 these costs rose 5.9 per cent, about the same as in 1976. This advance reflected an historically high rate of increase in wages and other forms of compensation coupled with a growth in productivity that was only slightly above its postwar trend. Paralleling this increase in costs, the underlying rate of inflation remained in the neighborhood of 6 per cent for the second successive year.

COSTS

The exceptionally rapid increase in compensation per hour was the principal pressure on unit labor costs in 1977. For each of the past 2 years, the average annual increase in such compensation has been around 9 per cent—the most rapid of the postwar era except during 1973–75. The past rate of inflation continued to be a significant



Based on U.S. Dept. of Labor data for nonfarm business sector.

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4. Selected measures of prices and costs

Percentage change from year-earlier quarter

Measure	All sectors		Excluding food sector	
	1976 Q4	1977 Q4	1976 Q4	1977 Q4
Consumer price index....	5.0	6.6	6.3	6.4
Wholesale price index....	4.1	6.0	6.6	6.7
Implicit deflator for gross national product.......	4.7	5.8	5.4	5.9
Unit labor cost [1].........	5.8	5.9	—	—

[1] Private nonfarm business sector.

factor in wage increases, since in many sectors wage adjustments are linked—either formally or informally— to previous changes in prices. In addition, large increases in payroll taxes and in minimum wages have contributed to the sharp rise in compensation costs.

During 1977 growth in productivity decelerated to a 2¾ per cent annual rate from the cyclically advanced pace of the previous 2 years—a pattern consistent with this stage of expansion.

PRICES

Although unit labor costs are the single most important determinant of underlying price trends, other factors also affect prices. During 1976, for example, prices of food and energy rose slowly, and this damped the rise in the over-all index; in 1977, on the other hand, there was a marked acceleration in consumer prices in the first half as a result of the weather-induced short supply of farm products and the heavy demand for energy caused by the harsh winter.

Foods

In addition to weather-related supply shortages, two factors contributed to the first-half acceleration in consumer prices: One was a huge increase in coffee prices stemming from the mid-1975 freeze in Brazil, and the other was rising prices of meats. In the second half, as farm supplies increased, the prices of almost all major food groups decelerated. Food prices at the retail level slowed to an annual rate of 3½ per cent, which held the rate of increase in the consumer price index to 4¾ per cent. Prices of consumer foods at wholesale

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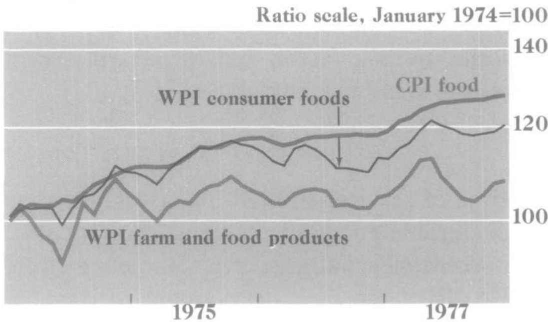
Food prices



U.S. Dept. of Labor data, seasonally adjusted.

also slowed considerably from the first-half rate, and wholesale prices of farm and food products declined. Nevertheless, retail prices of cereal and bakery products increased considerably over the year, mainly because of higher costs of labor, energy, and other material inputs.

Energy

A rapid rise in energy prices exacerbated inflationary pressures early in 1977. Substantial price increases for fuel oil were posted as a result of high prices charged by the Organization of Petroleum Exporting Countries (OPEC) and of the cold winter that caused imports of petroleum to soar. Much of the increase in fuel oil costs reflected the fact that a large proportion of the expenditures for such oil represented more expensive imports. Later in the year the rise slowed, as demand returned to more normal levels and the OPEC price increase had been largely accommodated.

A factor partially restraining price increases during much of 1977 was the slow rise in gasoline prices. Accumulation of large supplies in the spring and only moderate growth of demand led to some declines in gasoline prices in the summer. Nevertheless, for the year as a whole retail prices of gasoline increased about 4½ per cent, about twice the rate during 1976 when the removal of import fees and the rollback of upper-tier crude oil prices had held down prices of gasoline.

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At the retail level prices of natural gas and electricity rose at a double-digit rate during 1977 for the fourth straight year. Higher fuel costs for electric utilities were a factor, but the sharp rise in allowable prices for natural gas was more important.

Other prices

Apart from food, retail prices of services showed the largest increase during 1977, and prices of durable goods the smallest. For services, the biggest component of consumer budgets, price increases were about the same as in 1976. Rent increases accelerated to 6½ per cent, the fastest since 1947. These were moderate, however, compared with the rise in the cost of medical services——led by physicians' fees and hospital charges—of about 9 per cent.

Changes in used-car prices dominated the movement of average prices of durable goods during 1977. Prices of such goods accelerated markedly in the first quarter as used-car prices continued the spectacular climb that had begun in the fall of 1976. The increase in the durable goods index then decelerated significantly as prices of used cars fell at an annual rate of nearly 20 per cent from April through October. New-car prices (domestic models and foreign-made combined) increased steadily during 1977 as a result of strong demands, increased production costs, and the effect of less favorable foreign exchange rates on domestic prices of foreign-made cars. Meanwhile, prices of other durable goods, such as furniture and appliances, continued their moderate rate of increase. Over the four quarters of 1977 prices of durable goods rose 4.7 per cent.

At the wholesale level, prices of finished goods rose 6.8 per cent in 1977; this was more than twice the increase in 1976, and it reflected mainly the behavior of food prices. Prices of producer finished goods accelerated in 1977 due in large part to the rise in prices of machinery and equipment. Late in the year sizable price increases for 1978-model-year trucks were also a major influence in the over-all rise in this index. Prices of consumer finished goods other than food rose 6¼ per cent in 1977 compared with 5 per cent in 1976.

Substantial increases in construction costs—reflecting sharp rises for lumber and building materials—kept prices of intermediate materials from slowing in 1977. These increases, as well as a high level

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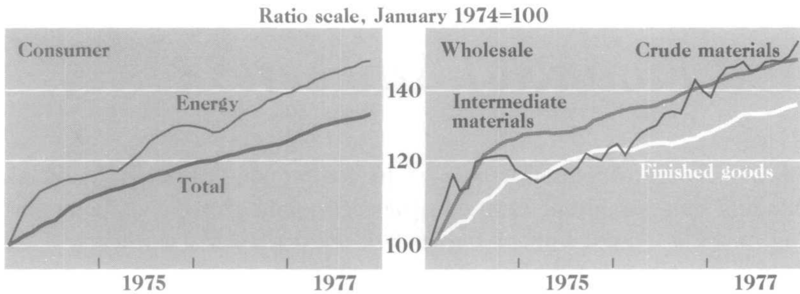
Prices



U.S. Dept. of Labor data, seasonally adjusted.

of building activity, were an important factor in the rise of almost 13 per cent in prices of residential structures during 1977.

The pace of inflation for crude commodities slowed during 1977. Prices of many commodities rose sharply early in the year in connection with the increased tempo of economic activity. By spring, however, excess world capacity for internationally traded basic materials had led to significant downward adjustments in prices; late in the year increases were moderate.

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Monetary Policy and Financial Markets

In 1977 monetary policy sought to foster conditions in financial markets that would encourage further economic growth, while avoiding excessive expansion of money and credit, which would tend to aggravate the Nation's inflationary problems. The public's demand for money, relative to economic activity and interest rates, was stronger during most of the year than in previous years. Although this apparently reflected in part a diminution of the effects of changes in financial techniques used, transactions demands for cash balances also continued to expand in response to rapidly rising nominal incomes and expenditures.

In view of the vigorous growth in the key monetary aggregates, especially *M*-1, the Federal Reserve adopted a gradually less accommodative stance in the provision of reserves. At the same time, demands for credit in the aggregate were exceptionally robust, and total funds raised by all sectors reached a new high relative to GNP. Beginning in the spring, interest rates rose appreciably in short-term credit markets, but credit supplies generally were ample. Although 1977 saw a belated emergence of some normal cyclical pressures on financial markets, conditions at year-end remained conducive to a further expansion in economic activity.

MONEY AND RESERVE AGGREGATES

Each quarter since the spring of 1975, the Federal Open Market Committee (FOMC) has made projections of growth rates over the coming year for the major monetary aggregates—*M*-1, *M*-2, *M*-3—believed to be appropriate for expected economic conditions. The projections, expressed as ranges, are from quarterly-average base periods, which are moved ahead at quarterly intervals. The longer-run ranges are subject to review and modification at any time, and it is understood that short-run factors may cause month-to-month growth rates to fall outside the ranges contemplated for the year ahead.

For the completed periods since the FOMC began to employ 1-year projections, the actual rates of expansion of the monetary

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aggregates have been broadly in line with the announced ranges. However, in contrast to experience earlier in the current recovery, the actual growth of *M*-1 during the 1-year periods ending in each of the four quarters of 1977 was above the midpoint—and in two instances above the upper end—of the ranges specified. This tendency for actual growth of *M*-1 to "overshoot" the projected ranges apparently reflected in part a sharper-than-anticipated slackening in recent quarters of the rate of adoption of money-economizing financial innovations, which intensified demands for transactions balances to support the continued expansion of economic activity.

An effort was made during 1977 to reduce the growth ranges as a means of slowing the rate of inflation to the extent consistent with the objective of supporting the economic expansion. At the FOMC meeting in January 1977 the *M*-1 range adopted for the period from the fourth quarter of 1976 to the fourth quarter of 1977 was 4½ to 6½ per cent, unchanged from the range adopted earlier for the year ending with the third quarter of 1977. However, the lower boundaries of the ranges for the broader aggregates were reduced by ½ of a percentage point each—to 7 to 10 per cent for *M*-2 and 8½ to 11½ per cent for *M*-3. These downward adjustments reflected in part an expected moderation of flows into savings deposits and small-denomination time deposits from the rapid rates of growth in 1975 and 1976; in those years the public had shifted substantial amounts of assets from market instruments to depositary claims as market rates fell to levels considerably below the ceiling rates on deposits. In late 1976 banks and thrift institutions reduced their offering rates and curtailed their promotional activities in an attempt to slow these deposit inflows.

At the April 1977 meeting members of the FOMC agreed that it would be desirable to make a reduction of some kind in the longer-run ranges for monetary growth. It was observed that such action would be a further step toward rebuilding confidence in economic prospects and would be consistent with the President's announced objective of achieving a 2-percentage-point reduction in the rate of inflation by the end of 1979. Moreover, some Committee members observed that the economic situation had strengthened and that inflationary forces had appeared to increase. Also, some of the key monetary aggregates were growing at a relatively strong pace. Because of uncertainties associated with developments in the real

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5. Adopted longer-run growth ranges and actual growth rates of monetary aggregates, 1975–77 [1]

Per cent

Period	M-1	M-2	M-3
March 1975 to March 1976:			
Projected	5–7½	8½–10½	10–12
Actual	5.0	9.6	12.3
1975 Q2 to 1976 Q2:			
Projected	5–7½	8½–10½	10–12
Actual	5.2	9.5	12.0
1975 Q3 to 1976 Q3:			
Projected	5–7½	7½–10½	9–12
Actual	4.6	9.3	11.5
1975 Q4 to 1976 Q4:			
Projected	4½–7½	7½–10½	9–12
Actual	5.7	10.9	12.8
1976 Q1 to 1977 Q1:			
Projected	4½–7	7½–10	9–12
Actual	6.3	10.9	12.8
1976 Q2 to 1977 Q2:			
Projected	4½–7	7½–9½	9–11
Actual	6.6	10.7	12.4
1976 Q3 to 1977 Q3:			
Projected	4½–6½	7½–10	9–11½
Actual	7.8	11.0	12.7
1976 Q4 to 1977 Q4:			
Projected	4½–6½	7–10	8½–11½
Actual	7.8	9.8	11.7

[1] The initial 12-month range established in March 1975 used the average for that month as the base; all subsequent ranges were based on quarterly averages; thus the 12-month period ending with the second quarter of 1976 started with the second quarter of 1975 as the base, and so on.

economy and with pending legislative actions—principally the energy program—the Committee decided to leave the projected growth range for *M*-1 unchanged. At the same time, however, it reduced the upper ends of the longer-run ranges for *M*-2 and *M*-3 by ½ of a percentage point for the period from the first quarter of 1977 to the first quarter of 1978.

In July the FOMC decided to retain the existing ranges for *M*-2 and *M*-3, but it reduced the lower limit of the *M*-1 range by ½ of a percentage point. As in January and April, this action was taken in order to encourage a financial environment conducive to reduction in longer-run inflationary pressures.

Discussion of the longer-run ranges at the October meeting focused on the uncertainty regarding the factors that had caused the growth in *M*-1 to expand vigorously in the second and third quarters.

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Among the possible explanations, it was suggested that the improvements in financial technology that had been acting to retard the growth of demand deposits since late 1974 had moderated, and that a slowing in the pace of substitution, rather than an increase in transactions demands, might have produced much of the observed pick-up in growth of cash balances during the preceding two quarters.

Given the difficulty of anticipating trends in monetary growth at that time, the Committee decided to retain the growth range for *M*-1 at 4 to 6½ per cent for the period from the third quarter of 1977 to the third quarter of 1978. The upper and lower limits of the ranges for the broader aggregates were reduced by ½ of a percentage point to reflect the expected impacts of increases in market rates since the spring on inflows of interest-bearing deposits to banks and thrift institutions. The ranges for *M*-2 and *M*-3 then stood at 6½ to 9 per cent and 8 to 10½ per cent, respectively.

Behavior of the aggregates

Expansion of the monetary aggregates (before revisions based on new benchmark data and new seasonal adjustment factors) exhibited exceptional month-to-month volatility during 1977. This was particularly true for *M*-1. Indeed, a substantial portion of the year's increase in that aggregate occurred in the first month of the second, the third, and the fourth quarters, with only small portions of these surges accounted for by identifiable special factors. For the year as a whole, *M*-1 grew about 2 percentage points faster than in 1976, while the broader aggregates slowed slightly.[1]

During the first quarter of 1977, growth of the aggregates slowed a little from the pace of the previous quarter. The moderate increase in market yields early in the quarter had a larger-than-usual impact on inflows of time and savings deposits to banks and thrift institutions; the firming in market rates came at a time when many of these institutions had already curtailed promotional activity, had cut offering rates on certain types of accounts, and had stopped issuing some categories of deposits in response to very rapid expansion of their deposit inflows. Sharp increases in household spending—both on fuel, made necessary by the severe winter weather, and on purchases

[1] Figures in text and tables are based on data as revised in March 1978.

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6. Growth in monetary aggregates [1]

Per cent

Period	M-1	M-2	M-3
1973	6.2	8.8	9.1
1974	5.0	7.7	7.1
1975	4.4	8.3	11.1
1976	5.7	10.9	12.8
1977	7.8	9.8	11.7
1977—Q1	6.9	10.9	12.2
Q2	8.1	9.0	10.2
Q3	8.1	9.9	11.9
Q4	7.2	8.0	10.6

[1] M-1 = Currency held outside the Treasury, Federal Reserve Banks, and the vaults of all commercial banks, plus demand deposits other than interbank and U.S. Government. M-2 = M-1 plus time and savings deposits at commercial banks other than large negotiable certificates of deposits (CD's) at weekly reporting banks. M-3 = M-2 plus deposits at mutual savings banks, savings capital at savings and loan associations, and shares at credit unions.

NOTE.—Yearly rates of growth are derived by relating daily-average data for the fourth quarter to those for the year-earlier quarter; quarterly rates are seasonally adjusted and annualized.

of durable goods—also diverted funds that might otherwise have flowed into time and savings deposits in this period.

Growth in the narrowly defined money stock picked up in the second quarter—as demand deposits surged in April and then grew at a much slower rate in the ensuing 2 months—but expansion of the broader aggregates again slowed. The April bulge in demand deposits was attributable in small part to some special factors—including earlier-than-normal distribution of social security checks and a build-up of balances before midmonth in anticipation of unusually large personal income tax payments.

However, most of the second-quarter acceleration was probably associated with increasing transactions demands generated by the continued strong pace of economic expansion and the declining influence of financial innovations on the demand for money. The rapid expansion of M-1 in April, in the context of reports of considerable strength in the economy, prompted the FOMC to raise the operating range for the Federal funds rate. Accordingly, that rate rose about 60 basis during late April and the first 3 weeks of May to a level of 5⅜ per cent.

By mid-May yields on 90-day Treasury bills and other money market instruments had increased to levels slightly above the ceiling rates on commercial bank savings deposits, and inflows of these

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deposits weakened each month during the quarter. Savings deposits of State and local governments—generally larger depositors with ready access to alternative money market investments—were particularly affected by the rise in market yields. In contrast, growth in bank time deposits, especially those in denominations of less than $100,000, was strong as ceiling rates remained above yields on market instruments of comparable maturity.

The growth rates in *M*-1 and in the broader aggregates continued rapid in the third quarter. In the first month of the quarter demand deposits again surged, and the rapid growth of the aggregates induced the FOMC to raise the operating range for the Federal funds rate.

In late July and early August short-term market interest rates rose in association with movements in the Federal funds rate. As a result, businesses and State and local governments increasingly found yields on market instruments more attractive than allowable rates on savings deposits, and deposit levels in these accounts showed no growth or declined somewhat during the quarter. Individuals and nonprofit organizations did not react so promptly, however, and flows into their savings accounts were larger than in the previous quarter. Although the time deposit component of *M*-2 accelerated during the third quarter, much of this growth reflected an increase in large time deposits not subject to rate ceilings, which more than offset a fall-off in flows into small-denomination time accounts.

Deposit flows to thrift institutions picked up during the summer months as these institutions reinstated long-term accounts at ceiling rates and increased promotional activities designed to retain or attract maturing "wild card" accounts. In July 1973 banks and thrift institutions had been permitted to issue deposits in minimum denominations of $1,000 with maturities of 4 years or more and with offering rates exempt from regulatory ceilings. Before ceilings were reimposed in November of that year, all depositary institutions had attracted about $27 billion of these "wild card" deposits. As these accounts began to mature in July 1977, the thrift institutions—with generally higher ceiling rates than commercial banks—apparently were able to attract a large portion of these interest-sensitive funds from banks while also retaining a large share of their own accounts.

With short-term interest rates continuing to increase late in the third quarter and early in the fourth, the monetary aggregates began to slow somewhat. Rapid expansion of *M*-1 in the first month of

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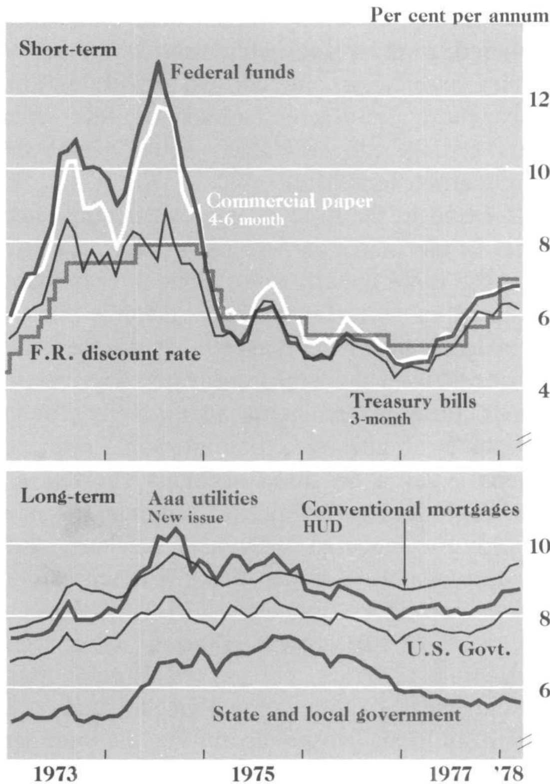
Interest rates



Monthly averages except for conventional mortgages, which are based on quotations for one day each month. Yields: U.S. Treasury bills, market yields; prime commercial paper, dealer offering rates; conventional mortgages, rates on first mortgages in primary markets, unweighted and rounded to nearest 5 basis points, from Dept. of Housing and Urban Development; Aaa utility bonds, weighted averages of new publicly offered bonds rated Aaa, Aa, and A by Moody's Investors Service and adjusted to a Aaa basis; U.S. Govt. bonds, market yields adjusted to 20-year constant maturity by U.S. Treasury; State and local govt. bonds (20 issues, mixed quality), *Bond Buyer.*

this quarter again was followed by slower expansion in the subsequent 2 months. In part reflecting the earlier increases in interest rates, the growth of the narrow money stock over the fourth quarter as a whole, at a still substantial 7¼ per cent annual rate, was somewhat below the rapid pace of the second and third quarters.

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With yields on market securities for most of the fourth quarter at or above ceiling rates on deposits with maturities of less than 4 years, inflows of savings and small-denomination time deposits to banks and thrift institutions abated further. This slower growth was offset in part by the continuing expansion of large time deposits other than negotiable CD's at large weekly reporting banks, so the broader aggregates decelerated only moderately.

In the second half of the year, banks relied heavily on managed liabilities to finance strong growth of loans in the face of slowing inflows of deposits subject to rate ceilings. Large time deposits increased by more than $20 billion in this period after having declined almost continuously since early 1975. More than half of this increase was in large-denomination time deposits, which are included in *M*-2 and *M*-3. Funds from nondeposit sources—including Federal funds purchased from sources other than banks, securities sold under repurchase agreements, Euro-dollar borrowings, loans sold to affiliates, and other liabilities for borrowed money—also grew rapidly; over this period, such funds expanded $8 billion. None of these nondeposit sources is included in the major monetary aggregates.

Financial technology and the growth of *M*-1

During the last three quarters of 1977 the narrowly defined money stock expanded rapidly even as growth in GNP moderated and short-term market interest rates rose substantially. Over all, the behavior of *M*-1 during these three quarters was about in line with the relationship among changes in money, income, and interest rates that had prevailed prior to 1975.

This return to a pattern consistent with the historical relationships contrasts with the first 2 years of the current recovery, when *M*-1 increased at a much slower rate than past experience would have suggested. In this earlier period, regulatory actions as well as expanded efforts of the public to adopt financial innovations designed to economize on cash balances contributed to a substantial retardation of the growth in *M*-1. More recently, however, the constraining effects of these factors appear to have diminished.

By adding new classes of economic agents that are permitted to hold savings accounts and by facilitating the use of such accounts

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7. Growth in components of *M*-1[1]

Per cent

Period	*M*-1	Member bank demand deposits	Currency	Nonmember bank demand deposits
1975	4.4	2.2	8.9	4.8
1976	5.7	3.1	9.6	7.6
1977	7.8	5.3	9.5	11.3
1977—Q1	6.9	2.5	8.5	14.9
Q2	8.1	5.0	8.8	13.8
Q3	8.1	8.1	9.1	6.2
Q4	7.2	4.9	10.3	8.6

[1] Yearly rates of growth are derived by relating daily-average data for the fourth quarter to those for the year-earlier quarter; quarterly rates are seasonally adjusted and annualized.

for third-party payments, regulatory changes have played an important role in recent years in dampening expansion of *M*-1. For example, it is estimated that NOW accounts, business and State and local government savings accounts, telephonic transfers from savings to demand deposits, and preauthorized payments from savings accounts depressed *M*-1 growth by about 1½ percentage points from late 1975 to late 1976. Reflecting principally a slower growth in NOW accounts and the completion by many firms of a one-time transfer of a portion of their demand balances to business savings accounts, these factors probably depressed *M*-1 growth by no more than 1 percentage point in 1977. In general, the constraining effects of these regulatory factors appear to have been disappearing gradually as the public has adjusted its stock of financial assets to the new regulatory environment.

In addition to the effects of recent regulatory changes, unusually high interest rates in 1973 and 1974 had provided businesses and individuals with an increased incentive for updating and improving cash-management techniques and for adopting more efficient payment practices. Through increased use of such cash-management techniques as remote disbursing and wire transfers, nonfinancial corporations were especially successful in trimming their demand balances.

Implementation of more efficient cash-management practices, whether by businesses or individuals, tends to lower the desired stock of demand balances associated with a given level of economic activity and interest rates. Such practices help to explain the shortfall in *M*-1 growth in 1975 and 1976. However, once the lower desired stock

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of money balances has been reached, the rate of growth in *M*-1 should return to a range more consistent with historical experience.

With interest rates significantly below their 1974 peak levels the incentives for introducing more sophisticated cash-management practices appear to have diminished. As the rate of implementation of cash-economizing financial innovations has generally declined, the drag on *M*-1 growth—which was particularly strong in the early part of the current recovery—appears to have abated somewhat.

Member bank reserves

During 1977 member banks' demands for reserves reflected the quickening in the expansion of deposits—particularly demand deposits, which have relatively high reserve requirements. The resultant increase in required reserves put upward pressure on the Federal funds rate—the rate paid on overnight loans by banks and others—as member banks sought funds to meet their reserve needs. Despite several increases in the FOMC's operating ranges for the Federal funds rate, which led to a cumulative rise in the rate of about 2 percentage points over the year, the System supplied reserves to member banks at a considerably faster pace than in the preceding 2 years.

Part of the increase in such reserves was reflected in larger borrowings at the discount window, which many banks found to be an attractive source of short-term funds. Despite increases in the discount rate in August and October the Federal funds rate exceeded the discount rate by as much as 10 to 60 basis points after midyear. Consequently, although total reserves grew at a 5¼ per cent pace during the year, nonborrowed reserves increased only 2¾ per cent, with increased borrowings accounting for the difference.

INTEREST RATES

Interest rates generally increased in 1977, after having declined, on balance, over the preceding months of the current economic expansion. Short-term market interest rates led the upswing, rising around 2 percentage points from year-end 1976 to year-end 1977. In long-term credit markets, yields on corporate and Treasury bonds advanced 60 to 75 basis points, while primary home mortgage rates moved up about 20 to 30 basis points. Yields on municipal securi-

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ties, on the other hand, remained about unchanged or moved down somewhat during the year, reflecting some further reduction from the high level of risk premiums reached in 1975 as well as strong demands by institutional investors for tax-exempt securities.

In the early weeks of 1977 nearly all short- and long-term interest rates rose significantly, reversing the large decline that had been recorded in the closing weeks of 1976. Upward rate pressures were intensified as market expectations regarding prospective credit demands apparently were raised in response to indications of renewed strength in the economy and the likelihood of a larger Federal deficit arising from the administration's proposed tax rebate plan.

By early February most market interest rates had adjusted to the change in market outlook, and there was little further net movement in either short- or long-term rates until April, when accelerating growth in *M*-1 initiated a period of rapid expansion in this key aggregate that continued through October. With *M*-1 expanding at a pace well above the upper limit of the longer-run range set by the FOMC, the Federal Reserve did not fully accommodate the associated increase in demands for bank reserves. As a consequence, the Federal funds rate moved up in several successive steps from about 4¾ per cent in April to 6½ per cent in October. Other short-term market interest rates rose by roughly similar amounts.

Member bank borrowing at the Federal Reserve's discount window increased substantially during the summer, as short-term interest rates moved up to levels well above the 5¼ per cent discount rate, which had prevailed since November 1976. To restrain such borrowing, the Federal Reserve raised the discount rate to 5¾ per cent in late August. Following an additional advance in market rates in September and October, it raised the discount rate again—to 6 per cent—in late October.

In contrast to the rise in short-term interest rates, yields in long-term credit markets generally edged lower over the spring and summer. The modest downward pressures on most long-term rates appeared attributable largely to adjustments in expectations occasioned by the withdrawal of the administration's tax rebate plan and by indications of a slowing in the economic expansion and a moderation in the rate of inflation. Demands of institutional investors for long-term bonds, in addition, remained quite substantial throughout this period. Moreover, nonbank thrift institutions, with large

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inflows of deposit funds, were able to accommodate strong demands for mortgage credit at only slightly higher interest rates. In late summer and early fall, however, long-term yields generally began to rise, responding in part to the continued upward movement of short-term rates.

With monetary expansion moderating after early October, the Federal funds rate remained near 6½ per cent between mid-October and year-end. Given this stability, other short-term rates showed little net change throughout this period. Long-term interest rates, on the other hand, after having remained unchanged for a time, resumed their upward movement during the latter half of the quarter. These increases apparently were in response to changes in expectations, given evidence of greater strength in the economy and the administration's announcement of its intention to propose substantial cuts in taxes. The marked slowing of inflows into thrift institutions, meanwhile, contributed to upward pressures on mortgage rates.

Most short- and long-term rates rose somewhat further in early January 1978, as the weakening in the foreign exchange value of the dollar prompted the Federal Reserve to increase the discount rate to 6½ per cent and to allow the Federal funds rate to rise to around 6¾ per cent. Tax-exempt bond yields and primary mortgage rates, however, increased relatively little.

The rise in interest rates in 1977, especially in short-term rates, conformed to the patterns experienced in past periods of appreciable economic expansion. By contrast, over the earlier part of the current recovery most interest rates had fallen rather than risen. The return of late to a more typical cyclical pattern appears attributable to the reversal of a number of factors that had lowered interest rates in 1975 and 1976. First, after having previously declined and having supported a moderation in inflationary expectations, the rate of price advance stabilized in 1977, thus limiting any further reduction in inflation premiums in interest rates. Second, the Federal Reserve's efforts to restrain monetary growth have added to general upward pressures on interest rates. Finally, as discussed in greater detail later, credit demands strengthened substantially, and credit flows during the year reached record levels relative to GNP.

Even so, by early 1978 net increases in interest rates over the current recovery were still well below those that had occurred during comparable periods in other post-World-War-II business cycles.

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Short-term rates stood only about ¾ to 1 percentage point above their levels at the cyclical trough of the economy in March 1975, while most long-term interest rates were little changed or had declined on balance.

AGGREGATE FLOWS OF FUNDS

Net funds raised in U.S. credit and equity markets by all nonfinancial sectors reached an estimated $336 billion in 1977; relative to GNP this represented a new high of 18 per cent. Household borrow-

8. Net funds raised in credit and equity markets

Billions of dollars

Sector, or type of instrument	1974	1975	1976	1977	1977[1] H1	1977[1] H2
Total funds raised	**229.0**	**219.5**	**296.8**	**398.6**	**369.2**	**427.9**
By sector:						
Nonfinancial sectors	*189.6*	*205.6*	*268.3*	*335.9*	*306.2*	*365.6*
U.S. Govt	11.8	85.4	69.0	56.8	40.3	73.2
Other	*177.8*	*120.2*	*199.2*	*279.1*	*265.9*	*292.4*
Nonfinancial business	97.0	47.3	74.6	111.2	109.6	112.8
State and local govt	16.2	11.2	14.6	24.8	21.7	27.9
Households	49.2	48.6	89.8	130.9	129.6	132.2
Foreign	15.4	13.2	20.3	12.2	5.0	19.5
Financial sectors	*39.4*	*14.0*	*28.6*	*62.7*	*63.1*	*62.3*
Sponsored credit agencies	17.3	3.2	2.9	5.7	7.8	3.7
Mortgage-pool securities	5.8	10.3	15.7	20.4	17.9	22.9
Private financial intermediaries	16.3	.4	10.0	36.5	37.4	35.7
By type of instrument:						
U.S. Govt. securities	*34.3*	*98.2*	*88.1*	*84.2*	*68.4*	*99.9*
Public debt and budget agency securities[2]	11.9	85.5	69.1	56.8	40.4	73.3
U.S. Govt.-related	*22.4*	*12.7*	*19.0*	*27.3*	*28.0*	*26.6*
Sponsored credit agency securities	16.6	2.3	3.3	6.9	10.1	3.7
Mortgage-pool securities	5.8	10.3	15.7	20.4	17.9	22.9
Corporate and foreign bonds	23.9	36.3	37.0	31.7	26.8	36.5
Corporate equities	4.8	10.2	12.2	9.9	10.0	9.8
Tax-exempt securities[3]	17.1	13.6	15.1	28.1	20.3	27.9
Mortgages	*60.5*	*57.2*	*86.8*	*129.7*	*119.5*	*139.8*
Residential	40.2	41.4	67.0	100.1	93.8	106.3
Other	20.3	15.8	19.8	29.6	25.7	33.5
Bank loans n.e.c.	38.4	−14.4	6.7	30.4	28.9	31.8
Open market paper and Rp's	17.8	.5	13.0	26.1	32.9	19.3
Consumer credit	10.2	9.4	23.6	35.6	35.5	35.7
Loans from Federal home loan banks	6.7	−4.0	−2.0	4.3	3.5	5.2
Other[4]	15.3	12.5	16.3	18.6	15.3	21.9

[1] Semiannual data are seasonally adjusted annual rates.
[2] Includes mortgages.
[3] Short- and long-term borrowing also includes industrial pollution control bonds, which are treated as business borrowing.
[4] Includes mutual fund shares.
NOTE.—Data from Federal Reserve flow of funds accounts. Rp's = repurchase agreements.

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9. Net funds supplied in credit and equity markets

Billions of dollars

Sector	1974	1975	1976	1977	1977[1]	
					H1	H2
All sectors	**229.0**	**219.5**	**296.8**	**398.6**	**369.2**	**427.9**
All sectors to nonfinancial sectors	189.6	205.6	268.3	335.9	306.2	365.6
All sectors to financial sectors	39.4	14.0	28.6	62.7	3.1	62.3
U.S. Govt. and sponsored credit agencies	29.6	19.3	13.9	17.3	15.6	19.0
Mortgage-pool securities	5.8	10.3	15.7	20.4	17.9	22.9
Federal Reserve System	6.2	8.5	9.8	7.1	4.6	2.7
Foreign sources	11.7	10.8	18.0	42.3	31.0	53.7
Private financial intermediaries	*132.0*	*129.3*	*199.6*	*249.5*	*239.9*	*259.1*
Commercial banks	64.7	27.6	58.0	79.8	80.6	79.1
Thrift institutions	27.1	52.1	71.8	86.8	85.1	88.4
Insurance and pension funds	36.7	50.8	61.6	71.4	68.8	73.9
Other	3.5	−1.1	8.1	11.5	5.3	17.7
Private domestic nonfinancial sectors	*43.7*	*41.2*	*40.0*	*61.9*	*53.2*	*70.5*
Households	37.5	23.0	11.4	20.7	19.9	21.5
Nonfinancial business	2.2	14.2	15.3	17.5	13.6	21.3
State and local governments	4.0	4.1	13.3	23.7	19.7	27.6
Memo: Net change in deposits and currency held by private domestic nonfinancial sectors	75.7	97.1	130.1	143.6	127.2	160.0

[1] Semiannual data are seasonally adjusted annual rates.
NOTE.—Data from Federal Reserve flow of funds accounts.

ing led the surge in credit demands. Much of this borrowing was in home mortgages and reflected very large sales of existing homes and the highest level of single-family housing starts in more than two decades. Such borrowing expanded much more than capital expenditures on new and existing homes, as households—through refinancings, junior mortgages, and transactions in existing homes—drew upon their increased equity associated with the large rise in house prices in recent years. Flows of consumer credit rose vigorously as well, supporting substantial increases in consumer spending.

External financing by nonfinancial businesses also increased markedly as the gap between capital outlays and internally generated funds widened from the modest level in 1976. The appreciable expansion in both long- and short-term financing reflected mainly increases in commercial and industrial mortgage borrowing and in loans, other than mortgages, from commercial banks.

Although net Federal borrowing in 1977 was noticeably less than in the previous 2 years, it remained high by historical standards. Substantial foreign acquisitions of U.S. Government securities—mainly

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in conjunction with support of the dollar by foreign central banks—and large acquisitions of such obligations by State and local governments helped to limit interest rate pressures in the U.S. Government securities market.

Although their aggregate surplus expanded, State and local governments raised an increasing volume of funds in credit markets. A significant portion of such borrowing was for advance refundings of outstanding obligations; the proceeds of such refundings were reinvested in nonmarketable Treasury obligations to satisfy arbitrage regulations of the Internal Revenue Service.

As is usual, private financial institutions provided the bulk of funds advanced to nonfinancial sectors. Ample deposit growth during most of 1977 enabled commercial banks and thrift institutions to expand loan portfolios sharply, on balance, even though inflows of savings and small-denomination time deposits slowed in the latter part of the year. The depositary institutions liquidated U.S. Government securities and increased their reliance on managed liabilities in order to accommodate vigorous loan demands in the face of this reduction in deposit growth. Finance companies provided increased amounts of short- and intermediate-term credit to both businesses and consumers during the year, stepping up their borrowings in the bond and commercial paper markets to do so. Life insurance companies and pension funds—traditionally long-term investors—also increased their lending in 1977, as their cash flows continued to expand.

Household sector

Households were the major borrowers in 1977; their borrowing, which was a record $131 billion, represented two-fifths of the net funds raised in credit and equity markets by all nonfinancial sectors. With the strong expansion in mortgage and consumer credit, the ratio of outstanding household debt to annualized disposable personal income rose to a record of more than 70 per cent by year-end. At the same time scheduled repayments of principal and interest on such debts, relative to disposable income, approached earlier highs.

Meanwhile, the real value of the household sector's financial net worth—financial assets less liabilities, deflated by the consumer price index—declined somewhat, reflecting in part an erosion of common stock values during the year. However, the real value of the sector's

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total net worth, including tangible assets, changed little, as prices of homes continued to increase at a faster pace than prices of most consumer goods and services.

Despite some apparent deterioration in the financial position of the household sector, there were few direct indications of increasing financial strains. At the year-end delinquency rates on short- and intermediate-term consumer instalment debt were about a fifth below those at the peak of the recession. Moreover, delinquency and foreclosure rates on home mortgages declined during the year.

Consumer instalment credit expanded sharply again in 1977, somewhat more than the substantial growth in sales of consumer durable goods. Commercial banks provided more than one-half of the total expansion of such debt, with finance companies and credit unions supplying most of the balance. Reflecting strong auto sales, particularly in the first half of the year, auto credit led the expansion in instalment borrowing. Rates paid on short- and intermediate-term consumer credit, which normally move sluggishly, increased only slightly over the course of the year.

As in 1976, home mortgages accounted for the major share of household borrowing, lengthening the maturity of this sector's liabilities. Much of the increase in mortgage debt was associated with the rapid pace of homebuilding. Nevertheless, the net increase in household mortgage debt exceeded the record volume of household capital expenditures on new and existing homes by an unusually wide margin—on the order of $15 billion, compared with a high of about $6 billion in 1973.

The unprecedented difference between home mortgage debt formation and capital expenditures on homes apparently was associated primarily with record sales of existing homes at high and rising prices. Not all home-sellers invested all their housing equity—much of which had been accumulated during the rapid inflation in home prices since 1970—in other dwellings. In a period of ample mortgage funds, many households opted instead for as large a mortgage as lenders would permit on homes purchased, thus raising funds through the mortgage market to be used for purposes other than housing outlays. To a lesser degree, the surge in mortgage indebtedness represented greater use of second mortgages and a larger number of refinancings of first mortgages by homeowners who had not changed residences.

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Direct mortgage investments by savings and loan associations accounted for more than half of the record volume of home mortgage funds advanced to households in 1977. Rapidly expanding issues of "pass-through" securities—guaranteed by the Government National Mortgage Association or the Federal Home Loan Mortgage Corporation and representing shares in mortgage pools—accounted for about a fifth of the total; substantial amounts of these securities were acquired by pension and retirement funds and a wide variety of other investors. The share of home mortgage funds provided directly by commercial banks rose to nearly a fifth of the net increase in such mortgages outstanding, while mutual savings banks and households accounted for most of the remaining 10 per cent.

The record volume of home mortgage funds was raised with relatively little upward pressure on interest rates. Average interest rates on new commitments for conventional home mortgages in the primary market increased only about 20 basis points during the year. However, in secondary markets for Government-underwritten mortgages, where returns move more closely with corporate bond yields, rates rose by 60 basis points or more.

Nonfinancial business sector

Although net funds raised by nonfinancial businesses in credit and equity markets reached a record $111 billion in 1977, the volume of funds obtained remained below previous highs relative to GNP. Increased availability of internal funds, largely through moderately improving profitability, supplemented external financing.

As corporations stepped up their capital outlays during the year, the financing gap—the excess of capital expenditures, including inventory investment, over internally generated funds—widened considerably. While quite a bit larger than during the two previous years, the gap was still smaller than the highs recorded in 1973 and 1974. Businesses were generally able to finance this expanding gap without significantly eroding the strength of balance sheets built up over the two previous years. The ratio of corporate liquid assets held to short-term liabilities edged up further over the year, although the ratio of short- to long-term debt rose somewhat.

Financing in short- and intermediate-term markets picked up noticeably during the year, as the sum of business loans at banks and of commercial paper issued by nonfinancial firms expanded by more

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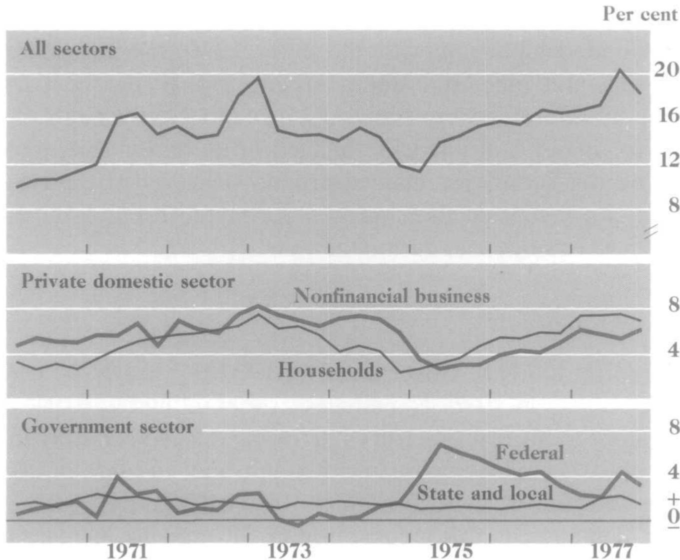
Funds raised relative to GNP



Based on flow of funds data (Federal Reserve) and on GNP data from U.S. Dept. of Commerce. Seasonally adjusted.

than 13 per cent. Meanwhile, business loans at finance companies grew at an even faster rate; such loans were used in large part to carry inventories at automobile dealers.

Despite the step-up in short-term indebtedness, long-term financing predominated over the year. Public bond offerings by higher-rated industrial corporations, many of which had largely completed balance-sheet restructuring, were below the totals in the two previous years. But private placements of corporate bonds, associated primarily with debt issues of lower-rated manufacturing and other industrial concerns, continued at a very high rate. The risk premiums in the interest rates charged lower-rated borrowers remained relatively small, as funds were readily available from life insurance companies and pension funds—the major investors in private placements. Income-property mortgages, to finance expansion of multifamily and commercial building activity, provided an additional important source of long-term funds for nonfinancial businesses.

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The net amount of equities issued by nonfinancial corporations in 1977 was moderately less than in either 1975 or 1976, and it remained small in comparison with the early 1970's. With values of manufacturing and industrial stocks eroding by 10 per cent or more, new equity offerings were reduced substantially. By contrast, price indexes for major utility stocks changed little, on balance, and equity issues by this industry remained around the level of the two previous years. As a consequence, utilities accounted for two-thirds of the value of new equities sold during the year.

Federal Government

Net funds raised by the U.S. Government in 1977 fell nearly 20 per cent below the volume in 1976. Nonetheless, the total matched 1944 as the third highest in history. Treasury borrowing declined sharply in the early part of 1977, reflecting greater-than-seasonal strength in tax receipts and a shortfall in Federal outlays. In the latter part of the year, however, demands by the Treasury on credit markets increased along with an expansion in the Federal deficit. Net borrowing by Federally sponsored credit agencies rose slightly over the year, mainly as a result of expanded support of the mortgage market in the fourth quarter by such housing-related agencies as the Federal Home Loan Bank System and the Federal National Mortgage Association.

The Treasury continued in 1977 to pursue a financing policy designed to lengthen the maturity structure of its debt. To do this, it sold cycles of intermediate-term notes and sold both a long-term note and a bond in its midquarterly refundings. As a result the Treasury was able to reduce the quantity of bills outstanding—the first substantial reduction in any calendar year since 1953. Although sales of Treasury bills picked up appreciably in the final 3 months of the year, they still accounted for only one-fourth of total cash raised through marketable offerings in that quarter.

The foreign sector represented a major source of demand for Treasury securities during 1977; it accumulated more than half of the net increase in the Federal debt. Meanwhile, State and local government net purchases accounted for one-fourth of the net change in the total. The banking system, which over the two previous years had acquired record amounts of Treasury securities, reduced its holdings on balance.

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State and local governments

State and local governments borrowed heavily during 1977, although they had a record aggregate operational surplus for the year of almost $14 billion—excluding net savings by social insurance funds. Despite lingering difficulties of some governmental units, such as New York City, the surpluses were fairly widespread. A few States—particularly Texas and California—experienced very large surpluses.

Net borrowing by these governments in 1977 reached an unprecedented $25 billion, nearly double the volume of 1976. Although net offerings of short-term securities were light, reflecting in part the more conservative financial practices of many governmental units, issues of long-term, tax-exempt debt were swollen by advance refundings of outstanding high-cost obligations. Such refundings accounted for about a fifth of the gross offerings of municipal securities over the year. In addition, some State and local units, especially housing and hospital authorities, took advantage of the favorable environment in the municipal securities market to obtain funds for current or future capital outlays.

The large supply of municipal securities was readily absorbed by the market. Property and casualty insurance companies, with rising cash flows and earnings, made record investments in State and local government obligations, while commercial banks, with increased taxable earnings, acquired more of these securities than in any other year except 1971. Individuals also made larger purchases of tax-exempt obligations, partly through municipal bond funds.

Given the extremely strong demands for State and local government securities, average yields on municipal bonds declined by about 40 basis points over the year—in contrast to the moderate increases posted for yields on long-term Treasury and corporate issues. The decline reflected largely a reduction in yields on lower-rated municipal issues as the risk premium on such issues narrowed considerably, owing to increased confidence on the part of investors that stemmed from the general improvement in the financial positions of cities and States and from court decisions reaffirming the rights of bondholders.

Private financial intermediaries

Private financial intermediaries provided about three-fourths of the total volume of funds raised by all nonfinancial sectors of the econ-

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omy in 1977. This was roughly the same proportion as in 1976, but well below levels of 90 per cent or more recorded in the early 1970's. Total loans and investments of commercial banks expanded by more than 10 per cent during 1977, as bank loans increased about 14 per cent, while investments rose only moderately. Reductions in bank holdings of Treasury issues offset most of the increase in other securities, which was concentrated mainly in tax-exempt issues.

All major loan categories at commercial banks expanded briskly. Growth of consumer and real estate loans was particularly rapid; these components accounted for more than half of the net increase in bank loans for the year. Reflecting both the willingness of business firms to assume more short-term debt and the more aggressive loan policies at large banks, business loans at banks grew by about 13 per cent, a markedly larger increase than in 1976. Business loans increased quite rapidly at smaller banks over most of the year. At large banks, in contrast, where business loans had declined from early 1975 to late 1976, growth in these loans was moderate in the early months of 1977 and then accelerated in the latter part of the year.

During the first half of 1977 the rise in commercial bank credit was supported primarily by growth in deposits subject to rate ceilings, with bank holdings of Treasury securities expanding along with loans. After midyear, however, banks reduced their portfolios of Treasury securities and increased their reliance on managed liabilities in order to meet stronger loan demands as inflows of savings and small-denomination time deposits slowed. Large-denomination time deposits —which are not subject to rate ceilings—rose sharply, particularly in the fourth quarter. During the latter part of the year banks also relied more heavily on nondeposit sources of funds, especially purchases of Federal funds from nonbank sources and sales of securities under repurchase agreements.

Deposit growth at the nonbank thrift institutions was quite large for 1977 as a whole, but toward the year-end it slowed as market rates of interest moved above ceiling rates for most deposit categories. Savings and loan associations utilized their large net deposit inflows, and also increased their reliance on borrowed funds, to help meet the extraordinarily strong demands by households for home mortgage funds. Borrowings from the Federal home loan banks expanded significantly, particularly in the fourth quarter. Savings and loan

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associations also increased their borrowing from other sources, partly through issues of mortgage-backed bonds, but they did not reduce their liquid asset holdings significantly. By year-end, with mortgage demands continuing strong, outstanding mortgage commitments (including loans in process) at savings and loan associations reached a record $35 billion, $10 billion higher than a year earlier.

Mutual savings banks concentrated their cash flows largely on meeting high levels of mortgage demands. The over-all supply of investable funds at savings banks, though smaller than at savings and loan associations, was still quite large by historical standards. Moreover, residential mortgage loans were attractive long-term investments for these institutions. In all, the industry channeled four-fifths of its total deposit growth, including interest credited, into mortgages and mortgage-backed, pass-through securities. Meanwhile, the savings banks substantially increased their outstanding commitments to make mortgage loans.

A 20 per cent increase in deposits at credit unions supported a strong increase in lending activity at these institutions. Credit unions accounted for more than one-fifth of the total expansion in consumer instalment credit—a somewhat smaller share than in 1976, but still well above their market share prior to 1975.

Life insurance companies continued to acquire large amounts of corporate bonds through private placements in 1977. In addition, the outstanding commitments of these companies to acquire long-term, income-property mortgages rose to a record high, as construction of commercial buildings expanded. Outstanding commitments for residential mortgages, however, remained well below the levels of the early 1970's. Property and casualty companies, as noted earlier, greatly increased their acquisitions of tax-exempt securities.

Net accumulation of financial assets by private pension funds increased dramatically during the year, as cash flows into these funds continued to be buoyed by increased funding requirements of the Employee Retirement Income Security Act. Pension funds acquired large amounts of equities, Treasury securities, and corporate bonds, as well as appreciable amounts of mortgage-backed securities. Meanwhile, State and local government retirement funds, which were also experiencing relatively large cash flows, concentrated their investments in corporate bonds and Treasury securities.

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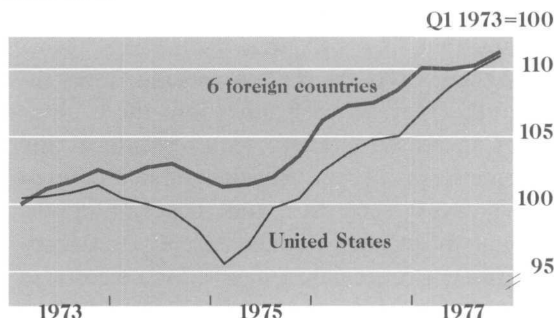
International Developments

In 1977 the major industrial trading partners of the United States—that is, Canada, France, Germany, Italy, Japan, and the United Kingdom—made little progress in recovering from the 1974-75 recession.

Estimated growth in real GNP in those countries averaged only about 3 per cent in 1977, and in most other countries in the Organization for Economic Cooperation and Development (OECD) growth rates were even lower. Industrial production was especially weak. After rapid growth in the first quarter, output grew slowly or declined, although there was a significant pick-up in Germany and Japan late in the year. Unemployment rates in many countries were higher than they had been at the trough of the recession.

Final domestic demand in the major industrial countries grew even more slowly than GNP in 1977. Investment expenditures were especially weak, and neither government nor private consumption expenditures were strong enough to take up the slack, even though the latter showed signs of increasing strength after midyear in several countries. Inventory accumulation fell short of the pace set in

Real GNP



Figures for foreign GNP are weighted-average, seasonally adjusted quarterly indexes of real GNP for Canada, France, Germany, Italy, Japan, and the United Kingdom; weights are average shares in 6-country total of real GNP.

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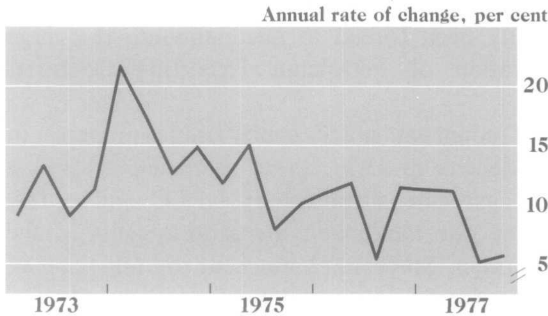
Inflation in 6 foreign countries



Weighted-average increases in consumer price indexes of Canada, France, Germany, Italy, Japan, and the United Kingdom; weights are shares in 6-country total of real GNP.

1976 and may even have been negative. Net exports, on the other hand, made a significant contribution to growth in almost all major foreign countries, as they had in 1976.

The slow rate of recovery in economic activity abroad, on the other hand, permitted progress in controlling inflation, as consumer prices in all countries except Canada rose more slowly in 1977 than they had in 1976. In Italy and Japan the rate of inflation fell by 6 or more percentage points, while in France, Germany, and the United Kingdom progress was less but nevertheless significant. In Canada, where inflation had been in the low end of the range for major countries in 1976, the rate of price increase rose to nearly 10 per cent per annum. While the generally lower rates of inflation abroad allow more room for policies designed to promote economic activity, inflation rates are still high by historical standards and, in some cases, continue to constrain such policies.

In part because of the slow growth in economic activity, the current-account positions of the six major foreign industrial countries showed smaller deficits or larger surpluses in 1977 than in 1976. For countries such as Great Britain, France, and Italy, which had experienced difficulty in financing deficits in 1976 at stable exchange rates, this was a welcome adjustment in their external positions. On the other hand, the nearly unchanged $3½ billion current-account sur-

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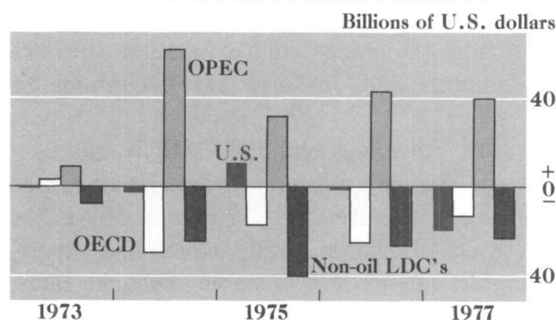
plus for Germany and the enlarged—$11 billion—current-account surplus for Japan increased considerably the pressure on other countries that had already been forced to accommodate the large surplus of the Organization of Petroleum Exporting Countries (OPEC).

Though a number of countries made considerable progress in adjusting their external deficits in 1977, there remained a striking imbalance between the aggregate surpluses of OPEC and a few industrial countries on the one hand, and the large deficits of the rest of the world on the other. Since 1973 much of the financing of external deficits has come from commercial bank lending. Despite misgivings about the sustainability of such a large capital flow, much of it short term, the process thus far has been relatively smooth, and many of the largest debtors have been able to reduce their need for such financing.

Nevertheless, additional financing facilities—to supplement the existing channels should they be required—are much needed to stabilize the international economic environment. A major step to fill that need is the proposed Supplementary Financing Facility of the International Monetary Fund (IMF). Agreement was reached by participating countries to provide $10 billion for such a facility (called the Witteveen Facility), and the administration has requested that the Congress approve U.S. participation in the amount of $1.7 billion.

Structure of world current-account balances



Data are from the U.S. Treasury, the IMF, the OECD, and national sources. LDC's are "less developed countries." OPEC refers to the Organization of Petroleum Exporting Countries.

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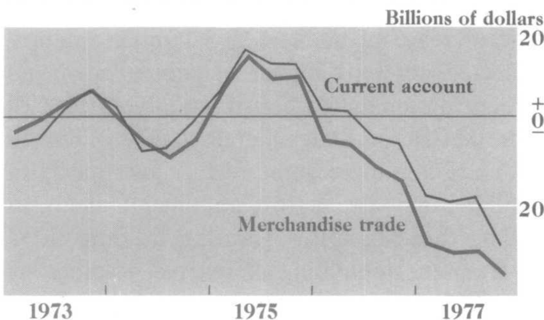
U.S. INTERNATIONAL TRANSACTIONS

With foreign economic activity almost flat during much of 1977, the U.S. trade and current accounts moved sharply into deficit. Imports of both petroleum and other products grew rapidly as recovery in the United States proceeded, while exports were only slightly above their 1976 level. The rise in the trade deficit was offset only in part by an increase in net receipts from military and service transactions. The resulting $20 billion current-account deficit was much larger than had been expected, and it contributed to downward pressures on dollar exchange rates in the fourth quarter of 1977.

In the course of the year growth in foreign official assets held in the United States was more than adequate to cover the current-account deficit. This inflow reflected efforts by foreign authorities to avoid appreciations of their currencies resulting from capital inflows or large current-account surpluses. Private capital flows in the U.S. accounts registered a sizable net outflow in 1977, and in addition the errors and omissions in the accounts appear to have shifted from a net inflow of nearly $10 billion in 1976 to a $3 billion outflow in 1977.

The increase in the merchandise trade deficit to $31 billion in 1977 from $9 billion in 1976 reflected a 22 per cent increase in the value of imports, but only a slight increase in exports. Oil accounted for about one-third of the rise in imports, as consumption rose and stocks were built to record levels. The expansion in imports other than oil in 1977 was spread over most commodity categories, with the

U. S. balances on trade and current account



Data are from U.S. Dept. of Commerce. Changes are at seasonally adjusted annual rates.

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largest increase in industrial materials and nonautomotive consumer goods.

Foreign countries shared unevenly in the 1977 expansion of U.S. imports. Imports (mostly petroleum) from OPEC members increased $8 billion, or about 30 per cent, while imports from other developing countries grew $7 billion, or about 25 per cent. Imports from the developed countries rose $12 billion; about one-third of this 18 per cent increase was from the European Economic Community. Imports from Japan rose $3 billion, or 20 per cent.

U.S. merchandise exports expanded about 5 per cent in 1977, somewhat less than the rate in 1976. All of the 1977 increase, however, was accounted for by price rises as economic growth in most major industrial countries slowed, particularly during the second and third quarters. As investment demand abroad was fairly weak during the year, the demand for U.S. capital goods and industrial supplies, which account for about one-half of U.S. exports, was held down during 1977. Agricultural exports increased about 4 per cent, about half in volume and half in prices. Between June and December, however, agricultural export prices dropped by 10 per cent as the result of good harvests and ample supplies around the world.

The $6 billion increase in total exports went largely to Western European countries ($2½ billion) and to Canada ($2 billion). U.S. exports to OPEC countries increased about $1½ billion; the size of this increase was about the same as that in 1976, but only about half the increases in 1974 and 1975. Exports to non-OPEC developing countries increased $1 billion in 1977 after having declined slightly the year before. Exports to communist countries declined by $1½ billion.

Military sales increased $2 billion in 1977; transfers were primarily to the Middle East and consisted of aircraft, military equipment, and construction services. The increase of about $¾ billion in military expenditures in 1977 reflected not only higher personnel payments but also payments to foreign nationals for construction services.

Foreign official assets in the United States increased $31 billion in 1977, not including the $6.8 billion increase in OPEC investments in this country. The $16 billion increase in foreign official assets in the United States (excluding those of OPEC) during the first three quarters resulted largely from the rebuilding of reserve holdings by

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10. U.S. international transactions

Billions of dollars

Item	1976	1977 p	1977 Q1	1977 Q2	1977 Q3	1977 Q4 p
	CURRENT ACCOUNT					
Merchandise trade balance	*−9.3*	*−31.2*	*−7.1*	*−7.7*	*−7.6*	*−8.9*
Exports	114.7	120.5	29.5	30.7	30.9	29.5
Imports	124.0	151.7	36.6	38.3	38.4	38.4
Military and service transactions, net	*12.9*	*15.8*	*4.0*	*4.3*	*4.6*	*2.9*
Investment income, net	9.8	11.9	3.2	3.4	3.2	2.1
Military transactions, net	.4	1.4	.5	.3	.6	.1
Other services	2.7	2.5	.3	.5	.8	.7
Unilateral transfers	−5.0	−4.8	−1.2	−1.2	−1.3	−1.1
Balance on current account	**−1.4**	**−20.2**	**−4.3**	**−4.6**	**−4.3**	**−7.0**
	FOREIGN OFFICIAL ASSETS					
Changes in foreign official assets in U.S. (increase, +)	*17.9*	*37.4*	*5.7*	*7.9*	*8.2*	*15.5*
(Of which: U.S. Govt. liabilities other than securities) [1]	(4.9)	(1.9)	(.7)	(.5)	(.3)	(.4)
OPEC	9.3	6.8	3.2	1.1	1.4	1.0
Other foreign official institutions	8.6	30.7	2.5	6.8	6.8	14.5
	U.S. GOVT. TRANSACTIONS					
Changes in U.S. assets (increase, −):						
Reserve assets, total	*−2.5*	*−.2*	*−.4*	*	*.2*	*
Reserve position in the IMF	−2.2	−.3	−.4	−.1	.1	*
Convertible currencies and other	−.3	.1	*	.1	*	*
Other U.S. Govt. assets	−4.2	−3.7	−.9	−.8	−1.2	−.8
	PRIVATE CAPITAL FLOWS					
Reported by banks and securities dealers	*−14.6*	*−6.7*	*−.6*	*−.6*	*.6*	*−6.1*
Bank-reported capital, net (outflow, −)	−9.9	−4.9	−1.9	1.8	.9	−5.8
Securities:						
U.S. net purchases (−) of foreign securities	−8.7	−5.4	−.7	−1.8	−2.2	−.7
Foreign net purchases (+):						
Of U.S. Treasury securities	2.8	.6	1.0	−1.4	1.3	−.3
Of U.S. corporate securities	1.3	2.9	.9	.7	.5	.8
Corporate financial transactions	*−5.0*	*−3.6*	*−1.0*	*−3.0*	*1.7*	*−1.4*
Direct investment:						
U.S. direct investment (−) abroad	−4.6	−5.0	−.4	−2.0	−1.1	−1.5
Foreign direct investment (+) in United States	2.2	1.5	.5	.6	.6	−.2
Other corporate transactions, net (outflow, −)	−2.6	−.1	−1.1	−1.5	2.1	.4
	STATISTICAL DISCREPANCY					
Statistical discrepancy	*9.9*	*−3.0*	*1.4*	*1.1*	*−5.2*	*−.3*

1 Largely prepayments for military and other purchases.
p Preliminary.
* Less than $50 million.

NOTE.—Current-account items are seasonally adjusted; seasonal factors are no longer calculated for capital transactions. Data are from U.S. Dept. of Commerce, Bureau of Economic Analysis. Details may not add to totals because of rounding.

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the United Kingdom and Italy. These increases in reserves reflected borrowings from the IMF and in private international capital markets as well as the proceeds of intervention purchases of dollars in the exchange market. In the fourth quarter of 1977 the sources of official inflows became more diffuse as several countries—including Germany, Japan, and Switzerland—engaged in large intervention purchases of dollars.

Private capital transactions reported by banks and securities dealers showed a net outflow of $7 billion in 1977, an $8 billion reduction from that recorded in 1976. More than one-half of the drop was reported by banks, as the amount of new funds provided to their overseas affiliates was considerably reduced. This reduction reflected a somewhat slower growth in international credit demand and a greater reliance by foreign branches of U.S. banks on funds raised directly in foreign money markets. U.S. net purchases of foreign securities declined more than $3 billion, mainly because of a reduction of Canadian borrowings in the United States. Foreign net purchases of U.S. Treasury and corporate securities were about the same as in 1976, as an increase in purchases of both U.S. corporate bonds and stocks was offset by net sales of U.S. Treasury securities by private foreigners.

During 1977, U.S. Government foreign assets, apart from reserve assets, rose about $4 billion, as they had in 1976. U.S. reserve assets increased slightly as compared with an increase of $2.5 billion in 1976, reflecting reduced drawings of dollars by other countries from the IMF. Such drawings increase U.S. reserve claims on the IMF.

FOREIGN LENDING BY U.S. BANKS

Although U.S. banks continued to increase their loans and other claims on foreigners in 1977, the rate of increase was appreciably smaller than in the immediately preceding years. Claims on foreigners held by both domestic offices and foreign branches of U.S. banks rose $27 billion, or 13 per cent, as compared with $40 billion, or 24 per cent, in 1976. These numbers exclude U.S. offices of foreign banks.

Claims on the Group of Ten (G-10) countries, Switzerland, and offshore banking centers, which accounted for almost 60 per cent of total claims on foreigners at the end of 1977, rose more slowly in 1977 than in 1976. Claims on the smaller developed countries increased about as much in 1977 as the year before, although claims

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on Scandinavian countries accelerated while those on South Africa and Turkey leveled off in reflection of the more cautious attitudes of banks toward those countries. Claims on oil-exporting countries, while still rising quite rapidly, increased more slowly in 1977, partly because of Indonesia's reduced need for new external borrowing. There was a marked deceleration in the rise in claims on the non-oil developing countries, in large part because of improvement in the trade balances of Brazil, Mexico, and the Philippines and because of uncertainties about Peru's stabilization efforts.

FOREIGN BANKS IN THE UNITED STATES

Total assets of U.S. offices of foreign banks increased 15 per cent during the 12 months ending November 1977, reaching a level of $78 billion. During the same period their "standard banking assets," which include loans, money market assets, and securities but exclude clearing balances and claims on related institutions, increased 18 per cent, reaching $55 billion.

Commercial and industrial lending and participation in U.S. money markets as both borrowers and lenders continue to be two important activities of the U.S. offices of foreign banks. As of November 1977, commercial and industrial loans of U.S. offices of foreign banks amounted to $22 billion, a figure equal to 18 per cent of comparable loans made by large U.S. banks that report weekly to the Federal Reserve. While a large proportion of these loans are related to the financing of U.S. trade with foreign countries and of third-country trade, U.S. offices of foreign banks have become increasingly active participants in the domestic commercial and industrial loan market.

Deposit liabilities to nonbanks grew more rapidly than standard banking assets during the 12 months ending November 1977—increasing 21 per cent to a level of $23 billion, more than two-thirds of which represented liabilities to U.S. residents. The growth in their deposit liabilities has enabled the U.S. offices of foreign banks to reduce their relative reliance on net advances from related institutions, which amounted to $9.5 billion as of November 1977.

FOREIGN EXCHANGE MARKETS

The dollar came under downward pressure in the exchange markets in 1977. Over the course of the year, it declined 6.7 per cent

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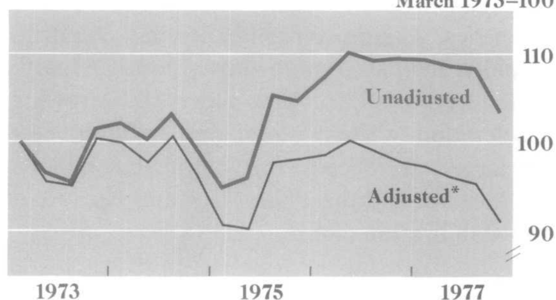
Weighted-average value of the U.S. dollar



* Calculated by dividing the index of the weighted-average exchange value of the dollar (against 10 leading currencies) by the ratio of foreign to U.S. consumer price indexes.

NOTE.—Monthly-average market exchange rate of the U.S. dollar against 10 major foreign currencies weighted by foreign trade in 1972. The weight for each currency is the share of that country's total trade (exports plus imports) in the total trade of the 10 countries plus the United States.

against a weighted average of 10 major foreign currencies. If exchange rates are adjusted for differential rates of inflation, the decline in "price adjusted" exchange rates was even greater. The dollar came under particularly heavy selling pressure during the fourth quarter, when it dropped 5.8 per cent—often in disorderly exchange markets. Foreign central banks made net purchases of $35 billion during the year, and the Federal Reserve System sold a net $800 million equivalent of German marks in the fourth quarter.

In 1976 private demands for dollar-denominated assets had been strong enough to cause the dollar's exchange value to rise by 4.5 per cent despite a sharp swing into deficit of the U.S. trade balance. However, the dollar did not continue to rise in 1977. As our trade deficit increased to $31 billion, with the prospect for little change in 1978, the dollar weakened, even though interest rate differentials moved in favor of the dollar and U.S. price performance was relatively favorable.

The dollar's weakness in the early part of the year was disguised, to some extent, by large intervention purchases of dollars by the central banks of the United Kingdom and Italy. Those two central banks had suffered heavy reserve losses during 1976, and they were anxious to rebuild their reserve positions. At the same time, they were concerned about limiting appreciations in their currencies that they

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felt might soon be reversed, given the fact that their domestic inflation rates continued to be substantially higher than those of most other industrial countries. Their intervention purchases, while not aimed at supporting the dollar, nevertheless had that effect.

Throughout the spring administration officials urged foreign countries with sizable current-account surpluses and with relatively low inflation rates to expand their domestic economies at faster rates. At the same time they pointed out that international adjustment required that countries with surpluses allow appreciation of their currencies.

Following particularly strong statements of this sort in connection with the June 24 OECD ministerial meeting, the market began to believe that the United States welcomed a depreciation of the dollar, particularly against the Japanese yen and the German mark, as part of the process of international adjustment. In July the dollar dropped sharply, particularly against the yen and the mark; this movement was only partially reversed later following statements by the Chairman of the Board of Governors of the Federal Reserve System and by the Secretary of the Treasury on the desirability of a strong U.S. dollar.

After holding relatively steady during August and September, the dollar again came under pressure near the end of September following the annual meeting of the IMF. It became apparent that economic growth in major countries other than the United States was falling considerably short of targets announced at the economic summit meeting held in May and that prospects for economic growth in 1978 appeared only marginally better. Slow growth abroad and the increasing uncertainty surrounding U.S. energy policy made a substantial reduction of the U.S. trade deficit in 1978 appear less likely. Downward pressure on the dollar intensified, particularly after the United Kingdom ended its large purchases of dollars and allowed sterling to float on October 31.

Exchange markets became even more disorderly in the fourth quarter, especially near the year-end. The variation in the weighted-average dollar, measured by the average daily absolute percentage change, had declined quite steadily from March 1973 through the spring of 1977. In December, however, the daily variation increased to the highest for any month since the advent of generalized floating. Bid-ask spreads increased commensurately, and rates moved sharply in thin markets. In this atmosphere the System increased its scale of

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11. Changes in selected exchange rates, December 1976–December 1977

Currency	Per cent
Japanese yen	22.3
Swiss franc	18.0
German mark	10.8
U.K. pound	10.5
Belgian franc	7.7
Netherlands guilder	6.7
French franc	3.9
Italian lira	−0.9
U.S. dollar [1]	−5.6
Canadian dollar	−7.2
Swedish krona	−12.5

[1] Weighted-average value against 10 leading currencies.

intervention. In this intervention, the System was joined by the U.S. Treasury on January 4, 1978, when a new swap facility between the Exchange Stabilization Fund and the German Federal Bank was announced. By late January the exchange markets had become somewhat more settled.

Among individual foreign currencies, those showing the largest percentage increases against the dollar were the yen, the mark, and the Swiss franc—currencies of those countries that enjoyed the largest current-account surpluses. Sterling was also particularly strong; it appreciated by 10.5 per cent against the dollar, even as the Bank of England added some $16 billion to its reserves. Among the currencies of the G-10 countries, the dollar appreciated against only the Canadian dollar and the Swedish krona.

LOOKING AHEAD

The world economy made little progress in 1977 in what has become a long, slow climb from the 1974–75 recession. The problems that have slowed the recovery are likely to persist for some time. The legacy of the demand pressures and inflation of the 1973 boom, reinforced by the increase in the price of oil, is still very much in evidence. The world has not yet found a structure of current-account

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balances that would allow the OPEC surplus to be absorbed in a sustainable way by other countries. The dramatic rise in the U.S. current-account deficit was largely offset by increases in surpluses of other major developed countries. The deficits of non-oil developing countries and of some of the smaller developed countries remained large relative to their ability to attract financing, and such deficits continue to be a constraint on policies designed to stimulate economic growth.

The worldwide inflation that was produced in part by the jump in energy prices is also still in evidence, although some progress has been made in reducing it. A further shift in emphasis in 1978 toward policies designed to encourage real growth will depend upon continued progress in controlling inflation. Generally slack conditions in labor markets and low rates of capacity utilization should allow increased scope for noninflationary growth in 1978.

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Official Statements on Growth Targets for Monetary Aggregates

Given below are statements by Federal Reserve Chairman Arthur F. Burns on February 3, May 3, July 29, and November 9, 1977, in response to H. Con. Res. 133, passed March 24, 1975, concerning objectives and plans of the Federal Reserve with respect to the ranges of growth or diminution of monetary and credit aggregates in the upcoming 12 months.

STATEMENT BEFORE THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS, U.S. HOUSE OF REPRESENTATIVES, FEBRUARY 3, 1977

I am pleased to meet once again with this distinguished committee to present the report of the Board of Governors of the Federal Reserve System on the condition of the national economy and the course of monetary policy.

When I last met with you in July 1976, the growth of economic activity had begun to slow perceptibly, after a year of brisk recovery. At that time, I noted that the balance of economic forces suggested an early return to stronger rates of expansion in production and employment. The favorable turn of events during the past several months indicates that our economy is, in fact, emerging from the recent pause.

Periods of retardation in economic growth, followed by a renewed upsurge of economic activity, have been a fairly common feature of business-cycle expansions. In 1962, for example, the growth of output slowed markedly for several quarters, but a more rapid pace resumed in 1963. Earlier, economic expansion appeared to falter in late 1951 and early 1952, and then picked up with some vigor. Looking back still further to the business cycles before World War II, we find that periods of retarded growth and subsequent resurgence frequently occurred during the longer phases of economic expansion.

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The improvement in the condition of the national economy over the past several months is due in some measure to the impetus provided by governmental policies. Monetary policy remained accommodative throughout 1976. Indeed, open market operations by the Federal Reserve sought late last year to encourage somewhat more ample supplies of money and credit. Also, the discount rate on loans to member banks was reduced in November, and reserve requirements on demand deposits were again lowered in December. By promoting some easing of conditions in the money and capital markets at a time of business hesitation, these actions helped to bolster the state of business and consumer confidence.

Fiscal actions also became more stimulative during the latter half of 1976. Expenditures of the Federal Government, as measured in the national income and product accounts, fell short of official projections during the first half of last year. Later in the year, as a part of the earlier shortfall was made up, Federal expenditures rose rather rapidly.

These facts deserve only passing notice. The noteworthy feature of the recent pick-up in business activity is that it mainly resulted from the normal workings of self-corrective forces within the private economy. Last summer, many manufacturers curtailed production of items for which inventories were rising too rapidly. Retailers, in their turn, offered price concessions to consumers and increased their advertising in order to stimulate sales. Before long, consumers began to respond energetically. Retail sales regained strength in October and then moved up substantially further in the closing months of the year.

Homebuilding activity, which has been in an upward trend since early 1975, also rose significantly late last year in response to improving conditions in the mortgage and real estate markets. The strong underlying demand for housing—especially in sections of the country experiencing rapid population growth—led to a rapid increase in sales of new and existing homes and to a rising level of new starts for both single-family and apartment dwellings. Total housing starts during the last 3 months of 1976 advanced nearly 15 per cent from the preceding quarter and reached the highest level in more than 3 years.

Thus, despite some weakening in the pace of business investment in fixed capital, the physical volume of final purchases—that is, all

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purchases of goods and services except for additions to inventories—rose at an annual rate of almost 5 per cent in the fourth quarter. This was the most rapid advance of any quarter during 1976. The strengthening of final purchases enabled business firms across the Nation to work off a good part of the excess inventories that had accumulated over the preceding months. True, the aggregate volume of business inventories rose further in the fourth quarter, but the rate of advance was much slower than in the summer and much slower also than the increase in final sales. This reduced pace of inventory accumulation, along with strikes in some major industries, was responsible for a disappointing performance of physical output during the final quarter of last year. But it set the stage for a return to a more vigorous rate of economic expansion by bringing sales and stocks into better balance.

Actually, the pace of orders and production has already begun to quicken. New orders for durable goods began moving up in November and rose sharply further in December. The output of our Nation's factories, mines, and power plants also rebounded sharply in November, as the depressing impact of major strikes abated; and another strong advance of production was registered in December.

Conditions in labor markets were improving noticeably around year-end. Employment rose briskly in December, and unemployment declined across a range of industries. The reduction in unemployment among heads of households was particularly encouraging. A strengthening of demand for labor has also been evident in the recent declining rate of layoffs and the rising pace of new hires at manufacturing establishments. With employment growing more rapidly, the volume of personal income during the fourth quarter rose at an annual rate of nearly 11 per cent—half again as fast as in the previous 3-month period.

Activity in the current quarter is being adversely affected by plant shutdowns in many parts of our country as a result of shortages of natural gas and other fuels. The difficulties imposed on many American families by the bitterly cold winter will be long remembered, but I do not expect large or lasting effects on the performance of the economy during 1977.

Thus, further good gains in economic activity seem very likely during the course of this year. Consumers are now spending more

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freely—the percentage of disposable personal income spent on goods and services during the fourth quarter was the highest in several years. Except for areas where the weather has been unfavorable, retail sales during January appear to have continued at a satisfactory pace. Moreover, consumers have built up their stock of liquid assets substantially during the past year, and they have also been cautious in adding to their debts. The over-all financial condition of the household sector has thus improved, and this will contribute to stronger consumer markets in the months ahead.

Prospects for residential construction are also bright. Construction of single-family homes has already rebounded sharply, and production of multifamily units is now gradually recovering from overbuilding and the other problems that had been troubling this sector. Mortgage credit is in ample supply. Commitments by thrift institutions for home mortgage loans are at record levels; the inflow of savings to these institutions is continuing at a high rate; and mortgage interest rates are gradually declining. Housing starts should therefore continue to move up at a good pace.

Our export trades, too, can be expected to improve during 1977. Many foreign economies experienced a retardation of growth last year just as we did, and they too are likely to enjoy a pick-up in the tempo of activity relatively soon. The demand for our exports should therefore increase. Of course, our imports will also be increasing as the domestic economy continues to expand, so that our net trade balance may not improve appreciably during the course of this year. The growth of imports, however, is not expected to be as rapid as it was in 1976, and net income from services should increase further. Thus, our deficit on current account with other countries will probably be rather moderate in 1977.

Business spending should contribute substantially to economic expansion this year. Inventory investment may proceed at a cautious pace for a little while longer; but with consumer purchases continuing to grow satisfactorily, business firms will soon have to add substantially to their inventories.

Outlays for plant and equipment should also strengthen as 1977 unfolds. During the course of this recovery, businessmen have been planning for the future with considerable caution. Additional hesitancy developed last summer when the pace of expansion slowed, and a few firms postponed new projects while some others stretched out

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their capital expenditure programs. These attitudes are now changing. Confidence has been strengthened by President Carter's firm statement rejecting wage and price controls, as well as by the recent trend of business developments.

I feel reasonably confident that 1977 will be a good year for the Nation's economy, but this is no time for complacency. Much remains to be accomplished. Although the proportion of our adult population holding jobs has been rising, more than 7 million people are still out of work, and our labor force is growing very rapidly. Last year women entered the labor force in exceptionally large numbers, and the total number of individuals at work or seeking employment rose on an unprecedented scale—by 2.8 million.

Although unemployment is widespread, the inflation from which our country has also been suffering has not come to an end. Despite heartening progress over the past 2 years, prices are still rising at a troublesome rate. In 1976 consumer prices on the average rose about 5 per cent—down from 7 per cent in 1975 and 12 per cent in 1974. But the American people are not content to live with a 5 per cent rate of inflation, nor should they be. If the general price level were to continue rising at a rate of 5 per cent a year, the value of a family's savings—or the purchasing power of a retiree's pension check—would be cut in half in just 15 years. Worse still, if a 5 per cent rate of price advance were to be accepted complacently by Government, inflationary expectations would intensify, and the actual rate of price increases would then almost certainly move toward higher levels.

Unfortunately, it will be difficult to achieve a significant reduction in the rate of inflation in the immediate future. Wholesale prices of industrial commodities rose during the past half year at an annual rate of over 9 per cent. At the consumer level, prices of heating fuels and gasoline have of late been rising rapidly again. As the pace of economic activity quickens in coming months, pressures could develop for larger and more widespread increases in wages and prices than we have recently experienced. The outlook for prices is thus a worrisome matter, and it must be given very careful attention. For a durable prosperity will not be achieved in our country until we gain better control of the inflationary forces that have damaged our economy for more than a decade.

There are several other longer-range problems to which public policy must attend. During the past decade, increases in the output

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per manhour in the private sector have averaged less than 2 per cent a year—a substantial decline from the 3 per cent rate achieved during the preceding decade. There are numerous reasons for this sorry performance. For one thing, the work habits of the American people are not what they once were: absenteeism is a growing problem for many firms, and there are other manifestations of less dedication by workers. Another reason is that the expansion and modernization of our industrial plant has been inadequate. Last year, our country devoted less than 10 per cent of its total output of goods and services to the production of new plant and equipment. Other industrialized nations have been committing a much larger fraction of their resources to capital formation than we—and they have also been experiencing faster economic growth.

Public policy must also come to grips with the need to revitalize our central cities, with the need to reform a welfare system that has become chaotic and inordinately costly, and with the need to strengthen our national security by regaining substantial independence in the energy area. Energy consumption is rising rapidly again, and the recent very cold weather has reminded us poignantly of the critical role played by supplies of natural gas and petroleum in our economy. The shortage of natural gas is now receiving constructive attention from the Congress. But, unfortunately, we are still at the mercy of a few oil-exporting countries; in fact, our dependence on foreign sources of oil is substantially larger now than at the time of the 1973 oil embargo.

We will not solve this or our other longer-term problems simply by loosening the Federal purse strings and letting the money roll out. That course would sooner or later accelerate inflation and thereby create other, and perhaps even greater, economic problems. It should be abundantly clear by now that a healthy and prosperous economy can be achieved only by pursuing policies that are consistent with steady progress toward restoration of general price stability.

That principle is continuing to guide Federal Reserve policy. Over the past year, growth rates of the major monetary aggregates have not been excessive, and our projected ranges for the future have been gradually reduced. This course of action, by dampening inflationary expectations, has helped to restore public confidence—both here and abroad—in the value of our currency and in the future of our economy.

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Mainly as a result of this lessening of inflationary fears, interest rates have not increased as they usually do in a period of cyclical expansion. In fact, the level of interest rates on short- and long-term securities is appreciably lower now than it was at the beginning of economic recovery in 1975.

Thus, the monetary policy we have pursued has fostered conditions in financial markets that have aided the process of economic recovery. Supplies of credit have been ample. In fact, the volume of funds raised by the nonfinancial sectors of the economy has increased considerably faster than the dollar value of the gross national product. Meanwhile, the financial condition of business firms has improved materially; and financial institutions have rebuilt their liquidity, so that they will be able to accommodate a substantial rise of credit demands in the months ahead.

The growth rates of major monetary aggregates have remained relatively close to those we had expected earlier. In the year ended in the fourth quarter of 1976, *M*-1—that is, the money stock defined narrowly so as to include only currency and demand deposits—rose 5.4 per cent, somewhat below the midpoint of the range projected a year ago. In contrast, *M*-2—which also includes savings and consumer-type time deposits at commercial banks—increased 10.9 per cent, just above the upper end of its projected range. Growth of *M*-3—a still broader measure of money that encompasses, besides the components of *M*-2, the deposits at savings banks, savings and loan associations, and credit unions—amounted to 12.8 per cent, and also exceeded its range by a small margin.

There was an unusually wide gap during the past year between the growth rates of *M*-1 and the broader monetary aggregates. This stemmed in large measure from changes in financial markets that have served to reduce reliance on demand deposits for handling monetary transactions. Recent financial innovations have important implications for the conduct of monetary policy, and it may therefore be worthwhile to comment on them.

Elements of the innovational process currently under way in financial markets can be traced as far back as the early 1950's. When interest rates rose during the cyclical upswing of 1952 and 1953, some large corporations began to invest their spare cash in Treasury bills. In subsequent years, more and more firms increased their efforts to develop better systems of cash management, so as

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to minimize holdings of demand deposits which—under existing law—bear no interest. In time, individuals began to emulate business practices—by shifting idle funds into liquid market securities or savings deposits.

In the late 1950's and early 1960's, the innovational process was accelerated by more aggressive efforts of commercial banks, especially the larger institutions, to bid for loanable funds. Major efforts were made to attract the highly interest-sensitive funds of corporations and other large depositors. For example, banks in the money market centers began in 1961 to sell large-denomination certificates of deposit on a significant scale; and a secondary market, which soon developed for these instruments, enhanced their acceptability.

With inflation pushing interest rates to extraordinary heights during the past decade, both business firms and individuals have intensified their search for ways to minimize holdings of non-interest-bearing assets. Financial institutions, meanwhile, have been competing actively to meet the public's needs. As a consequence, the innovational process has accelerated. An array of new financial instruments and practices has developed that has enabled the public to hold an increasing fraction of its transactions balances in interest-bearing form.

For example, the so-called negotiable orders of withdrawal (NOW) accounts have grown steadily in the New England States, and they serve effectively as checking accounts for many individuals. Smaller businesses and State and local governments nowadays hold a significant part of their cash balances in the form of savings accounts at commercial banks—which only recently were granted authority to accept such deposits. Moreover, many individuals are learning to use savings accounts for transactions purposes by making payments through third-party transfer arrangements, or by telephonic transfers of funds from savings to demand deposits to cover newly written checks. Others are using money market mutual funds for the same purpose. And still others have worked out overdraft arrangements with their banks to reduce the amount of funds held in demand deposits bearing no interest.

In projecting its monetary growth ranges, the Federal Open Market Committee has had to keep these developments of financial technology carefully in mind because they affect the rates of growth of monetary aggregates that are needed to sustain economic expansion.

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At its meeting about 2 weeks ago, the Committee adopted ranges for the year ending in the fourth quarter of 1977 that differ only a little from those announced last November. For *M*-1, the previous range of 4½ to 6½ per cent has been retained. For *M*-2 and *M*-3, the lower boundaries of the ranges were reduced by ½ of a percentage point. Consequently, the new range is 7 to 10 per cent for *M*-2 and 8½ to 11½ per cent for *M*-3.

The downward adjustment of the lower boundary of the ranges for *M*-2 and *M*-3 largely reflects technical considerations. By historical standards, growth of the broader measures of money in 1976 was relatively rapid in relation to growth of *M*-1. Over the course of last year, *M*-1 rose 5.4 per cent, very close to the 5.6 per cent average of the preceding 10 years. But *M*-2 increased 10.9 per cent in 1976, in contrast to an average yearly rise of 8.3 per cent over the preceding decade; and *M*-3 increased 12.8 per cent, in contrast to an average annual increase of 8.8 per cent in the preceding 10 years.

It seems likely that growth rates of these broader aggregates will move back toward historical norms in 1977. Last year the growth of *M*-2 and *M*-3 was influenced by shifts of existing stocks of financial assets from market securities to time and savings deposits. This adjustment of assets may not go much further. Moreover, some banks and thrift institutions, having experienced larger inflows of funds than they can readily invest, have of late taken steps to slow deposit inflows—by reducing the interest rate offered on savings certificates and deposits, or by curtailing promotional activity, or in other ways. These actions should tend to moderate the growth of *M*-2 and *M*-3 without impairing the flow of funds for homebuilding.

Besides these technical considerations, the adjustment of the lower limit of the projected ranges for *M*-2 and *M*-3 reflects the Federal Reserve's firm intention to continue moving gradually toward rates of monetary expansion that over the longer run are consistent with general price stability. The step we have taken on this occasion is a very small one, but it may still bolster the confidence of the public in the commitment of the Federal Reserve to do what it can to unwind the inflation from which our economy continues to suffer.

The projected range for *M*-1 in the year ahead reflects our assumption that the financial innovations now in train will continue to reduce materially the proportion of transactions balances that are held in

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the form of currency and demand deposits. If our assumption is correct, the range we have projected for *M*-1, together with the ranges projected for *M*-2 and *M*-3, should be adequate to finance a faster rate of growth of physical production in 1977 than we experienced in 1976. I must note, however, as I have repeatedly in the past, that profound uncertainties surround the relationships among the various monetary aggregates and between rates of monetary expansion and economic performance. We shall therefore monitor emerging developments closely and stand ready to modify our projected growth ranges as circumstances may dictate.

Let me also take this opportunity to state once again that substantial further reduction in growth rates of all major monetary aggregates will be needed over the next few years if our Nation is to succeed in halting inflation. The long-run growth rate of physical production at full employment has declined in recent years and is probably around 3½ per cent at present. Judging by the experience of the past two or three decades, a stable price level would require a rate of expansion in *M*-1 that over the long run is well below the growth rate of total output. Growth rates of the broader monetary aggregates consistent with general price stability might be somewhat higher than long-term growth of output; but in any event they would have to be far below the rates experienced in recent years.

Our Nation needs to make progress during 1977 in creating more jobs and in expanding our industrial capacity. We at the Federal Reserve fully recognize this fact, as our recent policy actions have made clear. We are also mindful of the need to make further progress in the battle against inflation. Highly expansionist policies that seek to achieve striking gains in economic activity with little or no regard to their inflationary consequences are apt to fail. Once inflationary expectations are inflamed, conditions in financial markets will deteriorate, and the confidence of businessmen and consumers will be eroded. Hopes for a sustained economic recovery would then be undermined.

Public policy must find a middle ground. Deficits in the Federal budget must be scrupulously watched and gradually reduced. Growth in supplies of money and credit must also be brought down gradually to rates consistent with general price stability.

Our Nation has paid a heavy price for permitting inflation to get out of control in the late 1960's and early 1970's. We must not

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lose sight of that fact. The substantial progress we have made in slowing inflation since 1974 has helped to heal our economy. Gradual restoration of price stability is within our means. Unless we stay on that course, the lasting prosperity to which the American people aspire will continue to elude us.

STATEMENT BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, U.S. SENATE, MAY 3, 1977

It is a pleasure to meet once again with this distinguished committee to present the report of the Board of Governors of the Federal Reserve System on the condition of the national economy and the course of monetary policy.

When we last met to discuss these subjects in November, the economy was beginning to emerge from a period of relatively slow growth. That fact was not widely recognized at the time. By concentrating unduly on comprehensive measures of economic activity, many people failed to see the gathering momentum of positive economic forces. Then, early this year, the disruptions caused by unusual weather obscured further the underlying strength of the economy.

It is quite apparent today, however, that a reacceleration of economic growth did get under way late last year and that expansion is again proceeding vigorously. As 1976 drew to a close, final sales of goods and services picked up, reflecting primarily a resurgence of consumer buying and a strong advance in homebuilding. The improvement in sales enabled business firms to work off a good part of the excess inventories that had accumulated over the preceding months when buying was sluggish. With sales and stocks coming into better balance, the pace of new orders and production began to quicken. The demand for labor strengthened, and personal income expanded more rapidly.

The inclement winter weather and shortages in fuel supplies disrupted this expansionary process only briefly, and not nearly so severely as was suggested by early reports. As the weather took a turn for the better in the second half of February, industrial and commercial activities snapped back smartly in most parts of the country.

Even with the adverse effects of the weather, the Nation's total pro-

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duction of goods and services rose in the first quarter at about a 5¼ per cent annual rate—twice the pace of the preceding quarter. Conditions in the labor market improved, as is evidenced by the sharp rise in hirings while layoffs remained at a low level. The unemployment rate fell by ½ of a percentage point as sizable gains in employment more than offset the continued rapid growth of the labor force. At the same time, the rate of utilization of our Nation's industrial plant also edged higher during the first quarter and by March reached 82 per cent in manufacturing.

In all, the recent behavior of economic activity has been encouraging, and the prospects for further economic advance are good. Trends in the consumer sector certainly are favorable. The expansion of jobs and incomes during the past half year has served powerfully to improve consumer sentiment. During the final quarter of 1976 the percentage of disposable income devoted to consumer spending was the highest in several years, and in the first quarter of this year the spending percentage rose still further. Our households, viewed collectively, did not let higher fuel bills interfere with other expenditures. In fact, automobile sales rose to the highest level since 1973, as an increasing number of consumers displayed a willingness to incur additional instalment debt in order to finance the purchase of big-ticket items.

The strong pace of consumer buying late in 1976 caused inventories to fall below desired levels in many lines of activity. More recently, inventory investment has picked up as businessmen sought to keep larger stocks to accommodate their customers. The increasing volume of work at manufacturing plants has had a similar effect. Nevertheless, inventories generally remain quite lean, and inventory investment can be expected to continue rising as sales move up in the months ahead.

Homebuilding has also shown strength in recent months—especially in the single-family sector where new starts apparently reached a record high in March. With credit readily available and consumer confidence improving, sales of new homes were brisk even during the harsh winter months. Activity in the multifamily sector, meanwhile, has recovered much more slowly from the depression brought on by overbuilding in the early 1970's. But vacancy rates are now generally falling, and it is thus reasonable to expect the construction of apartment units to gather strength as time passes.

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The pace of business investment in new plant and equipment, while still lagging relative to earlier business-cycle expansions, is also gaining strength. Business equipment posted the largest advance of any major category of industrial production during the first quarter. The most recent surveys of business plans point to a substantial further increase in spending on plant and equipment this year. So, too, does the trend of orders for business capital goods, which have risen more than 20 per cent over the past year. With corporate profits improving and with rates of utilization of industrial capacity rising, the potential clearly exists for good gains in business fixed investment.

Governmental demand for goods and services also appears to be an expansive influence in the economy at this time. Budget estimates suggest that Federal purchases of goods and services in calendar 1977 will increase at a faster rate in constant-dollar terms than they did last year. In addition, a quickening pace of spending by State and local governments is likely to take place in the months ahead. In the aggregate, State and local operating budgets have moved during the past 2 years from deficit to surplus, thanks to the combination of strongly rising tax receipts and relatively subdued expenditure growth. With this turnabout in their budgetary situation, State and local governments are likely to loosen their purse strings. And the tendency in that direction may well be accelerated if the Congress follows through with present plans to enlarge, both this year and next, the flow of Federal grants-in-aid to States and localities.

The only major component of final demand that is not exhibiting strength at present is our foreign trade balance. The dollar value of oil imports increased sharply in the first quarter because of the cold weather, but other imports—including coffee and other consumer goods—also rose substantially. Meanwhile, the relatively slow recovery of many foreign economies kept down the expansion of our exports. Only strength of investment income and other nontrade items has held the over-all current-account deficit to moderate proportions. Although the deterioration in our trade balance may be behind us, it is hard to see significant improvement over the remainder of the year.

With the exception of foreign trade, however, demand factors generally seem to point to good growth in our Nation's output of goods and services this year. Buttressing that expectation is the fact

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that financial conditions provide a satisfactory foundation for further economic expansion.

The Federal Reserve has continued to pursue a course of monetary policy intended to promote conditions conducive to substantial expansion in economic activity, while guarding against the release of new inflationary forces. During the past 2 years the increases that have occurred in the stock of money have proved adequate to finance substantial gains in the physical volume of output and employment. This experience has demonstrated once again that consideration of the stock of money alone is not sufficient for assessment of the adequacy of the economy's liquidity. Money has a second dimension, namely, velocity, or—in common parlance—the intensity with which it is being used. Over short periods of time the truly dynamic factor is not so much the stock of money as the willingness of the public to use their money balances. Upswings in business and consumer confidence are commonly reflected in substantial increases of monetary velocity. Moreover, in the case of the narrowly defined money supply, intensity of use has been increasing with special rapidity since 1975, reflecting numerous innovations in financial technology that serve to reduce reliance on demand deposits for handling monetary transactions.

Supplies of credit have been ample—perhaps more than ample—during the past 6 months, and most rates of interest are near their lowest levels in several years. In this environment, many economic entities have been able to achieve a further strengthening of their financial condition.

Large business firms with high credit ratings issued a massive volume of long-term bonds during 1975 and the first half of 1976, and they used the proceeds largely to repay short-term debt and to acquire liquid assets. Such restructuring of balance sheets appears to have abated in the past half year or so, and many companies are now cautiously enlarging their borrowing from banks and through the commercial paper market. This expansion of short- and intermediate-term liabilities has occurred unusually late in the current cyclical expansion and it has been moderate to date.

Meanwhile, some large corporations—especially utility and communications firms—have availed themselves of the attractive financing conditions by selling bonds to refund high coupon issues of earlier years. More important still, many smaller and lower-rated

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firms have found in the past several quarters a more receptive market for their long-term debt obligations, and they have thus been able to make progress in strengthening their balance sheets. Life insurance companies and other investors in the private placement market have been aggressively seeking lending opportunities and have recently supplied a record amount of credit to small- and medium-sized firms. Moreover, the spread between interest rates on prime- and lower-rated bond issues in the public market for securities—which had become unusually wide during the recent recession—has now narrowed to dimensions that are normal for business-cycle expansion.

The favorable condition of financial markets has been of help as well to State and local governments during the past half year. Particularly in the final quarter of 1976, the proceeds of substantial issues of new long-term bonds were used to repay outstanding short-term debt, thus continuing a practice that has prevailed since mid-1975. This process of debt restructuring, together with the progress made in strengthening budgetary positions, has improved dramatically the standing of many States and municipalities with the investment community. Testifying to that is the fact that interest rates on municipal securities have declined more than interest rates on other fixed-income obligations. Not only that, the spread between yields on higher- and lower-quality bond issues has narrowed sharply in recent months. These developments have led to numerous advance refundings of existing debt, thereby lowering the future interest burden on taxpayers.

Despite larger loan demand from business and consumers since last fall, commercial banks have been able to maintain their sharply improved liquidity. Indeed, they have added further to their holdings of Treasury securities, which today are more than double what they were at the end of 1974. Many banks have strengthened their equity position during the past 6 months through earnings retention, and some have also augmented their capital by issuing new stock or subordinated long-term debt.

Savings banks and savings and loan associations too have been able to accommodate heavy credit demands without reducing liquidity. The relatively low level of market rates of interest has sustained good inflows of consumer time and savings deposits to those institutions. Against this background, outstanding mortgage commitments have risen to record levels and mortgage interest rates have declined.

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These developments have contributed to the brisk pace of home sales and to the upward thrust of housing construction.

In sum, both general financial conditions and the growth patterns that have been unfolding in key sectors of our economy justify considerable optimism about the immediate future. Even so, there are some uncertainties in the present situation that deserve serious attention. The most important of these relate to energy and inflation.

One of the reasons capital spending has lagged during this economic expansion has been a reluctance of businessmen to undertake long-term investment projects without a clearer view of the future cost and availability of petrochemical feedstocks and various energy sources. The President's proposal of a broad energy program is a long-needed step toward creating a more certain environment for decision-making. However, with congressional action still to be taken and with the final shape of any program unknown, the situation at the moment is as uncertain as ever. Furthermore, in view of the prospect of significant tax or other incentives or disincentives in the not too distant future, there will be a tendency here and there to hold off on major expenditures a bit longer to see what develops. This could have the effect of retarding the advance not only of business capital outlays in the months ahead but also of spending by households—especially on automobiles and energy-saving home improvements.

Because of these possibilities, it obviously is important that the Congress lose no time in considering the President's energy recommendations. I fully realize the practical obstacles to quick action in matters so complex, but I also feel bound to observe that significant risks to economic performance will exist as long as businessmen and the general public remain uncertain of what to expect in the energy area.

The course of economic expansion may also be significantly affected by the pace of inflation. Inflation has accelerated in recent months. Both wholesale and consumer prices advanced at an annual rate of about 10 per cent in the first quarter, with the flare-up of food prices only part of the explanation. Particularly worrisome is the fact that we have now experienced three successive quarters of increase at about an 8 per cent annual rate in the critically important industrial commodities component of the wholesale price index. This development reflects an upward climb during the past year of close

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to 6 per cent in the labor cost per unit of output for private business firms; it also reflects an effort on the part of many companies to widen profit margins from the low level to which they had fallen during the recession.

With wage increases now showing some tendency to quicken and with the economy at a stage where productivity gains are likely to become smaller than they have been during the past 2 years, there is no relief in sight for the underlying cost pressures that businesses have been experiencing. This unhappy circumstance inevitably casts a cloud on our Nation's ability to maintain a satisfactory rate of economic growth into 1978 and beyond.

Experience teaches that when serious inflation persists, consumer confidence and purchasing power will ultimately erode. Continuing inflation at high rates likewise tends to work against sustained expansion in business investment activity, for it raises the risk premium that businessmen attach to new undertakings. Forward business planning becomes more hesitant in an environment in which managers are unable to assess cost and profit prospects with any confidence over the longtime horizons that are frequently involved in new investment projects.

Recognizing these difficulties, President Carter has outlined a multifaceted program to fight inflation. I want to assure this committee that the members of the Federal Reserve Board fully support the President's determination to bring down the rate of inflation. All of the measures in his projected program can be helpful, but there is no doubt in our minds that the main key to success in the battle against inflation is prudent management of the Nation's finances.

The Federal Open Market Committee was well aware of its heavy responsibility to encourage economic expansion and yet help to curb inflation when it met last month to discuss the longer-run growth of the monetary aggregates. The Committee decided to leave unchanged over the year ending in the first quarter of 1978 the previous growth range of 4½ to 6½ per cent in *M*-1, which is a monetary measure confined to currency and demand deposits. For *M*-2, and likewise for *M*-3, the upper boundary of the growth range was reduced, however, by ½ of a percentage point. Consequently, the growth ranges projected for the coming year are 7 to 9½ per cent for *M*-2 and 8½ to 11 per cent for *M*-3. As the committee may recall, *M*-2 includes savings and consumer-type time deposits at com-

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mercial banks besides currency and demand deposits, while *M*-3 is a still more comprehensive aggregate—since it also includes the deposits at savings banks, savings and loan associations, and credit unions.

As you can see, the Federal Open Market Committee has again moved very cautiously in adjusting the projected monetary growth ranges. In addition to taking account of the usual uncertainties about the relationship between money and economic activity, we recognized that the impact of the as yet unsettled energy program on aggregate supply and demand in the period ahead cannot be foreseen with any precision. Nonetheless, we did feel it appropriate to take another small step toward bringing the long-run growth of the monetary aggregates down to rates compatible with general price stability.

Sustained progress in this direction will, I believe, be absolutely necessary if President Carter's publicly announced goal of reducing the pace of inflation by 2 percentage points by the end of 1979 is to be achieved. The trend of growth in monetary aggregates is still rapid, perhaps much too rapid. To be sure, the Federal Reserve has moved fairly steadily toward lower ranges for monetary expansion during the past 2 years. But that movement has been extremely gradual; indeed, at the current pace it would require nearly a decade to reach rates of growth that are consistent with a stable price level.

I must report, moreover, that despite the gradual reduction of projected growth ranges for the aggregates during the past 2 years, no meaningful reduction has as yet occurred in actual growth rates. That unintended consequence is partly the result of data deficiencies that complicate the already formidable task of adjusting or approximating monetary growth objectives. Initial estimates of the monetary aggregates sometimes differ considerably from estimates made later when fuller data became available.

A factor contributing to the measurement problem has been the inadequacy of deposit data for nonmember commercial banks. While our estimates of nonmember bank deposits—which constitute a growing proportion of the money stock—have often been on the mark, on occasions there have been significant errors. Our most recent benchmark revision of *M*-1, based on nonmember bank data from the call report for last September, raised the estimate of growth over the year ended in the fourth quarter of 1976 from 5.4 to 5.7

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per cent; and this figure is still subject to subsequent revision on the basis of the call report for December.

We at the Federal Reserve are diligently trying to improve the quality of the Nation's monetary data. Last year a committee of distinguished economists, whose aid we had sought, completed a study of the statistics on monetary aggregates. Some of the recommendations of the committee are being implemented with the aid of the Federal Deposit Insurance Corporation. Other recommendations of the consultant committee are being studied by our staff, and further changes are likely to be instituted in the near future. Nevertheless, experience suggests that monetary measurement will continue to lack the precision of science, and so too will the Federal Reserve's actions aiming to influence developments in financial markets.

Events during the past several months have again demonstrated quite clearly that the twists and turns that occur in financial markets often are dominated by developments unrelated to Federal Reserve actions. For instance, from late in 1976 to late April, the Federal funds rate—the one interest rate over which the Federal Reserve has close control—traded within a narrow range between 4⅝ per cent and 4¾ per cent; yet, other market rates of interest in that period fluctuated over ranges as wide as a full percentage point. Those fluctuations in interest rates in large part reflected changing public perceptions of the outlook for the Federal budget. Thus, interest rates moved upward sharply when the administration proposed a new fiscal policy, including the so-called rebate program; and they fell markedly when the President announced that he had dropped the rebate plan.

What this demonstrates anew is that financial market participants have become acutely aware of the inflationary pressures created by Federal budget deficits and the resultant adverse impact on credit conditions. The caution of the Congress with respect to the tax rebate proposal and the President's willingness to adjust his fiscal program in light of emerging economic developments have done much to enhance confidence that our Government is moving toward a more responsible financial posture.

In concluding this morning, I am obliged to observe that we have still a considerable distance to go in putting our financial house in order. Too often in the past, we have lacked the courage or the patience to stay long enough on a monetary and fiscal path that will

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lead to noninflationary economic growth. We cannot afford to backslide once again. Unless we achieve a less inflationary environment, there will be little chance of sustaining the expansion that is now in progress or of significantly reducing the high level of unemployment that is blighting the lives of millions of Americans. That, in a sentence, is the Board's central message to the Congress.

STATEMENT BEFORE THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS, U.S. HOUSE OF REPRESENTATIVES, JULY 29, 1977

I am pleased to appear before this committee once again to present the report of the Board of Governors of the Federal Reserve System on the condition of the national economy and the course of monetary policy.

Since the closing months of 1976, our Nation has experienced a vigorous and broadly based economic expansion. The gains in the industrial sector have been especially impressive; during the past 8 months, the combined output of factories, mines, and power plants has risen at an annual rate of 9½ per cent. Activity in other sectors of the economy also has increased briskly. As a result, total employment in June was almost 3 million higher than last October—an unprecedented gain in so short a period. The unemployment rate remains high; but it has declined in recent months by nearly a full percentage point, despite rapid growth of the labor force. The rate of utilization of our industrial plant capacity also has risen significantly and now exceeds 83 per cent in manufacturing.

Demand for consumer goods has continued to propel the expansion. With confidence buoyed by improving economic conditions, consumers have been spending freely from current income besides adding significantly to their personal indebtedness. The strong buying mood of consumers is reflected in the personal saving rate, which in the first half of this year averaged less than at any time since the early 1960's.

Retail sales climbed steeply during the fall and winter months and remained at a high level this spring. Over the past three quarters, retail sales, after adjustment for price increases, have risen at an annual rate of about 6 per cent. Auto sales contributed greatly to the advance, averaging—on a seasonally adjusted basis—almost 1 million cars per month since March.

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The rise of consumer spending played a major role in prompting a resurgence of inventory investment early this year. A moderate inventory correction in the latter part of 1976 had reduced the ratio of stocks to sales to exceptionally low levels in many lines of trade and manufacturing. Once sales again accelerated, businessmen had to rebuild their inventories in order to meet customer demands. The annual rate of additions to business inventories reached $14 billion in the first quarter of this year and perhaps $20 billion in the quarter just ended.

In the past 2 months or so, it appears that stocks in certain categories of nondurable goods reached somewhat higher levels than businessmen desired. The latest data on employment and production in manufacturing suggest that business firms have again moved promptly to reverse the build-up. With inventory positions generally still lean and sales prospects favorable, inventory investment is likely to contribute to economic expansion later in the year and on into 1978.

The upward trend of sales and of capacity utilization has encouraged businessmen to enlarge their outlays for plant and equipment. There are some signs that business capital spending may finally be gaining significant upward momentum. Order backlogs of capital goods manufacturers have been climbing. Business equipment posted the largest advance of any major category of industrial production during the first half. New contracts and orders for plant and equipment most recently have been running more than 20 per cent above year-earlier levels. To date, business capital expenditures have been concentrated largely on vehicles and other light equipment, but there is some tentative evidence that large construction projects and heavy machinery are beginning to make a contribution to the capital goods recovery. All told, the evidence at hand points to moderate strength in spending on plant and equipment in the months ahead.

Residential construction meanwhile has remained a major area of strength in the economy. Sales of homes have been brisk, and the average level of single-family housing starts in the second quarter was the highest in more than two decades. The multifamily sector has continued to recover slowly, but the low vacancy rates in many localities are likely to stimulate additional construction. In certain parts of the country, especially in California, speculative activity in the single-family sector has recently emerged, and this development

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bears watching. In general, however, the expansion of homebuilding seems to be realistically attuned to the Nation's mobile population. In the Board's judgment, residential construction will post further gains in coming quarters.

Governmental spending has picked up recently, most markedly in the State and local sector. The budgetary position of many State and local governments has improved considerably, being bolstered by Federal grants, by higher tax rates, and by the effects of economic expansion on tax revenues. State and local units have been able to expand employment more rapidly of late, although growth has not been as strong as in the 1960's and early 1970's. Their construction programs, delayed in many cases as governmental units concentrated on rebuilding their financial position, are moving ahead again and should provide significant impetus to economic activity in coming quarters.

The only major weak spot in the economy has been the foreign trade sector. Exports have been sluggish this year, being limited by the relatively slow economic expansion in other industrial nations. Most of these countries have experienced indecisive rebounds in business investment, and this has restricted the demand for American machinery—an important part of our sales abroad.

Cyclical developments have also played a large role on the import side of the trade ledger. In general, the demand for imported industrial materials has increased in step with the recent rapid growth of production in this country. Imports of cyclically sensitive durable goods—such as machinery, autos, and other consumer items—are also reflecting recent economic trends. And needless to say, oil imports have risen enormously this year, swelled first by cold weather and then by inventory building in anticipation of price increases by the Organization of Petroleum Exporting Countries (OPEC).

Continuing advances in investment income and other nontrade items have partly offset the deficit in our foreign trade; even so, the current-account deficit has reached record size. Oil imports should experience some decline later this year, aided by the availability of Alaskan oil. But prevailing trends in economic activity here and abroad suggest little likelihood of significant near-term reduction in our foreign trade or current current-account deficits.

In general, financial developments have favored economic expansion in our country, and they are continuing to do so. However,

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some familiar cyclical patterns have begun to emerge since the turn of the year.

Borrowing by households has been growing very rapidly. Instalment credit has expanded at a 16 per cent annual rate thus far this year. Measured relative to disposable personal income, growth of instalment credit has reached a pace comparable to past peak rates.

Mortgage credit flows have been of record magnitude. Mortgage credit has, in fact, grown much faster than could be expected on the basis of past relationships between borrowing and residential construction, thus suggesting that households have been putting mortgage funds to a broad variety of uses.

Despite the rapid growth of consumer and mortgage credit, measures of household debt burden generally remain within the range of historical experience. Moreover, delinquency and bankruptcy rates have declined significantly from their recession highs. At this juncture, debt burdens do not appear to constitute a serious impediment to further gains in household expenditures; but we must not overlook the possibility of excesses in this area.

Business firms also have placed heavy demands on credit markets this year. Their over-all need for external financing has grown because capital outlays have risen much faster than profits. The net funds raised by nonfinancial corporations increased by about 30 per cent between the second half of 1976 and the first half of this year.

The character of business borrowing has also shifted considerably. Until the latter part of 1976, business firms concentrated on repayment of short-term debt with the proceeds of long-term borrowing. Since last fall, long-term indebtedness has continued to grow, but not nearly so rapidly as short- and intermediate-term borrowing. Bank loans to businesses have increased at an annual rate of 11 per cent since last September, and commercial paper and finance company loans have increased even faster.

These developments have caused liquidity ratios of corporate balance sheets to decline somewhat—a normal cyclical development, although delayed in this case. Still, the state of corporate liquidity remains relatively comfortable because of the extensive improvement achieved during the preceding 2 years.

Credit demands by State and local governmental units have been very large this year. About a fifth of the record bond offerings has been devoted to advance refunding of debt issues that were sold in

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earlier years when interest rates were appreciably higher. The remainder has included substantial amounts to finance construction of public power plants, hospitals, and water and sewer facilities.

Federal Government borrowing, in contrast, has declined from last year—a development which, among other things, reflects the recovery of Treasury revenues and an expenditure pattern still characterized by shortfalls. However, both the administration's projection and the first concurrent resolution indicate that the deficit for fiscal year 1978 will substantially exceed that for the current year. If actually realized, this would be an unusual development. Normally, of course, Federal borrowing diminishes in the course of an economic expansion. In view of the probable need to finance an increasing volume of private capital formation, the prospect of greater demands for funds by the Federal Government in the next fiscal year has been a cause of some disquietude in financial circles.

The strong demands for money and credit that have accompanied our economic expansion have been reflected in a rise in short-term interest rates since the turn of the year. The Federal Reserve might have accommodated credit demands by providing bank reserves more liberally. However, such a course would only have postponed briefly the rise in interest rates because the resulting build-up of liquidity would have intensified inflationary expectations. By responding promptly to the enormous expansion of the monetary aggregates in April, the Federal Reserve gave clear notice that it was alert to the danger of a new wave of inflation. This reassurance to the business and financial community that the Federal Reserve would not permit the money supply to run riot was well received by credit markets. Long-term interest rates, of course, are of much larger significance to the economy than short-term rates; but the long-term rates are also especially sensitive to inflationary expectations. It is well, therefore, to take note of the fact that interest rates on corporate and municipal bonds, instead of following the recent rise in short-term rates, remained fairly stable and are actually a little lower now than they were in April.

These developments in credit markets are, I believe, attributable in significant part to public confidence in the Federal Reserve's monetary policy. It is noteworthy that, in general, interest rates still remain below levels prevailing at the beginning of the economic recovery.

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During the past half year, the Federal Reserve has managed to keep the growth of the major monetary aggregates on a moderate path. *M*-1—which consists of currency and checking accounts at commercial banks—increased at an annual rate of 6.4 per cent. This is a faster rate of growth than occurred last year, and it reflects the very intense demand for transactions balances in recent months. Growth of the broader aggregates, on the other hand, has been slower than last year—a deceleration due partly to the low personal saving rate that has evolved and partly to some modest redirection of savings flows away from deposit accounts and into market securities as short-term interest rates have risen. Despite the moderate slowing of the broader monetary aggregates, financial institutions—both commercial banks and the thrift institutions—remain relatively liquid and in a good position to continue supporting economic expansion.

During the next few quarters, it is improbable that over-all economic growth will proceed as rapidly as it did during the past 6 months. Typically, bursts of consumer spending of the kind witnessed this year are followed by phases of moderation. Such moderation, indeed, seems to be signaled by recent data on retail sales. Nor, of course, is it to be expected that inventory investment will be adding as much to economic expansion as it did in preceding quarters. And in view of the high rate of single-family housing starts already attained, it is likely that housing will contribute less to growth.

These probable developments, however, do not portend an end to general economic expansion. We at the Board anticipate continuing growth—albeit at less rapid rates—in consumption, inventory investment, and homebuilding. We think, moreover, that investment activity by business firms will maintain a good growth pace and perhaps accelerate as businessmen are confronted, as they may well be, by reduced capacity margins next year. Meanwhile, as I noted earlier, there is reason to expect that the pace of State and local government spending will continue to quicken. What these various trends suggest is a change in the character of the expansion—with the over-all growth rate slowing but still high enough to produce some further reductions in unemployment.

The fact that the Nation's unemployment rate remains high by historical standards is a source of continuing concern. If we as a people are to address this problem effectively, our first task is to

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understand the special factors that make it so difficult now to achieve rapid reductions in joblessness.

The stickiness of the unemployment rate, it needs to be appreciated, does not reflect unusual slowness in the opening up of new job opportunities during the current expansion. On the contrary, the growth of jobs since the recession trough in March 1975—some 6½ million—has been more rapid than during the comparable phase of any cyclical recovery since World War II. It happens, however, that the rate of increase in the labor force also has been unprecedentedly rapid in the course of this expansion—amounting to more than 5½ million persons. Consequently, despite the huge rise that has occurred in employment, the reduction in over-all unemployment has been modest.

The single most important reason for the fast pace of labor force growth has been a veritable rush of adult women into the job market. Indeed, of the increase of 5.6 million that has occurred in the labor force since the recession trough, 2.4 million—or more than 40 per cent—is accounted for by women of age 25 or over. Strikingly, if the percentage of this adult female population in the labor force had been the same in June 1977 as it was in March 1975, when economic recovery started, the adult female labor force would have been lower by 1½ million this June. What we are witnessing, literally, is a revolution in the role of women in our society, and we need to focus on the economic implications of this phenomenon more carefully than we have.

Obviously, the fact that the labor market has had to absorb the "extra" influx of female job seekers is a major reason why the Nation's over-all unemployment rate has not moved downward more decisively. The rapid influx of women into the labor force takes on particular significance because it happens to reinforce another demographic factor that also is taxing the absorptive capabilities of the labor market. I refer to the continuing large additions of young people to the labor force—a reflection of the high birth rates of the 1950's.

Both adult women and young people tend to experience unemployment rates above average. Many have never held a regular job before. Others left the work force years earlier on account of marriage or the arrival of children. Whatever the state of the labor market, a decision to enter or re-enter the labor force often involves a fairly

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extended period of job hunting—frequently prolonged by lack of knowledge about available job opportunities. For married women—especially those with young children—the desired job is often part time and close to home, so finding the right position may take quite a lot of time. For young people, early work experience frequently involves various job shifts—and sometimes several periods of unemployment—until a job considered appropriate is found.

Because of the decline in birth rates that started in the early 1960's, growth in the younger-age component of the labor force can be expected to taper off in the next few years. But no sign of tapering is as yet visible in the labor force participation by adult women. A decided slowing of the inflation rate—if that were to occur—might check the rise in female labor force participation, since some women clearly have taken jobs in order to offset the effects of inflation on household budgets. However, social trends seem to be of greater significance in conditioning the movement of women into the labor force. Attitudes toward childbearing and childrearing and toward educational and career aspirations of women have been undergoing dramatic changes in our society, and it cannot be foretold when this process will wane.

Thus rapid labor force growth may persist, thereby continuing to make it difficult to reduce the over-all unemployment rate to levels that were once considered reasonably consistent with the goal of full employment. Indeed, the changed age–sex composition of the labor force—now weighted more than formerly toward groups that tend to have higher-than-average unemployment rates—probably has imparted an upward tilt to over-all unemployment of about 1 percentage point compared with 20 years ago.

In time, of course, as women gain experience in the labor market and as businesses adapt their operations so as to employ women more effectively, the upward bias should lessen. One of our prime policy objectives certainly should be to facilitate the assimilation of adult women and young people into the active work force. That is not likely to be accomplished by actions that rely simply on boosting aggregate monetary demand. Such actions would tend to accentuate inflationary pressures in the economy without doing a great deal to facilitate the desired assimilation. In fact, the need to protect family incomes against the ravages of inflation may cause even more women and young people to enter the labor force. We therefore need

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to recognize very clearly that accommodation of significant changes in the labor market requires policies that are specifically tailored to the elimination of structural hindrances to full employment.

Even before the sharp acceleration of growth in the entry of women into the labor force, there was reason to be concerned that reasonably full use of our commercial and industrial capacity might be reached before we began approaching full employment of our labor force. That concern, arising from the laggard behavior of capital formation, is now greater because of the unexpected rapidity with which the labor force is expanding. The inference seems inescapable that we need governmental policies that offer decisive encouragement to capital formation. Unless recognition of that need conditions the evolution of policies in such major areas as energy, taxes, social security, welfare, and governmental regulation, there will be small hope of maximizing job opportunities in the next several years.

We need an environment that is decidedly more conducive to business risk-taking than that which has prevailed in recent years. In my judgment, we are very much in danger of forgetting that ours is basically an enterprise economy whose vitality depends on whether business firms are able to earn an adequate rate of return on invested capital. Despite the increasing role of government in economic activities, profits are still the essential driving force of our economic system. Economic discussions nowadays deal extensively with the effects of monetary and fiscal policies on economic activity; but they do not focus frequently enough on the even more important matter of whether private businesses—which dominate job creation in our system—have adequate incentive to expand their operations or to undertake new ventures. Our citizenry may pay dearly if this myopia persists.

It also is important to rethink some of our national policies with respect to the market for jobs. One of the most critical needs is to avoid governmental actions that compound the problems that newcomers to the job market already have. New entrants—whether young people or adult women—often cannot be highly productive in the initial phase of their employment. Minimum wage legislation is blind to that fact, and thus limits employment opportunities for job seekers with little or no recent work experience. With young people and other newcomers to the labor force now accounting for a disproportionate share of the unemployed, this is hardly an opportune time for the

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Congress to contemplate a boost in the minimum wage that goes well beyond the President's original recommendation.

Statutory changes in minimum wages affect not only the lower end of the wage spectrum. In practice, they tend to have a leveraging effect on the general wage structure as various tiers of workers seek to maintain the differential between their wage and that of lower-paid workers. Such a development would reinforce the upward pressure on wages that already derives from the continuing advance of consumer prices, from tight labor markets here and there, and from large and well-publicized collective bargaining settlements in some industries.

Labor costs per unit of output in the private business sector rose by 5.4 per cent in the year ending in March. This increase reflects the difference between an average increase in labor compensation per hour of about 8 per cent and an average increase of 2½ per cent in output per hour. Since we are now in a phase of the business cycle when productivity gains are more likely to slow than to accelerate, the upward pressures on wages may lead to still stronger pressures on unit labor costs. Many businesses—not always justifiably—already feel a need to recoup labor cost increases or to increase profit margins. To the extent that they succeed in raising their selling prices, the inflation rate will tend to worsen and so too will inflationary expectations. To the extent that they fail, profit margins may narrow—a development that would diminish the likelihood of sustained expansion of capital investment.

The need to concern ourselves with impending cost distortions and inflationary trends is evident from the price record of the first half of this year. That record, to be sure, was influenced by some transitory forces, and there has been some diminution in the rate of inflation lately. Even so, the rate of inflation this year is running higher than it did last year. This is a disturbing development for international as well as for domestic reasons.

In recent weeks, the dollar—which had maintained remarkable stability against the average of foreign currencies since early last year—has experienced limited but conspicuous depreciation. This is a matter that no one in our Government can or does take lightly: first, because any material depreciation of the dollar against foreign currencies would have some adverse effect on our domestic price level; second, because the dollar is a store of value for much of the

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rest of the world. The fact that the dollar has weakened even in relation to the currencies of countries experiencing much greater inflation than the United States is a reminder that market psychology has a way of magnifying or distorting for a time underlying trends. A sound dollar is essential to our economic future, and everyone with major financial responsibility in our Government is keenly aware of that.

We at the Federal Reserve have persistently sought to protect the integrity of the dollar and at the same time to foster further economic expansion. The members of the Federal Open Market Committee, when they met earlier this month to discuss the longer-run growth of the monetary aggregates, carefully considered international as well as domestic developments. The Committee decided to leave unchanged for the year ending in the second quarter of 1978 the previously projected growth ranges of the broader monetary aggregates. *M*-2 thus is projected to grow within a range from 7 to 9½ per cent during the next year, and *M*-3 within a range from 8½ to 11 per cent. An adjustment, however, was made in the growth range for *M*-1; the lower boundary of this range was dropped by ½ of a percentage point, so this aggregate is projected to increase within a range from 4 per cent to 6½ per cent in the year ahead.

The adjustment in the projected growth range for *M*-1, while small, represents another step toward bringing the long-run growth of the monetary aggregates down to rates compatible with general price stability. Sustained progress in this direction is essential if the administration's publicly announced goal of reducing the pace of inflation by about 2 percentage points by the end of 1979 is to be achieved.

The trend of growth in monetary aggregates, I regret to say, is still too rapid. Even though the Federal Reserve has steadily sought during the past 2 years to achieve lower ranges for monetary expansion, the evolution of its projections has been extremely gradual; indeed, at the pace we have been moving it would require perhaps a decade to reach rates of growth consistent with price stability. I must report, moreover, that despite the gradual reduction of projected growth ranges for the aggregates during the past 2 years, no meaningful reduction has as yet occurred in actual growth rates. That unintended consequence is partly the result of data deficiencies that complicate the already formidable task of adjusting or approximating

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monetary growth objectives. Some of the data deficiencies we have experienced are being overcome. Even so, monetary measurement will continue to lack the precision of a science. So too will the Federal Reserve's actions aiming to influence developments in financial markets.

Implicit in our projections for monetary growth is the expectation that the velocity—or turnover—of *M*-1 will increase at a faster rate than it has on the average during comparable periods of previous business-cycle expansions. That does not seem an unreasonable expectation, inasmuch as the velocity of *M*-1 has, in fact, been increasing more rapidly during the current recovery than the historical record would have suggested—a development that reflects the increasing importance of a wide range of substitutes for traditional checking deposits. The Federal Reserve Board's staff estimates that the growing use of such substitutes—for example, negotiable orders of withdrawal (NOW) accounts, credit union share drafts, drafts on money market mutual funds, passbook savings accounts for business firms and State and local governments, and telephonic transfers from savings to checking accounts—depressed the rate of growth of *M*-1 by about 1½ percentage points in 1976. This year the impact may be smaller but nonetheless will remain significant.

The relationship between monthly or even yearly rates of monetary expansion and the performance of the economy is subject to considerable uncertainty under the best of circumstances. In the current environment of rapid change in methods of carrying on financial transactions that uncertainty is heightened. Consequently, the Federal Reserve will continue to maintain a posture of vigilance and flexibility in the period ahead. Current monetary policy represents our best judgment as to what is appropriate in the light of evolving economic and financial developments. We will not be slow in modifying that policy if actual conditions deviate materially from our expectations.

In concluding this report, I think it appropriate to emphasize the great complexity of the economic problems currently confronting our Nation. There are no instant, easy solutions that will deliver us from our difficulties. For our part, we at the Federal Reserve know that inflation ultimately cannot proceed without monetary nourishment. But we also live with a realization of our limited capacity to move dramatically or quickly in making means of financing less readily available. The shock of abrupt adjustment after so many years

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of druglike abuse of our economic system would be excessively risky. To the maximum extent feasible, however, we are determined to move toward re-establishing conditions of financial order in our society. That is not because financial order is itself an end with which we are preoccupied, but because our Nation cannot realize its potential for sustained prosperity and well-being until existing apprehensions about inflation are subdued.

We at the Board have no illusions about what the Federal Reserve alone can accomplish. Sound monetary policy is a prerequisite to the achievement of the employment and price goals set forth by the administration. But other elements are no less critical. The President's timetable for eliminating the deficit in the Federal budget deserves the earnest support of the Congress. Structural rigidities that are weakening our economy also require serious attention. It is fortunate that members of the Congress increasingly perceive that persistent budget deficits and ever-faster increases of the money supply, whatever their usefulness in the past, are no longer capable of solving our economic problems.

STATEMENT BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, U.S. SENATE, NOVEMBER 9, 1977

I am pleased to meet with this committee once again to present the report of the Board of Governors of the Federal Reserve System on the condition of the national economy and the course of monetary policy.

It might be useful to begin this testimony with a few comments on economic developments during the past several years. I do so because I believe that analysis of the current situation will be helped materially if we start with a reasonably clear understanding of how we got to where we are.

The key economic problems confronting our Nation today have their origin in events that extend back over a considerable time. A major conditioner of national economic affairs at present continues to be the fact that inflation was allowed to get so far out of control in the latter part of the 1960's and the early 1970's. Precisely why that happened is a very complex matter, involving both shocks to our economy—the chief one being the quantum jump in oil prices—and some mistaken actions by governmental and private decision-

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makers alike. But it is no part of my immediate concern to explore or assign responsibility. The point I want to stress is simply that the distortions of the inflationary blow-up that occurred in the 1972–74 period are still casting a heavy shadow on our economic environment.

Certainly, the recession of 1974–75 would not have been nearly so severe, and indeed might not have occurred at all, had it not been for the inflationary stress of the preceding several years. Blinded by the dizzying advance of prices and the effects of that advance on their nominal profits, businessmen were slow to recognize that the underlying condition of demand for their products was deteriorating. They thus continued aggressive programs of inventory expansion and capital-goods expansion longer than was prudent, with the consequence that economic imbalances cumulated to major proportions in 1973 and 1974. By the time businessmen recognized the mistaken assessments they had made, the need to scale back operations had become enormous. The worst recession in a generation ensued.

The scars of both the recession and its prelude are with us still. Psychologically, the recession was profoundly disturbing because of its magnitude and because it caught so many people by surprise. A good many of our citizens, it seems clear, had developed inordinate faith in government's ability to manage and sustain economic expansion. When they discovered that that faith was not justified, the experience was sobering—particularly for the not inconsiderable number of businessmen who in the froth of the earlier prosperity had added excessively to their short-term debts. Out of that trauma was born a resolve in the minds of many businessmen to be much more cautious in managing inventories, and also in adding to their fixed costs or in enlarging their current liabilities.

And, as this committee knows well, it was not only the business sector that was affected. Many State and local governments encountered problems that were just as searing—with New York City representing only the extreme case. That was partly because their normal expenditures tend to respond more elastically to inflation than do revenues, and partly because their budgets—particularly those of local governments—were hard hit during the recession by the costs of income-maintenance programs. It was not so long ago, as you may recall, that grave concern was being voiced across our land about the financial health of many State and local governments.

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The special legacy of inflation and recession has inevitably been on our minds at the Federal Reserve in hammering out monetary policy throughout the past 2½ years of recovery. We have recognized, on the one hand, that formidable risks of adding to inflationary expectations would accompany any pursuit of aggressive monetary ease. But at the same time, we have been sensitive to our obligation to foster financial conditions favorable to encouraging job opportunities so that the unemployment rate—which has remained very high by historical yardsticks—might be further reduced.

What we feel has been virtually obligatory in these circumstances is a middle course of moderate monetary expansion. That, in fact, is the course we have pursued to the best of our ability. Monetary aggregates, to be sure, have sometimes grown very slowly for short timespans; in other periods, they have grown very rapidly. Over all, however, the path has been one of moderation. This is evidenced, for instance, by an average annual rate of growth of about 6 per cent in *M*-1—the narrow money stock, which includes only currency and demand deposits—during the 10 full quarters of this recovery.

The rise in *M*-1 and in related monetary aggregates has been sufficient to finance a large gain in the physical volume of output and employment. Indeed, nearly 7 million jobs have been created since March 1975—a performance without parallel in both absolute and percentage terms since World War II. But the increases in the money supply, while so favorable to the physical expansion of economic activity, were sufficiently limited to permit a retreat from double-digit inflation. And clearly, the increases that occurred in the money supply have not excited new inflationary expectations—a fact evidenced by the dramatically atypical behavior of interest rates in this expansion. Short-term interest rates, despite the advances of recent months, are not materially higher today than they were at the beginning of this expansion. And long-term rates are actually lower by a significant margin. Charts 1 and 2 of the appendix to this statement, which depict the behavior of interest rates, make this entirely clear.[1]

All in all, we at the Federal Reserve are satisfied that monetary

[1] The appendix to this statement is available on request from Publications Services, Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

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policy has made an important contribution to the recovery and to the basic economic health of this Nation. Among other things, monetary policy has helped to produce a receptive, orderly environment for a massive amount of debt restructuring. During this expansion, business firms have been notably successful in reducing the ratio of short- to long-term debt, and State and local governments as well have been able to strengthen their financial posture. Progress of this kind has not only enhanced the potential of businesses and governmental units to play a continuing supportive role in the economic expansion; it has also quieted the not inconsiderable nervousness many investors felt a short time ago about holding debt issues, especially those enjoying top ratings. That is a very constructive financial-market development.

The recovery of economic activity during the past 2½ years has had features that might have been expected from the special circumstances that prevailed earlier. For instance, retail sales and housing starts weakened at the very beginning of 1973—well in advance of the peak of the previous cyclical expansion. These activities consequently avoided some of the extreme end-phase distortion that occurred elsewhere in the economy, and they have displayed the most conspicuous elements of strength during the current expansion. In both instances, the percentage gains since the recession trough in March 1975 are greater than have been usual in previous expansions. By contrast, a large residue of caution has characterized business spending for both inventories and fixed capital.

Indeed, the control that businesses are exercising nowadays over inventories has produced very prompt slowing in production whenever consumer spending showed signs of hesitancy. That fact goes a long way toward explaining why we have had considerable unevenness in the rate of over-all economic advance. While the pauses have produced some anxiety from time to time, the new determination of businessmen not to allow their inventories to become unbalanced is actually a constructive development.

A worrisome feature of businessmen's current caution, however, is their marked reluctance to proceed with capital investment programs comparable to those of previous expansions. In the 2½ years since the recession trough, "real" capital outlays have increased less than half as much as they did, on average, over like periods in previous postwar expansions. The shortfall has been especially marked in

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the case of major long-lived industrial projects, and it has occurred even in industries—such as basic chemicals—in which the rate of capacity utilization is well advanced. The relative weakness of spending on plant and equipment is, indeed, the most troublesome feature of the current expansion. In large part this weakness is due to the unsatisfactory performance of corporate profits—a difficulty that I discussed at length in a recent speech and one that must be overcome soon if the recovery is to take on a more balanced character and hence enjoy a good chance of being sustained.

One other unusual weakness of this recovery—and this again is something that could have been reasonably anticipated—has been the subdued expenditure pattern, until recently, of State and local governments. Their "real" spending, like that of businesses for fixed-capital assets, also is up by only about half as much from the recession trough as has been typical in previous expansions—a clear reflection of the generalized financial strains that State and local governments have experienced.

In sum, the character of the current economic recovery has differed in some major respects from that of earlier recoveries. This fact has considerable bearing on prospects for the continuation of the recovery and also for policy formulation. One thing that should be apparent is that the obstacles that have stood in the way of more vigorous economic growth are not likely to be successfully addressed by conventional stimulative actions. Simply opening up the monetary faucets or spewing out funds from the Treasury does not seem a promising course in view of the widespread concerns that now exist—particularly in the business and financial community. We need policies, rather, that are attuned to our special legacy—namely, past inflation, its aftermath of recession, and fears of new troubles that may yet come from a continuing high rate of inflation.

It has not been easy during recent months to interpret economic or financial developments with as much confidence as one would like to feel. This committee is aware, I am sure, of the wide divergence of judgment that has been expressed by private economists. A similar diversity of views—although less pronounced—has existed within the Federal Reserve System. This is simply a time when honest differences in assessment can easily arise among conscientious analysts. At the September meeting of the Federal Open Market Committee, for instance, the consensus favoring some firming of

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monetary policy found 2 of the 12 Committee members dissenting because they felt that the policy allowed for more firming than they believed to be justified and another two members dissenting because they thought that the intended firming was inadequate.

I can report, nevertheless, that the dominant view within the Federal Reserve is that economic expansion will persist well into 1978, probably at a pace sufficiently strong to result in some further reduction in the unemployment rate. The collective belief is that the reduced rate of increase in real gross national product (GNP) in the third quarter is now giving way to quicker expansion. A key element in this expectation is the emergence recently of a strong pattern in State and local government spending and employment—reflecting the improved budget position of these governments. Also supportive of the view that early 1978 will witness good gains in general economic activity is the fact that business capital spending, although far from robust, is moving ahead, and in particular is showing some recovery in major industrial construction.

The judgments that we in the System have about the more distant future are much more tentative—mainly because of uncertainties about capital formation and the generally weak trend of activity in foreign economies. Lagging recovery abroad has, of course, worked to the serious detriment of our export trades and this in turn has caused some weakening of the dollar in foreign exchange markets. The uneasiness that now appears to prevail in many parts of the business world casts a cloud on the longer-run prospects of the economy, but the possibility that the general expansion will actually accelerate as 1978 unfolds—particularly if capital spending can be invigorated—is very much a part of my own thinking as well as that of some other members of the Federal Reserve.

I must call your attention to a striking fact. The somewhat mixed character of recent economic news has been reflected in equity prices quoted on the stock exchanges, but it has had little counterpart in other financial developments. General credit expansion, indeed, has proceeded at a brisk pace this year—with an intensity that I do not think has been fully appreciated. The Federal Reserve has naturally given some weight to the evolving pattern of credit expansion in the course of its monetary policy deliberations. We have not been able to assume, as some others appear to have done, that the intense reaching out for credit is a process without significance.

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The total amount of funds raised in credit markets this year not only has expanded very rapidly from quarter to quarter in absolute terms but also has expanded much more rapidly than has the dollar value of GNP. Preliminary estimates indicate that total borrowings by all entities in this country ran at an annual rate of about $400 billion in the third quarter of this year—or some $90 billion more than in the third quarter of 1976. This raised the ratio of total borrowings to the dollar value of GNP above 20 per cent, close to the all-time peak record during the speculative boom of early 1973. It is hardly surprising, I submit, that such a volume of fund raising should press against available supplies of credit and tend to cause some interest rates to move upward. I would note especially that the quest for credit accommodation has not been confined to just a few sectors of the economy; rather, it has been very broadly diffused.

Households have absorbed a huge total of credit this year, mainly in the form of mortgage and instalment debt. Their net addition to mortgage and instalment debt, which was $46 billion in 1975 and $82 billion in 1976, rose to an annual rate of $105 billion in the first half of this year and to an estimated rate of $115 billion in the third quarter. This, I might add, has raised the combined instalment and mortgage repayment burden that households face—relative to their disposable income—close to the previous high experienced in 1973. I do not mean to imply that this as yet is a matter for serious concern. But this is an area that warrants continuing close scrutiny for signs of excess, with special attention given to the apparently increasing tendency of homeowners to borrow heavily against the accumulated equity in their residences.

Business firms, too, have borrowed much more this year than last. During the early stages of this economic expansion, the sum of retained earnings and depreciation actually exceeded outlays by nonfinancial corporations for inventories and fixed capital. This relationship was reversed in 1976, and—with the tempo of capital spending picking up this year—a larger "financing gap" than existed in 1976 has developed. For all of 1977, the Board's staff estimates that nonfinancial corporations will raise a net total of about $80 billion in credit markets, up almost 40 per cent from last year. The higher volume of business borrowing this year is being distributed between short- and long-term debt, with the former showing the more prominent rise—partly because some of the higher-rated industrial

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corporations have largely completed their desired balance sheet restructuring.

I know that it is widely believed that short-term and intermediate-term business borrowing has been sluggish. True, there has been some unevenness in borrowing pressures from region to region and from one type of lending institution to another; but any impression that shorter-dated business credit demands have been anemic is decidedly wrong. There has, in fact, been an impressively rapid rise since late last year in the combined total of business credit raised from banks, the commercial paper market, and finance companies. The rate of increase, to be sure, did slow materially this September, but that seems to have been an erratic deviation from the basic trend; preliminary data indicate extremely fast-paced growth of business loans in October.

Moreover, it has not been only the private sector of the economy that has reached out aggressively for credit this year. Borrowing by State and local governments has been running at record levels, partly because these governments have moved to take advantage of the significant renewal of lender confidence in tax-exempt securities. Our Board staff estimates that the net borrowing of State and local governments during this year for all purposes will come to about $25 billion, up more than 60 per cent from the borrowing in 1976. Much of this money is being used to finance construction of such things as water treatment and sewer systems and municipal power facilities.

And not to be forgotten is the continuing large appetite of the Federal Government for credit. Thus far during calendar 1977, it is true, such borrowing has been smaller than in the like period of 1976, reflecting a reduced budget deficit. But the rate of Federal borrowing nevertheless has remained exceptionally large and—what is more significant—it is now heading upward again, in contrast to the normal pattern of progressively lower financing needs as economic expansion proceeds. That reflects, of course, various tax cuts or tax-cut extensions embodied in the Tax Reduction Act of 1977 and various spending initiatives taken last spring with a view to quickening the pace of economic growth. For the full fiscal year 1978, the combined unified and off-budget deficit is now officially estimated at about $69 billion—nearly $16 billion higher than for fiscal year 1977. The Treasury started this fiscal year with a large cash balance.

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Even so, it appears likely that in the 6-month period ending with March 1978 the Treasury will have to raise about $10 billion more in financial markets than it did in the corresponding period 1 year earlier.

I have dwelt at some length on the evolving pattern of credit extension because, as I noted earlier, I do not think that what has been happening in credit markets is as widely appreciated as it should be. The vigor of credit extension certainly suggests a sense of greater dynamism in the economy than appears, for example, from business statistics for the third quarter. The vigor of credit extension is not, however, patently at odds with economic developments averaged out over several quarters. And it may be, of course, that undue attention has been given to the summer pause in trying to gauge how well the economy is doing. That is a possibility that the Federal Reserve has had to weigh. It would be a happier situation if there were less apparent conflict between different kinds of evidence, but in making decisions on monetary policy we must do the best we can whatever evidence can be mustered.

There is no rigid link between the total volume of credit outstanding in the economy and the Nation's stock of money, but movements in credit and money do tend, of course, to be positively related. If the demand for credit begins to strengthen at a time when financial institutions are relatively liquid, a good amount of credit expansion can occur without much—if any—change in monetary balances. But as the economy grows and credit expansion continues, sooner or later a need for enlarged money balances will arise in order to facilitate the enlarged total of credit transactions. Such a process has unquestionably been at work this year, and it explains in some measure why the growth of *M*-1—the narrow money stock—has accelerated recently in relation to money growth earlier in this expansion.

As you know, the Federal Open Market Committee (FOMC) has, however, the ability to take prompt steps that will in time check any unwanted acceleration in the money aggregates. There has been considerable discussion recently in economic and financial circles as to why we at the Federal Reserve have allowed money growth in the past 6 or 7 months to exceed the upside limit we had projected for longer-term monetary expansion. *M*-1 actually grew at an average annual rate of 9 per cent during the second and third quarters of this year—well above the 6½ per cent upper end of the longer-term

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growth range previously projected. Growth in the broader monetary aggregates has also run above their anticipated upper limits, but the excess in their case has been minor. The growth actually recorded in them has shown no quickening compared with earlier stages of the economic expansion. Still, their growth has rather consistently exceeded our objectives.

The high rate of growth in each of the major monetary aggregates during the past 6 months is thus a setback to the Federal Reserve's policy of gradually reducing the rates of growth of the monetary aggregates, so that they may in time be once again consistent with general price stability. But it is only a temporary setback. A zigzag course is sometimes inevitable or perhaps even desirable.

One fact that needs to be borne in mind is that the acceleration of money growth has not occurred in a smooth pattern. Instead, the tendency toward excess has proceeded in fits and starts, so it was virtually impossible to judge how durable—or meaningful—this or that large increase in *M*-1 was likely to be. Often in the past, spurts in monetary growth such as occurred in April and July of this year have been followed by strong reversals. Things did not quite happen that way this year.

Besides, it was virtually impossible even 3 months ago to isolate with any confidence the causes of the sudden spurt in monetary growth. While still somewhat obscure, the forces at work have now become clearer. At practically every hearing thus far held under House Concurrent Resolution 133, I have called attention to the dynamism of financial technology. More specifically, I have kept stressing that the growth of *M*-1 was for a time being retarded by such things as the development of negotiable orders of withdrawal accounts, the newly enjoyed authority of businesses and State and local governments to have passbook savings accounts, and the steadily increasing tendency of individuals as well as corporations to carry at least a part of their transactions balances in one or another type of income-earning asset. Such developments—which served to retard the growth of *M*-1 appreciably during 1975 and 1976—appear to have waned considerably this year. Econometric work done at the Board indicates that within the past half year the growth of *M*-1 moved back to something like its pre-1974 relationship to economic activity. But we still do not know whether the slowing of changes in financial technology is more than a temporary aberration.

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Under the circumstances, we have judged it wise to move cautiously in adapting policy. We have felt very keenly the need for some clarification of ambiguities before striking out decisively. We well realize that the middle course actually followed—that of gradually limiting the availability of bank reserves and thereby slowing the growth of money—has left us open to the charge of temporizing. In fact, we did not temporize at all, but we did move prudently.

On the one hand, restrictive action vigorous enough to have kept *M*-1 growth within the projected ranges would, we believe, have forced a far steeper climb in short-term interest rates than actually has occurred since April. This could have proved destructive to the smooth functioning of financial markets and might eventually have brought serious injury to our economy.

On the other hand, a determined effort by the Federal Reserve System to prevent any rise in interest rates during recent months would have produced—in the face of the credit pressures that have been experienced—a rate of monetary expansion well above the rise that has actually occurred. That would have been very damaging, for it would have practically destroyed any remaining hope of achieving mastery over the inflationary forces that now move our society. Indeed, the Federal Reserve might then have been viewed as having transformed itself into an engine of inflation—such as it was a generation ago when it reluctantly pursued a course of pegging Government security prices.

The increase of short-term interest rates that has occurred since late April has thus served to check what otherwise might well have been an explosion of the money supply. By taking measures to curb the growth of money, we have demonstrated that we remain alert to the dangers of inflation. As a consequence, long-term interest rates, which nowadays are extremely sensitive to expectations of inflation, have remained substantially stable. Had we not taken steps to bring the money supply under control, I have little doubt that fears of inflation would now be running stronger and that long-term interest rates, which play such a significant role in shaping investment decisions, would therefore now be higher than they in fact are. In that event, of course, the continuance of economic expansion would be less secure.

At the most recent meeting of the FOMC, held on October 18, we deliberated at length on the monetary growth aggregates that

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appeared desirable in the coming year. For the period extending from the third quarter of this year to the third quarter of 1978, the Committee decided to retain the growth range of 4 to 6½ per cent for *M*-1 specified at the July meeting. Some sentiment was initially expressed for reducing the upper end of the *M*-1 band with a view to compensating for the excessive growth that has been occurring. Other members favored widening the *M*-1 band because of uncertainty as to whether the basic relationship between money growth and GNP was again changing. In the end, there was a consensus that the growth range previously established for *M*-1 should be retained until more certain knowledge developed as to the relative importance of the influences now conditioning *M*-1 growth.

However, in the case of the broader money stock measures—which have been behaving more normally—the Committee decided to lower both the upper and the lower bounds of the projected growth ranges by ½ of a percentage point. Thus, the 12-month growth range for *M*-2—a measure of money that includes, in addition to *M*-1, savings and consumer-type deposits at commercial banks—was set at 6½ to 9 per cent. That for *M*-3—a still broader measure, which includes the deposits of thrift institutions as well—was set at 8 to 10½ per cent.

A crucial consideration in lowering the longer-term ranges for the broader aggregates was the Committee's wish to reaffirm its intent of gradually bringing down the growth of the monetary aggregates to rates compatible with reasonable price stability. Such action seemed particularly appropriate at a time when the behavior of *M*-1 might be interpreted as indicating that the Federal Reserve was faltering in its determination to lean against inflationary pressures. No such faltering has occurred, nor is it likely to occur. October's sharp advance of the wholesale price index should remind everyone of the need for unrelenting efforts to contain the push of inflation. The resolve of the Federal Reserve to undernourish and weaken inflation remains undiminished. We fully recognize that a powerful inflationary bias has become embedded in our economic life over many years and that general price stability cannot therefore be restored quickly; but we do not intend to depart from pursuing the maximum degree of monetary firmness consistent with our companion

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obligation to foster financial conditions that favor expansion of job opportunities.

I want to assure this committee that, in lowering the growth ranges for the broader aggregates, we did not overlook the implications for thrift institutions and the borrowers they serve. The new upper ends of the ranges for *M*-2 and *M*-3 are compatible, in our judgment, with a substantial flow of new savings into thrift institutions in the year ahead. These institutions are less vulnerable to deposit outflows than they were in earlier years, since a very large and increasing portion of their liabilities now consist of longer-dated certificates. Their earnings position has also strengthened considerably, and they enjoy relatively large liquid assets and good capability to borrow if necessary. In short, even if deposit inflows were to slow appreciably in the coming year, the ability of these institutions to support the homebuilding industry will probably remain strong.

I would like to emphasize one additional point before concluding this statement. The objective of the administration and the Federal Reserve to achieve better price performance in our country is obviously not being helped by the recent depreciation of the dollar against foreign currencies. A cheaper dollar in foreign exchange markets spells higher costs of imported goods—and these now have a much larger role in our domestic markets than they did a decade or two ago. Depreciation of the dollar can also cause serious international difficulties since the dollar is a store of value not only for foreign central banks but also for multinational corporations and individuals of wealth all over the world. We dare not, therefore, be complacent about the current depreciating tendencies of the dollar.

It is not easy to counter these tendencies at a time when our trade deficit has become enormous—a phenomenon that partly reflects the more advanced degree of economic recovery achieved in this country than abroad. To some extent imbalance in our foreign trade will be self-correcting as economic activity strengthens abroad, but we surely should seize every opportunity to help accentuate any tendency toward improvement. That means, first of all, that we need to adopt an energy policy that relies less heavily on imports of oil. It means, secondly, that we must have a business environment that is hospitable to new investments. And it means, finally, that respon-

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sible monetary, fiscal, and structural policies are required to protect our international price competitiveness. In short, and fortunately, these international considerations reinforce our basic domestic needs.

We at the Federal Reserve, I need hardly tell you, will continue to devote our energies to the maintenance of a sound dollar—a dollar that is both strong here at home and strong abroad.

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Part 2

Records, Operations, and Organization

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Record of Policy Actions of the Board of Governors

JANUARY 3, 1977

Amendment to Regulation L (Interlocking Bank Relationships Under the Clayton Act)

Effective January 4, 1977, the Board amended Regulation L to permit—under certain conditions—a director, officer, or employee of a member bank to serve simultaneously as a director, officer, or employee of a minority or women's bank.

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Jackson, and Partee.

The Board took this action to aid the development of minority and women's banks by making it easier for them to obtain the management and operating expertise of experienced bankers.

Interlocking relationships between member banks and other banks in the same city, town, or village are generally prohibited by the Clayton Act and by Regulation L. However, the statute allows the Board to make exceptions by regulation.

The amendment provides that any director, officer, or employee of a member bank may at the same time be a director, officer, or employee of one other bank that is controlled or managed by women or by members of minority groups subject to the following conditions:

1. The interlocking relationship must be determined by the Board of Governors to be necessary to provide management or operating expertise to the minority or women's bank.
2. No more than three interlocks are permitted between any two such banks, and the interlocks may not represent a majority of the board of the minority or women's bank.
3. No interlock may continue for more than 5 years.

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FEBRUARY 11, 1977

Bank Holding Company Divestitures

The Board issued a policy statement regarding divestitures required of bank holding companies.

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Burns.

The Board issued this statement to provide guidance to bank holding companies. The policy applies to divestitures required either by statute or by Board order. The text of the statement follows:

> From time to time the Board of Governors receives requests from companies subject to the Bank Holding Company Act, or other laws administered by the Board, to extend time periods specified either by statute or by Board order for the divestiture of assets held or activities engaged in by such companies. Such divestiture requirements may arise in a number of ways. For example, divestiture may be ordered by the Board in connection with an acquisition found to have been made in violation of law. In other cases the divestiture may be pursuant to a statutory requirement imposed at the time an amendment to the Act was adopted, or it may be required as a result of a foreclosure upon collateral held by the company or a bank subsidiary in connection with a debt previously contracted in good faith. Certain divestiture periods may be extended in the discretion of the Board, but in other cases the Board may be without statutory authority, or may have only limited authority, to extend a specified divestiture period.
>
> In the past, divestitures have taken many different forms, and the Board has followed a variety of procedures in enforcing divestiture requirements. Because divestitures may occur under widely disparate factual circumstances, and because such forced dispositions may have the potential for causing a serious adverse economic impact upon the divesting company, the Board believes it is important to maintain a large measure of flexibility in dealing with divestitures. For these reasons, there can be no fixed rule as to the type of divestiture that will be appropriate in all situations. For example, where divestiture has been ordered to terminate a control relationship created or maintained in violation of the Act, it may be necessary to impose conditions that will assure that the unlawful relationship has been fully terminated and that it will not arise in the future. In other circumstances, however, less stringent conditions may be appropriate.

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1. *Avoidance of Delays in Divestitures.* Where a specific time period has been fixed for accomplishing divestiture, the affected company should endeavor and should be encouraged to complete the divestiture as early as possible during the specific period. There will generally be substantial advantages to divesting companies in taking steps to plan for and accomplish divestitures well before the end of the divestiture period. For example, delays may impair the ability of the company to realize full value for the divested assets, for as the end of the divestiture period approaches the "forced sale" aspect of the divestiture may lead potential buyers to withhold firm offers and to bargain for lower prices. In addition, because some prospective purchasers may themselves require regulatory approval to acquire the divested property, delay by the divesting company may—by leaving insufficient time to obtain such approvals—have the effect of narrowing the range of prospective purchasers. Thus, delay in planning for divestiture may increase the likelihood that the company will seek an extension of the time for divestiture if difficulty is encountered in securing a purchaser, and in certain situations, of course, the Board may be without statutory authority to grant extensions.

2. *Submission and Approval of Divestiture Plans.* When a divestiture requirement is imposed, the company affected should generally be asked to submit a divestiture plan promptly for review and approval by the Reserve Bank or the Board. Such a requirement may be imposed pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act to issue such orders as may be necessary to enable the Board to administer and carry out the purposes of the Act and prevent evasions thereof. A divestiture plan should be as specific as possible, and should indicate the manner in which divestiture will be accomplished—for example, by a bulk sale of the assets to a third party, by "spinoff" or distribution of shares to the shareholders of the divesting company, or by termination of prohibited activities. In addition, the plan should specify the steps the company expects to take in effecting the divestiture and assuring its completeness, and should indicate the time schedule for taking such steps. In appropriate circumstances, the divestiture plan should make provision for assuring that "controlling influence" relationships, such as management or financial interlocks, will not continue to exist.

3. *Periodic Progress Reports.* A company subject to a divestiture requirement should generally be required to submit regular periodic reports detailing the steps it has taken to effect divestiture. Such a requirement may be imposed pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act, referred to above, as well as its authority under section 5(c) of the Act to require re-

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ports for the purpose of keeping the Board informed as to whether the Act and Board regulations and orders thereunder are being complied with. Reports should set forth in detail such matters as the identities of potential buyers who have been approached by the company, the dates of discussions with potential buyers and the identities of the individuals involved in such discussions, the terms of any offers received, and the reasons for rejecting any offers. In addition, the reports should indicate whether the company has employed brokers, investment bankers or others to assist in the divestiture, or its reasons for not doing so, and should describe other efforts by the company to seek out possible purchasers. The purpose of requiring such reports is to insure that substantial and good faith efforts are being made by the company to satisfy its divestiture obligations. The frequency of such reports may vary depending upon the nature of the divestiture and the period specified for divestiture. However, such reports should generally not be required less frequently than every three months, and may in appropriate cases be required on a monthly or even more frequent basis. Progress reports as well as divestiture plans should be afforded confidential treatment.

4. *Extensions of Divestiture Periods.* Certain divestiture periods—such as the December 31, 1980 deadline for divestitures required by the 1970 Amendments to the Bank Holding Company Act—are not extendable. In such cases it is imperative that divestiture be accomplished in a timely manner. In certain other cases, the Board may have discretion to extend a statutorily prescribed divestiture period within specified limits. For example, under section 4(c)(2) of the Act the Board may extend for three one-year periods the two-year period in which a bank subsidiary of a holding company is otherwise required to divest shares acquired in satisfaction of a debt previously contracted in good faith. In such cases, however, when the permissible extensions expire the Board no longer has discretion to grant further extensions. In still other cases, where a divestiture period is prescribed by the Board, in the exercise of its regulatory judgment, the Board may have broader discretion to grant extensions.

Where extensions of specified divestiture periods are permitted by law, extensions should not be granted except under compelling circumstances. Neither unfavorable market conditions, nor the possibility that the company may incur some loss, should alone be viewed as constituting such circumstances—particularly if the company has failed to take earlier steps to accomplish a divestiture under more favorable circumstances. Normally, a request for an extension will not be considered unless the company has established that it has made substantial and continued good faith efforts to accomplish the divesti-

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ture within the prescribed period. Furthermore, requests for extensions of divestiture periods must be made sufficiently in advance of the expiration of the prescribed period both to enable the Board to consider the request in an orderly manner and to enable the company to effect a timely divestiture in the event the request for extension is denied. Companies subject to divestiture requirements should be aware that a failure to accomplish a divestiture within the prescribed period may in and of itself be viewed as a separate violation of the Act.

5. *Use of Trustees.* In appropriate cases a company subject to a divestiture requirement may be required to place the assets subject to divestiture with an independent trustee under instructions to accomplish a sale by a specified date, by public auction if necessary. Such a trustee may be given the responsibility for exercising the voting rights with respect to shares being divested. The use of such a trustee may be particularly appropriate where the divestiture is intended to terminate a control relationship established or maintained in violation of law, or where the divesting company has demonstrated an inability or unwillingness to take timely steps to effect a divestiture.

6. *Presumptions of Control.* Bank holding companies contemplating a divestiture should be mindful of section 2(g)(3) of the Bank Holding Company Act, which creates a presumption of continued control over the transferred assets where the transferee is indebted to the transferor, or where certain interlocks exist, as well as section 225.2 of Regulation Y, which sets forth certain additional control presumptions. Where one of these presumptions has arisen with respect to divested assets, the divestiture will not be considered as complete until the presumption has been overcome. It should be understood that the inquiry into the termination of control relationships is not limited by the statutory and regulatory presumptions of control, and that the Board may conclude that a control relationship still exists even though the presumptions do not apply.

7. *Role of the Reserve Banks.* The Reserve Banks have a responsibility for supervising and enforcing divestitures. Specifically, in coordination with Board staff they should review divestiture plans to assure that proposed divestitures will result in the termination of control relationships and will not create unsafe or unsound conditions in any bank or bank holding company; they should monitor periodic progress reports to assure that timely steps are being taken to effect divestitures; and they should prompt companies to take such steps when it appears that progress is not being made. Where Reserve Banks have delegated authority to extend divestiture periods, that authority should be exercised consistently with this policy statement.

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FEBRUARY 16, 1977

Regulation Y (Bank Holding Companies)

The Board determined that the operation of a savings and loan association is not an appropriate activity for bank holding companies.

Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None.

The Bank Holding Company Act requires that the Board apply a two-step test when evaluating the proposed permissibility of an activity for bank holding companies. To reach an affirmative conclusion, the Board must find that the activity is (1) closely related to banking or managing or controlling banks and (2) a proper incident to banking. The latter test requires a determination that performance of the activity by a bank holding company "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."

The question of bank holding company operation of a savings and loan association was occasioned by—

1. The application of D. H. Baldwin Company, Cincinnati, Ohio, for permission to retain shares of Empire Savings, Building and Loan Association, Denver, Colorado, and the latter's subsidiary.

2. A request by First Security Corporation, Salt Lake City, Utah, for reconsideration of the Board's order requiring it to divest itself of shares of First Security Savings and Loan Association, Pocatello, Idaho.

In connection with similar applications submitted by two other bank holding companies, the Board had previously determined that the operation of a savings and loan association was closely related to banking.[1] The Board therefore turned now to the question of the propriety of the proposed affiliation.

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[1] Refer to the Board's order dated November 4, 1974, denying the application of American Fletcher Corporation, Indianapolis, Indiana, to acquire shares of Southwest Savings and Loan Association, Phoenix, Arizona (Federal Reserve *Bulletin*, December 1974, p. 868); and the Board's order dated April 10, 1975, denying the application of Memphis Trust Company, Memphis, Tennessee, to acquire shares of Homeowners Savings and Loan Association, Inc., Collierville, Tennessee (Federal Reserve *Bulletin*, May 1975, p. 327).

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Upon consideration of the entire record, including the record of the hearings conducted in connection with the two earlier cases, the Board concluded that operation of a savings and loan association is not a proper activity for bank holding companies since the adverse effects that were expected to result would not be outweighed by public benefits. The Board viewed the proposal as a serious threat to existing competition between banks and thrift institutions. Also, approval of the proposed affiliation would lead to various types of regulatory difficulties. For example, savings and loan associations are authorized under State and Federal laws and regulations to engage, either directly or indirectly, in several activities that the Board has deemed impermissible for bank holding companies. If the Board were to permit a holding company to engage, through a subsidiary savings and loan association, in an "impermissible" activity, it would most likely be compelled to allow other bank holding companies to engage in such activity directly even though the activity has been considered inappropriate for bank holding companies. On the other hand, if the Board were to deny a holding-company-affiliated savings and loan association permission to engage in such activity, the institution might not only be at a competitive disadvantage with respect to other savings and loan associations but also be unable to provide the normal range of services to the public.

The Board thereupon denied the two applications at hand.

The Board stated that any decision to permit affiliation between banks and savings and loan associations should be made by the Congress.

MARCH 7, 1977

Regulation Y (Bank Holding Companies)

The Board decided, for the present, that the issuance of money orders and similar consumer-type payment instruments should not be added to the list of activities generally permissible for bank holding companies under Regulation Y. At the same time, however, the Board announced that it would process bank holding company applications to engage in this activity on a case-by-case basis, and it approved two such applications.

> Votes for these actions: Messrs. Gardner, Wallich, Jackson, Partee, and Lilly. Votes against these actions: None. Absent and not voting: Messrs. Burns and Coldwell.

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To place a nonbanking activity on the list of activities permissible for bank holding companies under Regulation Y, the Board must apply a two-step test. It must determine that the activity is (1) closely related to banking and (2) a proper incident to banking.

In March 1976 the Board had published for comment a proposal to amend Regulation Y by adding to the list of permissible activities the issuance of money orders and similar consumer-type payment instruments. On the basis of the comments received and the entire record, the Board determined that the activity in question is closely related to banking: It is comparable to certain services performed by banks (such as the issuance of cashier's checks and certified checks); it involves financial skills generally possessed by banks; and it is a type of activity in which banks have historically engaged.

In the second step of the test—the question of whether the activity is a proper incident to banking—the Board is required to consider whether the performance of the activity by a bank holding company affiliate can be expected to produce public benefits (such as greater convenience, increased competition, or gains in efficiency) that would outweigh possible adverse effects.

Noting that very few bank holding companies had indicated a possible interest in engaging in this activity, the Board decided, for the time being, to process any applications on a case-by-case basis in lieu of amending Regulation Y. (The rulemaking proceeding would, however, be left open.) In evaluating each application, the Board would assess the net public benefits of the particular proposal submitted.

The Board then turned to the two applications at hand:

1. An application by Republic of Texas Corporation (a bank holding company), Dallas, Texas, to retain indirect ownership of Republic Money Orders, Inc., and Republic Money Orders of California, Inc., both of Dallas, and thereby to continue to engage in the issuance of money orders.

2. An application by Citicorp, New York, New York, to acquire a nonbank subsidiary, to be known as Citicorp Services, Inc., that would issue variable-denomination payment instruments functionally similar to money orders, cashier's checks, certified checks, and similar instruments currently issued by Citicorp's bank subsidiary.

The Board approved the applications but voted to place a limit of $1,000 on the face value of each instrument. The Board anticipated significant public benefits from the proposals submitted in that

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they included certain innovative features that would benefit consumers and promote competition in a market dominated by a few large firms. In placing a limit of $1,000 on the face value, the Board reasoned that the public benefits expected to flow from the two applications were associated primarily with the issuance of consumer-oriented instruments, and that the limit would have the effect of restricting the holding companies to that type of instrument.

MARCH 7, 1977

Adoption of Rules Regarding Public Observation of Meetings

Effective March 12, 1977, the Board adopted a new regulation, entitled Rules Regarding Public Observation of Meetings, to set forth the procedures by which the Board will carry out the provisions of the Government in the Sunshine Act.

> Votes for this action: Messrs. Gardner, Wallich, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns and Coldwell.

The law and the new regulation state that every portion of every Board meeting must be open to public observation except when the discussion is likely to disclose information falling within one or more of the 10 categories of exemptions listed in the law. If a portion of a meeting is closed, the discussion must be transcribed or recorded, except that in certain cases detailed minutes may be kept in lieu of a transcript or recording. The Board is required to make available the recording (or a transcription thereof), transcript, or minutes to the public; however, those portions falling within any of the 10 exemptions may be withheld.

The law and the regulation require that all meetings be announced to the public, and the Board is prohibited from conducting any business except in accordance with the law and the regulation.

MARCH 9, 1977

Amendment to Regulation Q (Interest on Deposits)

Effective March 24, 1977, the Board amended Regulation Q to provide a new exception to the rule requiring an interest penalty for early withdrawal of a time deposit.

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Votes for this action: Messrs. Gardner, Wallich, Jackson, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Coldwell, and Partee.

The amendment provides that when a depositor who maintains a time deposit in each of two or more merging banks loses Federal deposit insurance on a portion of the funds as a result of the merger, the surviving member bank may, within 1 year of the date of the merger, redeem the portion that has lost insurance coverage without imposing the interest penalty that would otherwise be required due to withdrawal prior to maturity. (If a depositor maintains separate time deposits totaling more than $40,000—the current limit of the Federal Deposit Insurance Corporation's coverage for a single depositor in one institution—after the merger he or she will lose deposit insurance on the portion that exceeds $40,000.)

The Board took this action because it did not believe that an interest penalty should be imposed when a depositor withdraws a time deposit prior to maturity solely to avoid loss of deposit insurance caused by a bank merger.

The penalty otherwise required by Regulation Q for withdrawal of a time deposit prior to maturity is (1) a reduction of the interest rate paid on the portion of the time deposit withdrawn to the maximum legal rate on passbook savings and (2) a loss of 3 months' interest on the portion withdrawn.

MARCH 11, 1977

Amendment to Regulation Q (Interest on Deposits)

Effective July 6, 1977, the Board amended Regulation Q to establish a new category of time deposit accounts at member banks for individual retirement accounts (IRA's) and Keogh plan retirement accounts.

Votes for this action: Messrs. Burns, Gardner, Wallich, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Coldwell.

The Board's amendment set a minimum maturity of 3 years for the new category of IRA and Keogh retirement accounts. By the terms of the amendment, member banks may pay interest on such accounts at a rate equal to the highest rate payable under Regulation Q for any

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category of time deposits by a Federally insured commercial bank, mutual savings bank, or savings and loan association. At the time the Board adopted the amendment, this rate was 7.75 per cent per year.

Retirement savers electing other types of time deposits for their IRA or Keogh plan funds are subject to the interest rate ceilings applicable to those categories of deposits. A differential—generally ¼ percentage point—between rates permitted to be paid by thrift institutions and rates permitted to be paid by commercial banks continues to apply to most other categories of deposits.

The Board's action was intended to assist individuals in saving for their retirement. The Board believed that it was in the public interest to enable an IRA or Keogh plan participant to obtain the highest possible return on his or her retirement savings without regard to the type of depositary institution in which the funds are maintained.

The Board also agreed to allow member banks to modify existing IRA or Keogh plan agreements to permit retirement savers to take advantage of the new rules.

MARCH 28, 1977

Regulation Q (Interest on Deposits)

The Board determined not to adopt a regulatory proposal regarding interest rates on pooled time deposits of $100,000 or more.

> Votes for this action: Messrs. Burns, Gardner, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Wallich.

The regulatory proposal, as published for comment in March 1976, would have prohibited member banks from paying interest on pooled time deposits of $100,000 or more at a rate above the Regulation Q ceiling rate for deposits of less than $100,000, when the bank knows or has reason to know that such deposits consist of funds pooled primarily to obtain higher interest rates. The Board's proposal was based in part on the belief that any active solicitation of funds by prospective poolers constituted a violation of the concept of the rate ceilings established by the Board and might lead to disruptive shifts of funds among depositary institutions.

On the basis of all available information and of the comments received, the Board determined that the regulatory proposal was not

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necessary at the present time. The Board noted that in February 1977 the Federal Deposit Insurance Corporation (FDIC) had decided to limit to $40,000 its coverage on deposits of any trust or other business arrangement that is required to register with the Securities and Exchange Commission as an investment company under the Investment Company Act of 1940. Certain categories of trusts—such as employee pension and profit-sharing plans and charitable trusts—were excluded from the new rule, but money market mutual funds, a primary source of pooled deposits, were included. The Board believed the FDIC's action would minimize the potential for disruptive shifts of funds among depositary institutions as a consequence of any active solicitation of pooled funds.

APRIL 11, 1977

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

Effective April 13, 1977, the Board adopted four technical amendments to Regulation H regarding real estate loans made by State member banks in flood-hazard areas of communities that are not participating in the national flood insurance program.

> Votes for these actions: Messrs. Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against these actions: None. Absent and not voting: Mr. Burns.

The Board took these actions to implement Public Law 94–375.

The Flood Disaster Protection Act of 1973 generally prohibits regulated lending institutions from making loans on improved real estate in flood-hazard areas unless the community is participating in the national flood insurance program. Since its enactment, the act has been amended several times, each time necessitating conforming amendments to the Board's Regulation H. (See the Board's ANNUAL REPORTS for 1973 through 1976.)

Public Law 94–375 and the Board's implementing amendments exempt the following categories of loans from the requirements of the act and the regulation:

1. Any loan made to finance the purchase of a dwelling occupied as a residence before March 1, 1976, or 1 year following identification of the area as a flood-hazard area, whichever is later.
2. Any loan made to finance the purchase of a building completed

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and occupied by a small business prior to January 1, 1976, subject to a dollar ceiling set by the Secretary of Housing and Urban Development.

3. Any loan or loans, which in the aggregate do not exceed $5,000, made to finance improvements or rehabilitation of a building occupied as a residence prior to January 1, 1976.

4. Any loan or loans, which in the aggregate do not exceed an amount set by the Secretary of Housing and Urban Development, made to finance nonresidential additions to or improvements on a farm.

APRIL 11, 1977

Amendment to Regulation Z (Truth in Lending)

Effective immediately, the Board amended Regulation Z to permit creditors in the Commonwealth of Puerto Rico to provide Truth in Lending information in Spanish if the information is available in English upon request.

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Burns.

The Board took this action in light of the fact that Spanish is the traditional and predominant language in Puerto Rico; census data indicate that more than one-half of the people over 10 years of age do not speak English.

Except in Puerto Rico, Truth in Lending disclosures must continue to be made in English, with foreign language disclosures permitted as supplemental information at the creditor's option.

APRIL 11, 1977

Amendment to Regulation Z (Truth in Lending)

Effective October 10, 1977, the Board amended Regulation Z to require advance disclosure of any variable-rate clause in a credit contract if that clause may result in an increase in the cost of credit to the customer.

> Votes for this action: Messrs. Gardner, Wallich, Partee, and Lilly. Votes against this action: Messrs. Coldwell and Jackson. Absent and not voting: Mr. Burns.

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The Board took this action to assist consumers in shopping for credit.

The amendment provides that if a credit contract contains a variable-interest-rate clause that may result in an increase in the cost of credit to the consumer, the lender must disclose the following items to the borrower before the borrower becomes obligated on the contract:

1. The fact that the annual percentage rate on the transaction is subject to increase.
2. The conditions under which the rate may increase, including identification of any index to which the rate is tied, and any limitation on the increase.
3. The manner in which an increase may be effected (such as an increase in the amount of the periodic payment, an increase in the number of payments, and/or an increase in the amount due at maturity).
4. For transactions involving home mortgages, numerical examples of the effects of a hypothetical increase of ¼ of 1 percentage point in the annual percentage rate.

Governors Coldwell and Jackson dissented from this action; Governor Coldwell preferred that creditors merely be required to alert borrowers to the existence of the variable-rate clause, whereas Governor Jackson believed that the disclosure requirements of Regulation Z were already too complex.

APRIL 27, 1977

Amendment to Regulation T (Credit by Brokers and Dealers)

Effective June 1, 1977, the Board amended Regulation T to modify the rule governing the calculation of the margin required on a "straddle" transaction.

> Votes for this action: Messrs. Gardner, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns and Wallich.

The Board's existing regulation provided that on a straddle—that is, when both a "put" and a "call" are issued, endorsed, or guaranteed in a general account, a special bond account, or a special convertible

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debt security account on the same number of shares of the same underlying security with the same expiration date and the same exercise price—the applicable margin requirement would be the margin on either the put or the call, whichever was greater, plus any unrealized loss on the other option. The Board's amendment deleted the requirement that the put and the call have the same expiration date and the same exercise price to qualify for the special margin requirement. The amendment also removed the reference to accounts other than the general account.

The effective date of the Board's amendment coincided with the date on which trading of put options would begin on the exchanges. (When the Board adopted its existing rule for margin requirements on options, the Securities and Exchange Commission had not yet authorized put trading for the exchanges.) The Board adopted this amendment to provide additional flexibility to investors.

MAY 2, 1977

Regulation Y (Bank Holding Companies)

The Board approved the application of European-American Bancorp, New York, New York, after becoming a bank holding company, to operate European-American Banking Corporation, a New York investment company.

> Votes for this action: Messrs. Wallich, Coldwell, Jackson, and Partee. Vote against this action: Mr. Lilly. Absent and not voting: Messrs. Burns and Gardner.

Since operation of a New York investment company was not on the list of activities permissible for bank holding companies under Regulation Y, the Board's consideration of the application of European-American Bancorp involved the application of a two-step test required by the Bank Holding Company Act. To permit bank holding company involvement in a proposed new activity, the Board must find that the activity is (1) closely related to banking or managing or controlling banks and (2) a proper incident to banking. (This process was required for either (1) the placement of an activity on Regulation Y's list of activities generally permissible for bank holding companies or (2) the processing of applications on a case-by-case basis; the Board elected to process on a case-by-case basis holding

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company applications—such as that submitted by European-American Bancorp—to operate New York investment companies.)

Noting that the investment company was engaged in virtually all of the usual activities of a commercial bank except that of accepting deposits, the majority of the Board concluded that operation of the investment company was so closely related to banking as to be a proper incident thereto. Against the background of the entire record, the Board approved, Governor Lilly dissenting, the application submitted by European-American Bancorp, subject to certain conditions.

The Board emphasized that its decision to approve the application was based on two facts: (1) that the proposal involved merely a reorganization and (2) that insofar as the investment company's credit balances were concerned, the proposal would not reduce the deposit base of the banking system subject to reserves, or otherwise create an opportunity that did not already exist to convert deposits from a reserve status to a nonreserve status. The Board stated that it would not look favorably on any proposal under Section 4(c)(8) of the Bank Holding Company Act that would have the effect of diminishing the reserve base either by facilitating the acceptance of reserve-free credit balances or by encouraging a shift from reserve-status deposits to reserve-free credit balances.

Governor Lilly's dissent from the Board's approval of the acquisition of shares of the investment company was due to his conclusion that European-American Banking Corporation was a "bank" for purposes of the Bank Holding Company Act and that it would therefore be inappropriate to approve acquisition of the company as a "nonbanking" company under Section 4(c)(8) of the act. He added that he did not subscribe to the Board's 1971 determination that a similar New York investment company was not a "bank" under the act. Governor Lilly, unlike the other Board members, believed the investment company's credit balances should be considered "deposits" for purposes of the act. He pointed out that customers of investment companies may draw against their credit balances by mail, telephone, or cable instruction, and in some cases by draft—the functional equivalent of a check—for the purpose of transferring funds to third parties in settlement of a wide variety of financial and commercial transactions. He added that for purposes of monetary policy, the

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Board considers credit balances to be sufficiently close to demand deposits to include them, along with demand deposits, in the narrow definition of the money stock (M-1).

JUNE 8, 1977

Amendment to Regulation J (Collection of Checks and Other Items by Federal Reserve Banks)

Effective September 1, 1977, the Board amended Regulation J by adding a new section concerning wire transfers of funds between member banks.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, and Partee. Votes against this action: None. Absent and not voting: Messrs. Jackson and Lilly.

The new section of Regulation J, designated Subpart B, codifies Federal Reserve System rules and procedures that have evolved over the years with respect to wire transfers of funds. The existing Regulation J, dealing with rules for check collection, remains unchanged and becomes Subpart A of the regulation.

Subpart B sets forth the rights and responsibilities of member banks and the Federal Reserve System for the wire transfers of funds.

The Federal Reserve's wire transfer service, which uses the System's computerized communications network linking the Board and all Federal Reserve Banks and their offices, allows member banks to transfer funds almost instantly from their reserve balances to the reserve accounts of other member banks, either for themselves or for their customers. The most frequent uses of this service are the transfer of excess reserves of member banks to banks needing additional reserves and the transfer of funds for corporations. In 1976 approximately $36 trillion was transferred over the network, with the average amount being approximately $2 million.

Neither Subpart A nor Subpart B deals with electronic payments processed through automated clearing houses (a system for processing payment instructions recorded on magnetic tape rather than on checks) or point-of-sale terminals (an electronic system to verify checks and/or to debit customers' bank accounts for their purchases at the time of sale).

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JULY 20, 1977

Amendments to Regulation Z (Truth in Lending)

Effective immediately, the Board amended Regulation Z to clarify provisions that allow merchants to offer discounts to customers who pay by cash rather than by credit card without disclosing the difference as a finance charge.

> Votes for this action: Messrs. Gardner, Wallich, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Coldwell, and Jackson.

The Board took this action to implement Public Law 94–222, which had recently been enacted.

The amendments (1) distinguish between discounts and surcharges; (2) prohibit merchants from imposing a surcharge for use of a credit card until February 27, 1979; (3) clarify the conditions under which merchants may give discounts of up to 5 per cent to cash customers without providing a truth-in-lending notice to credit-card customers that discloses the difference between the cash and credit prices as a finance charge; and (4) provide that any discount that is not considered a finance charge under Regulation Z is not to be considered a charge for credit under any State law (such as a usury or credit disclosure law).

If a merchant tags an item with only one price—the cash price—and charges a higher price to customers who pay by credit card, the difference is to be classified as a surcharge. Such a surcharge is prohibited until February 27, 1979, and thereafter the difference must be disclosed to the credit-card customer as a finance charge. In each of the following situations, however, the difference will be classified as a discount: (1) the merchant tags the item with a single price—the credit-card price—and offers cash customers a discount from this price; (2) the merchant posts two prices for each item; and (3) without posting prices, the merchant offers to give customers a discount for paying cash.

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AUGUST 3, 1977

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

Effective October 31, 1977, the Board amended Regulation H to require State member banks and their subsidiaries, departments, and divisions that are municipal securities dealers to file with the Board information regarding persons who are associated with them as municipal securities principals or municipal securities representatives.

> Votes for this action: Messrs. Wallich, Coldwell, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Gardner, and Jackson.

This action was taken to facilitate dealer compliance with rules that had recently been adopted by the Municipal Securities Rule-making Board concerning the qualifications of municipal securities principals and municipal securities representatives. Concurrently, the Board adopted several forms needed to implement the amendment.

The regulatory proposal, as published for comment in March 1977, had also included an amendment to Regulation Y (Bank Holding Companies) to apply to bank holding companies requirements similar to those being imposed upon State member banks. However, the Board declined to adopt the amendment to Regulation Y since it still had under consideration the issue of permissibility of municipal securities dealer activities for bank holding companies.

AUGUST 3, 1977

Regulation Q (Interest on Deposits)

Effective retroactively from July 21, 1977, the Board suspended Regulation Q penalties through January 31, 1978, to permit member banks to give emergency financial assistance to depositors affected by the severe flooding in the Johnstown, Pennsylvania, area in July 1977.

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Votes for this action: Messrs. Wallich, Coldwell, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Gardner, and Jackson.

The Board authorized member banks throughout the United States to permit those depositors who suffered financial loss as a result of the severe flooding in the Johnstown, Pennsylvania, area to withdraw time deposits before maturity without paying the penalty that Regulation Q would otherwise impose. (The regulation requires that if all or part of a time deposit is withdrawn before maturity, a member bank may pay interest on the amount withdrawn at a rate not to exceed that currently allowed for a passbook savings account, and the depositor must forfeit 3 months' interest.)

Noting that the President had declared the seven-county Johnstown area a major disaster area, the Board determined that the need to relieve the financial hardship being suffered by the victims of the disaster warranted suspension of the penalties.

AUGUST 29, 1977

Regulation Y (Bank Holding Companies)

The Board decided against adding to the list of activities generally permissible for bank holding companies under Regulation Y the business of acting as a futures commission merchant for the execution of futures contracts in gold and silver bullion and coins. At the same time, however, the Board decided that it would process bank holding company applications to engage in this activity on a case-by-case basis.

Votes for this action: Messrs. Gardner, Wallich, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns and Coldwell.

Since acting as a futures commission merchant for the execution of futures contracts in gold and silver bullion and coins was not on the list of activities permissible for bank holding companies, the Board's consideration of the application involved a two-step test required by the Bank Holding Company Act. To permit bank holding company involvement in a proposed new nonbanking activity, the Board must find that the activity is (1) closely related to banking or managing or controlling banks and (2) a proper incident to bank-

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ing. The latter test requires a determination that performance of the activity by a bank holding company "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." Such a test must be satisfied for either (1) the placement of the activity on the list of activities generally permissible for bank holding companies under Regulation Y or (2) the processing of applications on a case-by-case basis.

Consideration of the question was prompted by the applications of Republic New York Corporation, New York, New York, and its five parent bank holding companies to engage in the activity in question through Republic Clearing Corporation, also of New York. In June 1977, following receipt of the applications, the Board had published the proposal for public comment.

Following consideration of the comments received and the complete record, the Board affirmed its determination—made in 1973 in connection with an application by Standard and Chartered Banking Group, Limited, London, England, to engage indirectly in the same activity that was the subject of the Republic applications—that the activity was closely related to banking since national banks, Edge corporations, and most State member banks already had the statutory authority to deal in gold, silver, and coin. The Board decided, however, to process applications on a case-by-case basis, observing that there appeared to be limited bank holding company interest in the activity, and that by processing applications on a case-by-case basis it could assess the public benefits of the particular proposals submitted.

Concurrently, the Board approved the applications of Republic New York Corporation and its five parent bank holding companies.

AUGUST 31, 1977

Amendments to Regulation H (Membership of State Banking Institutions in the Federal Reserve System) and Regulation Y (Bank Holding Companies)

Effective October 3, 1977, the Board amended Regulations H and Y to prescribe the form and content of certain notices to be filed with the Board with respect to securities activities.

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Federal Reserve Bank of St. Louis

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Burns.

The Board took this action pursuant to the requirements of the Securities Acts Amendments of 1975.

The amendment to Regulation H requires that State member banks or their subsidiaries that are registered clearing agencies for stock market transactions file a notice with the Board regarding (1) any final disciplinary sanction imposed by them on any firm participating in the operations of the clearing agency and (2) any denial of an application to participate in their clearing operations.

The amendments to Regulations H and Y establish procedures by which State member banks, bank holding companies, and nonbank subsidiaries of bank holding companies that are participants in clearing agencies may request stays or review by the Board of disciplinary sanctions and denials of participation imposed by clearing agencies.

OCTOBER 31, 1977

Amendments to Regulation Q (Interest on Deposits)

Effective December 1, 1977, the Board adopted two amendments to Regulation Q to modify the conditions under which a penalty must be imposed for the early withdrawal of a time deposit.

> Votes for these actions: Messrs. Gardner, Wallich, Partee, and Lilly. Votes against these actions: None. Absent and not voting: Messrs. Burns, Coldwell, and Jackson.

The Board took these actions to provide consumers with more flexibility in handling their time deposit accounts.

The first of the two amendments related to the regulation's provision that any change in a time deposit contract resulting in either (1) an increase in the rate of interest paid or (2) an extension *or* reduction of the maturity of the deposit constituted a payment of the time deposit before maturity and was therefore subject to the regulation's mandatory early-withdrawal penalty. The amendment now adopted provides that an extension of the maturity of a time deposit will no longer be considered an early withdrawal so long as there is no increase in the rate of interest paid on the deposit.

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The second amendment related to the regulation's rules regarding early withdrawal of a time deposit in the event of the death of a depositor. In 1975 the Board had amended Regulation Q to permit member banks to redeem time deposits before maturity without imposing an interest penalty upon the death of any person whose name appeared on the deposit instrument. The Board now modified that provision to allow member banks to redeem a time deposit prior to maturity without penalty upon the death of any person who has legal or beneficial title to all or a part of the time deposit regardless of whether the individual's name appears on the deposit instrument.

The penalty for withdrawal of a time deposit before maturity is (1) a reduction of the interest paid on the portion of the time deposit withdrawn to the maximum permissible rate on passbook savings and (2) a loss of 3 months' interest on the portion withdrawn.

NOVEMBER 2, 1977

Amendment to Regulation M (Foreign Activities of National Banks)

The Board amended Regulation M to reduce from 4 per cent to 1 per cent the reserve requirement applicable to funds loaned by foreign branches of U.S. member banks to U.S. borrowers.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Jackson, Partee, and Lilly. Vote against this action: Mr. Coldwell.

This action was taken to enable the foreign branches of U.S. banks to compete on more equal terms with foreign banks in lending to U.S. borrowers.

Regulation M requires member banks that have one or more foreign branches to maintain (subject to certain exceptions) reserves against their foreign branch deposits in an amount equal to a percentage of the daily-average credit outstanding at those branches to U.S. residents. The requirement was established in 1969 during a period of monetary restraint to prevent member banks from using borrowings from their foreign branches to reduce the impact of the Federal Reserve System's monetary policy actions taken at that time.

In recent years, as the spread between loan and deposit rates for Euro-dollars has narrowed, the Board's reserve requirement on loans

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to U.S. borrowers by the foreign branches of member banks has affected the ability of such foreign branches to compete with foreign offices of foreign banks since the latter institutions can lend Eurodollars to domestic U.S. borrowers without maintaining reserve requirements.

Governor Coldwell would have preferred to take no action on this question pending completion of a staff study that was currently under way regarding banks' nondeposit sources of funds.

No change was made in the 4 per cent reserve requirement on borrowings by member banks from their overseas branches or from foreign banks.

The amendment applied to reserves required to be held beginning December 1, 1977, against demand deposits during the period October 20 through November 16.

NOVEMBER 21, 1977

Amendment to Regulation Q (Interest on Deposits)

Effective November 23, 1977, the Board amended Regulation Q to lower the minimum rate of interest that a member bank must charge on a loan secured by a depositor's time or savings deposit at that bank.

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Jackson, and Partee.

To prevent a depositor from obtaining a bank loan as a means of withdrawing a time deposit before maturity without incurring the penalty for early withdrawal, Regulation Q previously required that the interest rate on a loan secured by a depositor's time or savings deposit at that bank be at least 2 percentage points above the rate being paid on the deposit. (The requirement does not apply to savings deposits unless it is the bank's practice to require prior notice for the withdrawal of savings deposits.) The Board's amendment reduced the mandatory differential to 1 percentage point.

The Board took this action because it believed that a differential of 1 percentage point would be sufficient to discourage depositors from circumventing the purpose of the regulation.

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NOVEMBER 30, 1977

Amendments to Regulation D (Reserves of Member Banks) and Regulation Q (Interest on Deposits)

The Board amended Regulations D and Q as part of a proposed new program for Treasury investment of funds deposited in tax and loan accounts at banks.

> Votes for this action: Messrs. Gardner, Wallich, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns and Coldwell.

Public Law 95–147, enacted on October 28, 1977, authorized the U.S. Treasury to invest its tax and loan balances in interest-bearing obligations issued by depositary institutions. The purpose of the legislation was to provide the Treasury with a means of obtaining interest on the short-term balances that it maintains in tax and loan accounts. (Such balances arise primarily from the crediting to the tax and loan accounts of (1) income taxes withheld from taxpayers and (2) the proceeds of sales of savings bonds and other Treasury obligations.)

Regulations D and Q require that a member bank's liability on its promissory note issued as a means of obtaining funds to be used in its banking business be considered a deposit, except in certain situations. The funds so obtained are thus subject to the reserve requirements and interest rate restrictions of Regulations D and Q, respectively. Under the amendments approved by the Board, member bank obligations issued under the Treasury's new program would be exempt from such reserve requirements and interest rate restrictions.

Establishment of an effective date for the amendments was to be coordinated with the Treasury's implementation of its new program.

DECEMBER 23, 1977

Amendment to Regulation D (Reserves of Member Banks)

Effective immediately, the Board amended Regulation D to exempt from reserve requirements a member bank's borrowings from a member bank whose head office is located outside the States of the United States and the District of Columbia—in Puerto Rico, for example—provided the lending bank is already maintaining reserves against its deposit liabilities.

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Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Jackson, and Partee. Votes against this action: None. Absent and not voting: Mr. Lilly.

The Board took this action in order to treat borrowings from all member banks in an equal manner and to eliminate the duplication of reserve requirements that might otherwise occur.

While Regulation D requires member banks to maintain reserves on their deposits, the definition of "deposits" exempts from this requirement funds borrowed from the *domestic* office of another bank (Federal funds) since the lending bank may already be maintaining reserves on such funds. The existing regulation, however, imposes a 4 per cent reserve requirement on member bank borrowings from *foreign* offices of other banks.

The Board's amendment modifies the definition of "domestic banking office" to exempt from reserve requirements a member bank's borrowings from a bank whose main office is located outside the States of the United States and the District of Columbia—in Puerto Rico, for example—provided that the lending bank (1) is a member bank and (2) is already maintaining reserves against its deposit liabilities.

The interbank borrowing exemption from the reserve requirements of Regulation D and from the interest rate ceilings of Regulation Q is intended to facilitate reserve adjustments by member banks.

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Federal Reserve Bank of St. Louis

1977—DISCOUNT RATES

The Board approved two increases in the discount rate during 1977—from 5¼ to 5¾ per cent, effective August 30, and from 5¾ to 6 per cent, effective October 26. During the course of the year the Board voted on 2 occasions to turn down requests by individual Reserve Banks to lower the discount rate; it voted on 14 occasions to reject proposals to raise the rate.

The particular reasons for the Board's decisions are reviewed below. In reaching those decisions the Board also took into account general economic and financial developments, which are covered in more detail elsewhere in this REPORT, especially in the discussion of the U.S. economy in Part 1 and in the Record of Policy Actions of the Federal Open Market Committee in Part 2.

Early January: Proposed reductions turned down

On January 3 and January 7 the Board considered requests by three Federal Reserve Banks to reduce the discount rate from 5¼ per cent—the rate in effect since the latter part of November 1976—to 5 or 4¾ per cent. Other Reserve Banks had proposed that the current discount rate be maintained. During the Board's discussion it was observed that short-term market rates had declined considerably over the preceding few weeks and that currently they were below the discount rate. However, recently available indicators pointed to improvement in the domestic economy; growth in key monetary aggregates seemed to be accelerating; and the dollar was generally weak in foreign exchange markets. In these circumstances the Board felt that a reduction in the discount rate would not be desirable. Board members also felt that signaling a further move toward monetary ease would not be appropriate so soon after the Board's announcement of lower reserve requirements on December 17, 1976, and the reduction by the Federal Open Market Committee in the operating objective for the Federal funds rate in the closing weeks of the year.

Mid-January to mid-May: No discount rate actions

During the interval from mid-January to mid-May no proposals to change the discount rate were submitted by the Federal Reserve

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Banks. In the early weeks of the year short-term interest rates rose considerably as markets reacted to expectations of more rapid economic expansion and a larger Federal Government deficit. Subsequently, short-term market rates tended to stabilize and were in closer alignment with the discount rate than at the start of the year. In late April and early May short-term interest rates rose somewhat as rapid expansion in bank demand deposits—which coincided with a strong demand for business loans—led to a less accommodative provision of reserves by the System.

Mid-May through mid-August: Proposed increases turned down

From mid-May to mid-July the Board rejected a number of requests to raise the discount rate by ¼ or ½ percentage point. In proposing those increases the directors of the Federal Reserve Banks in question stressed the outlook for rising prices and the desirability of providing a signal of the System's determination to continue pursuing an anti-inflationary monetary policy. It was also argued that the rise in the Federal funds rate since mid-April was not likely to be reversed in light of the strength of the monetary aggregates.

During this period the Board felt that economic and financial developments did not warrant an increase in the discount rate, especially one of ½ percentage point. It was noted that the rise in the Federal funds rate had brought the two rates into reasonably close alignment and that the announcement of a higher discount rate might well be misconstrued as an indication of a major shift in monetary policy. The Board also noted that the discount rate was relatively close to other short-term market rates. In the circumstances the Board decided that it should continue its usual practice of allowing the discount rate to follow, rather than to lead, movements in market rates. This view was reinforced after the middle of May by a moderation in the growth of the monetary aggregates and by general stability in short-term market rates. Some Board members also believed that the discount rate should not be raised until it could be determined whether the sizable increases in the monetary aggregates in late April and the first part of May were transitory developments or the consequence of a more lasting strengthening in the demand for money.

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From late July to mid-August the Federal funds rate was raised from around 5⅜ per cent to 6 per cent as the System sought to moderate another escalation in the expansion of the monetary aggregates through a more restrained provision of reserves. Other short-term rates of interest also rose in this period, and by the middle of August they were well above the discount rate. Beginning in early August several Federal Reserve Banks proposed increases of ¼ or ½ percentage point in the discount rate.

At a meeting held on August 8 the Board turned down a pending increase of ¼ percentage point. Although sharing the view that a higher discount rate might be desirable soon in light of emerging conditions in financial markets, Board members did not feel that the discount rate was then greatly out of line with most short-term interest rates. The Board viewed the Treasury financing in progress at that time as an additional reason for not changing the discount rate.

Subsequently, on August 12, the Board turned down increases of ¼ or ½ percentage point recommended by four Federal Reserve Banks. Some Board members felt that a ¼ percentage point increase might be justified by the further advance in the Federal funds rate, although it was pointed out that other short-term market rates had risen by lesser amounts recently. In reaching its decision the Board agreed with the observation that the recent acceleration in monetary growth and the related rise in the Federal funds rate might prove transitory and that it would be prudent to wait until new data were available to facilitate an interpretation of the performance of the monetary aggregates.

On August 19 the Board rejected an increase of ½ percentage point that had been proposed by several Federal Reserve Banks. There was considerable sentiment among the Board members for bringing the discount rate into closer alignment with short-term market rates. In this connection it was noted that the recent rise in member bank borrowings appeared to be associated at least in part with the relatively low discount rate. One Board member indicated that he would have been prepared to approve a ¼ percentage point increase had such a proposal been pending at this meeting. Nevertheless, the Board members were unanimous in their view that a ½ percentage point increase would be too large at this time. In arriving at this decision the Board took into account a recent weakening in some economic indicators.

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The Board also felt that it would be desirable to allow more time for financial markets to adjust to the recent rise in the Federal funds rate and for the Board to observe the related performance of the monetary aggregates.

Late August to late October: Two proposed increases approved and others turned down

On August 29 the Board approved an increase in the discount rate from 5¼ to 5¾ per cent. The Board did not regard the increase as a monetary policy action, but rather as a technical move to bring the discount rate into better alignment with other short-term interest rates. In particular, the higher discount rate was intended to reduce the incentive for member banks to borrow from the Federal Reserve. Such borrowings had risen from a daily average of about $335 million in July to nearly $600 million in the first 2 weeks of August and to $1.7 billion in the most recent statement week. The Board felt that continued heavy borrowing at the discount window would tend to complicate the conduct of the System's open market operations. It also believed that the subsidy involved in the rate differential was likely to induce an increasing number of banks to borrow as time went on. In the circumstances, policing the discount window would become an increasingly difficult task for the Reserve Banks, although only a few cases of apparent arbitrage—borrowing from the Federal Reserve to relend at a higher rate—had been reported.

It was noted in the discussion that the market already seemed to have largely discounted a rate increase, even one of ½ percentage point, and that the market adjustment in other short-term rates was therefore likely to be minimal. One Board member also observed that an increase would tend to have a favorable impact on the position of the dollar in foreign exchange markets.

In the judgment of a majority of the Board members the foregoing considerations outweighed the possible disadvantage of raising the discount rate at a time when a number of economic indicators suggested a slowdown in the pace of the economic expansion. While the Board agreed that the expansion was likely to continue for some time, the risk of a downturn in economic activity could not be dis-

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missed entirely. One Board member also noted that a rise in the discount rate would tend to validate increases that had occurred in other interest rates during recent weeks.

In late September and early October the Board turned down several requests by two Federal Reserve Banks to raise the discount rate from 5¾ to 6 per cent. The Board took account of the facts that short-term interest rates had risen somewhat since late August and that member bank borrowings, after contracting sharply in the first half of September, had expanded again recently as the Federal funds rate had risen increasingly above the discount rate. Although an argument for a higher discount rate could thus be made on technical grounds and although a rise might help the dollar in foreign exchange markets, the Board felt there was no compelling case for an increase under current economic and financial conditions. The Board also believed that a discount rate increase under the circumstances prevailing at the time could be misconstrued as signaling a move toward a more restrictive monetary policy. Board members indicated that they did not want to reinforce market expectations of higher interest rates. However, some Board members believed that the discount rate might well have to be increased within the next few weeks, especially if continued strength in the monetary aggregates prompted a further rise in the Federal funds rate.

On October 25 the Board approved an increase in the discount rate from 5¾ to 6 per cent at all 12 Federal Reserve Banks. Short-term interest rates had risen appreciably further in recent weeks, and the relatively low discount rate had encouraged a large increase in member bank borrowings. In these circumstances the Board decided that a technical adjustment in the discount rate was desirable. A ½ percentage point increase could have been justified on those grounds, and indeed proposals for such an increase had been made by some Reserve Banks. However, the Board members were unanimous in the view that the increase should be limited to ¼ percentage point in light of the uncertainty prevailing then about the strength of the economy. In the Board's view the ¼ point increase was not intended, and was not likely to be interpreted, as a monetary policy move.

Subsequently, on October 28, the Board turned down a request from a Federal Reserve Bank to raise the discount rate by a further

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Federal Reserve Bank of St. Louis

¼ percentage point to 6¼ per cent. The Board continued to feel that, while the higher rate might be justified in terms of interest rate differentials, it was not warranted by current economic conditions. The Board also felt that an increase so soon after the previous rise could be misconstrued as signaling a further firming in monetary policy.

November–December: No discount rate actions

No proposals to change the discount rate were made by the Federal Reserve Banks during the last 2 months of the year. In this period, growth of the monetary aggregates moderated considerably from the rapid rates experienced in previous months and short-term interest rates fluctuated within a relatively narrow range.

Shortly after the turn of the year the Board approved an increase in the discount rate of ½ percentage point to a level of 6½ per cent. The action was taken in light of recent disorder in foreign exchange markets, which was viewed as constituting a threat to the orderly expansion of the domestic and international economy.

Votes on Reserve Bank actions to change the discount rate

Under the provisions of the Federal Reserve Act, the boards of directors of the Federal Reserve Banks are required to establish rates on discounts for and advances to member banks at least every 14 days and to submit such rates to the Board for review and determination. The Board votes listed below are those that involved approval or disapproval of actions to change the rate. Specific reference is made to the rate on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

A corresponding change in the rates under other sections of the Federal Reserve Act was approved each time the rate under Sections 13 and 13a was raised during 1977. As of December 31, 1977, the structure of rates was as follows: 6 per cent for borrowings under Sections 13 and 13a; 6½ per cent for borrowings at the regular rate and 7 per cent for borrowings at the special rate under Section 10(b); and 9 per cent for borrowings by individuals, partnerships, or corporations other than member banks under the last paragraph of Section 13.

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Federal Reserve Bank of St. Louis

January 3, 1977

The Board disapproved actions taken by the directors of the Federal Reserve Banks of Kansas City and San Francisco on December 30, 1976, to reduce the discount rate from 5¼ to 5 per cent.

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Jackson, and Partee.

January 7, 1977

The Board disapproved actions taken by the directors of the Federal Reserve Banks of Dallas and San Francisco on January 6 to reduce the discount rate to 5 per cent and 4¾ per cent, respectively.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Jackson.

May 13, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of St. Louis on May 12 to increase the discount rate to 5¾ per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Jackson, and Partee. Votes against this action: None. Absent and not voting: Messrs. Coldwell and Lilly.

May 16, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Atlanta on May 13 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Gardner, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns and Wallich.

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May 27, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Chicago on May 26 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Jackson, and Lilly. Votes against this action: None. Absent and not voting: Mr. Partee.

June 1, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Atlanta on May 27 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly.

June 13, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Atlanta on June 10 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Burns, Gardner, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Wallich.

June 29, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Atlanta on June 24 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Gardner, Wallich, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns and Coldwell.

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July 11, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Atlanta on July 8 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Burns, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Gardner, Wallich, and Coldwell.

August 8, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Atlanta on August 5 to increase the discount rate to 5½ per cent.

> Votes for this action: Messrs. Burns, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Gardner.

August 12, 1977

The Board disapproved actions taken on August 11 by the directors of the Federal Reserve Banks of Cleveland and St. Louis to increase the discount rate to 5¾ per cent and by the directors of the Federal Reserve Banks of Chicago and Minneapolis to increase the rate to 5½ per cent.

> Votes for this action: Messrs. Burns, Wallich, Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Gardner.

August 19, 1977

The Board disapproved actions taken by the directors of the Federal Reserve Banks of New York, Philadelphia, Kansas City, and San Francisco on August 18 to increase the discount rate to 5¾ per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Coldwell.

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August 29, 1977

Effective August 30, 1977, the Board approved actions taken by the directors of the Federal Reserve Banks of Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, and Minneapolis to increase the discount rate to 5¾ per cent.

> Votes for this action: Messrs. Gardner, Jackson, Partee, and Lilly. Vote against this action: Mr. Wallich. Absent and not voting: Messrs. Burns and Coldwell.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Bank of New York, effective August 31, and the Federal Reserve Banks of Boston, Kansas City, Dallas, and San Francisco, effective September 2.

Mr. Wallich dissented from this action because of the hesitation in some key indicators of economic activity and the associated uncertainty about the duration of the economic expansion. He conceded a technical argument in favor of raising the discount rate to bring it into better alignment with short-term market rates, but he preferred to wait for further evidence on the performance of the economy before taking any action.

September 26, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Boston on September 23 to increase the discount rate to 6 per cent.

> Votes for this action: Messrs. Coldwell, Jackson, Partee, and Lilly. Votes against this action: None. Absent and not voting: Messrs. Burns, Gardner, and Wallich.

September 30, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of New York on September 29 to increase the discount rate to 6 per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Jackson, Partee, and Lilly.

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October 7, 1977

The Board disapproved actions taken by the directors of the Federal Reserve Bank of Boston on October 3 and by the directors of the Federal Reserve Bank of New York on October 6 to increase the discount rate to 6 per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Jackson, and Partee. Votes against this action: None. Absent and not voting: Mr. Lilly.

October 25, 1977

Effective October 26, 1977, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco to increase the discount rate to 6 per cent.

> Votes for this action: Messrs. Burns, Gardner, Wallich, Coldwell, Partee, and Lilly. Votes against this action: None. Absent and not voting: Mr. Jackson.

October 28, 1977

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Chicago on October 27 to increase the discount rate to 6¼ per cent.

> Votes for this action: Messrs. Gardner, Wallich, Coldwell, and Partee. Votes against this action: None. Absent and not voting: Messrs. Burns, Jackson, and Lilly.

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Federal Reserve Bank of St. Louis

Record of Policy Actions of the Federal Open Market Committee

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

In the pages that follow, there are entries with respect to the policy actions taken at the meetings of the Federal Open Market Committee held during the calendar year 1977, including the votes on the policy decisions made at those meetings as well as a résumé of the basis for the decisions. The summary descriptions of economic and financial conditions are based on the information that was available to the Committee at the time of the meetings, rather than on data as they may have been revised later.

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

During 1977 the policy record for each meeting was released a few days after the next regularly scheduled meeting and was subsequently published in the Federal Reserve *Bulletin* as well as in this ANNUAL REPORT.

Policy directives of the Federal Open Market Committee are issued

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Federal Reserve Bank of St. Louis

to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market activities the Federal Reserve Bank of New York operates under two separate directives from the Open Market Committee—an Authorization for Domestic Open Market Operations and a domestic policy directive. In the foreign currency area it operates under an Authorization for Foreign Currency Operations and a foreign currency directive. These four instruments are shown below in the form in which they were in effect at the beginning of 1977. Changes in the instruments during the year are reported in the records for the individual meetings.

AUTHORIZATION FOR DOMESTIC OPEN MARKET OPERATIONS

In effect January 1, 1977

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $3.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) To buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime

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bankers' acceptances with maturities of up to 9 months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $1 billion.

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

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, or, under special circumstances, such as when the New York Reserve Bank is closed, any other Federal Reserve Bank, to purchase directly from the Treasury for its own account (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate ¼ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $2 billion.

3. In order to insure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System

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Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

DOMESTIC POLICY DIRECTIVE

In effect January 1, 1977

The information reviewed at this meeting suggests that growth in real output of goods and services in the fourth quarter has remained at about the reduced pace of the third quarter. In both October and November retail sales increased substantially. Industrial production rose appreciably in November—following 2 months of decline—in large part as a result of termination of strikes in two major industries, although advances in output were widespread among other industries. Employment in manufacturing also recovered from the effects of strikes. According to household survey data, the gain in total employment was large, but the unemployment rate increased from 7.9 to 8.1 per cent as the civilian labor force—which had changed little over the preceding 3 months—increased considerably. The wholesale price index for all commodities rose as much in November as in October, reflecting another substantial increase in average prices of industrial commodities; average prices of farm products and foods changed little. The advance in the index of average wage rates over recent months has remained below the rapid rate of increase during 1975.

The average value of the dollar against leading foreign currencies has declined slightly in recent weeks. The pound sterling and also the currencies associated in the European "snake" arrangement strengthened against the U.S. dollar, while the Canadian dollar depreciated sharply. In October the U.S. foreign trade deficit remained substantial.

M–1, which had expanded sharply in October, was unchanged in November. Although growth in *M*–2 and *M*–3 moderated, it remained substantial as inflows of the time and savings deposits included in these broader aggregates continued strong. Interest rates have declined appreciably in recent weeks. In late November Federal Reserve discount rates were reduced from 5½ to 5¼ per cent, and in mid-December member bank reserve requirements were lowered somewhat.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in

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domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

AUTHORIZATION FOR FOREIGN CURRENCY OPERATIONS

In effect January 1, 1977

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

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

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

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

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

D. To maintain an over-all open position in all foreign currencies not exceeding $1.0 billion, unless a larger position is expressly authorized by the Committee. For this purpose, the over-all open position in all foreign currencies is defined as the sum (disregarding signs) of open

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positions in each currency. The open position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

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

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	2,000
Bank of Italy	3,000
Bank of Japan	2,000
Bank of Mexico	360
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	1,400
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

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

3. Currencies to be used for liquidation of System swap commitments may be purchased from the foreign central bank drawn on, at the same exchange rate as that employed in the drawing to be liquidated. Apart from any such purchases at the rate of the drawing, all transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates.

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Federal Reserve Bank of St. Louis

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

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in accordance with Section 14(e) of the Federal Reserve Act.

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

7. The Chairman is authorized:

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

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

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

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

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

FOREIGN CURRENCY DIRECTIVE

In effect January 1, 1977

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

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

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MEETING HELD ON JANUARY 17–18, 1977

1. Domestic Policy Directive

Preliminary estimates of the Commerce Department indicated that growth in real output of goods and services (real gross national product) had slowed to an annual rate of 3.0 per cent in the fourth quarter, from 3.9 per cent in the third quarter and 4.5 per cent in the second. Such estimates also indicated that average prices—as measured by the fixed-weighted index for gross domestic business product—had risen at an annual rate of 5.0 per cent in the fourth quarter, compared with 4.3 per cent in the third and 5.2 per cent in the second.

According to those estimates, a sharp curtailment in business inventory accumulation during the fourth quarter had been the main factor in the reduction of growth in real output. The rise in business expenditures for fixed capital had also slowed, but total final purchases had risen at a somewhat more rapid pace than in the third quarter; in fact, at an annual rate of 4.8 per cent, growth in real final sales exceeded that in the first two quarters as well. In the fourth quarter personal consumption expenditures had expanded sharply and residential construction had risen at an accelerated pace.

The staff projections suggested that the rate of growth in real GNP would increase appreciably in the first quarter of 1977 as the decline in business inventory accumulation came to a halt. Growth in final purchases of goods and services in real terms was projected to be sustained; it was expected that the rise in business investment in fixed capital would pick up while the expansion in personal consumption expenditures and in residential construction would moderate somewhat from the high rates in the fourth quarter of 1976.

Staff projections for subsequent quarters of 1977 incorporated

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assumptions that rebates of Federal income taxes and one-time payments to recipients of social security would be disbursed in the second quarter; that both personal income taxes and corporate taxes would be reduced; and that Federal spending for job-creating programs would be expanded. Reflecting these assumptions as well as expectations of a strengthening in business fixed investment, the projections suggested that real GNP would grow at a moderately faster pace than in the first quarter. It was expected that the rate of increase in the fixed-weighted price index for gross business product would change relatively little during 1977.

Retail sales—which had strengthened considerably in October and November—were indicated by the advance estimate to have risen sharply further in December, with gains fairly widespread among categories of stores. The rise in the fourth quarter as a whole had been much larger than that in the third.

The number of new domestic automobiles sold rose to an annual rate of about 9⅓ million in December, the highest rate in more than 3 years. To some extent, however, the rise reflected recovery from the strike that had limited sales in October and November; sales for the fourth quarter as a whole—at an annual rate of about 8¼ million—were down a little from the third-quarter pace. The number of foreign models sold was the same in the fourth quarter as in the third.

Indicators of residential construction activity had remained strong in recent months. Private housing starts rose sharply in December to an annual rate of more than 1.9 million units, the highest since August 1973. Starts in the fourth quarter, at an annual rate of about 1.8 million units, were up 15 per cent from the third quarter. Although residential building permits declined somewhat in December, from the third to the fourth quarter they rose about as rapidly as starts. Mortgage commitments outstanding at savings and loan associations had risen $1 billion further in November to a record level of $24.5 billion.

In contrast with developments in markets for consumer goods and services and for housing, current indicators of business fixed investment had been relatively weak. New orders for nondefense capital goods had declined sharply in November, and the average for October and November was only a little above that for the third quarter. Contract awards for commercial and industrial build-

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ings—measured in terms of floor space—also had declined sharply in November and the average for October and November was below that of both the second and the third quarters.

Moreover, such indicators of business investment as shipments of nondefense capital goods, sales of trucks, and expenditures for nonresidential construction suggested that actual business outlays for plant and equipment would not show the strong gain in the fourth quarter that had been indicated by the Department of Commerce survey of spending plans taken in late October and November. That survey had also suggested that the increases planned for the first two quarters of 1977 would be no greater than the rise in prices. On the other hand, a later Department of Commerce annual survey, conducted in December, indicated that businesses were planning to spend 11.3 per cent more for plant and equipment in 1977 than in 1976. Thus, it appeared that the shortfall in the fourth quarter of 1976 might be made up early in 1977 and that capital spending might strengthen further during the course of the year.

The index of industrial production—which had risen 1.2 per cent in November, more than recovering the losses in the preceding 2 months caused in part by strikes—rose 0.7 per cent further in December. Expansion in production of motor vehicles accounted for a large share of the over-all gain in December, but increases were widespread among other final products and also among materials other than metals. Over the 12 months ending in December 1976 the total index had risen about 7 per cent.

Payroll employment in nonfarm establishments expanded considerably in December—reflecting mainly increases among the service-producing industries, although employment in manufacturing also increased somewhat. The average factory workweek was unchanged, after having recovered in November from the effects of strikes. As measured by the household survey, total employment had increased in December while the civilian labor force had changed little, and the unemployment rate declined from 8.1 to 7.9 per cent. Most of the reduction in unemployment was among adult men; for this group, the rate declined from 6.5 to 6.2 per cent.

The advance in personal income—which had been large in November, in part because of the ending of major strikes—was

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even larger in December. Gains in wage and salary payments were widespread among industries, and large increases were reported for farm proprietors' income and for dividend payments.

The index of average hourly earnings for private nonfarm production workers advanced at an annual rate of about 5 per cent in December, somewhat less than in the two preceding months. Over the 12 months of 1976 the index rose about 6¾ per cent, compared with about 8 per cent over the 12 months of 1975.

The rise in the wholesale price index for all commodities remained rapid in December. Average prices of farm products and foods rose substantially, in large part because of sizable increases for pork, oilseeds, coffee, cocoa beans, tea, and fresh fruits and vegetables. The rise in average prices of industrial commodities—which had accelerated around midyear—slowed to a relatively low rate, mainly reflecting a reduction in prices for natural gas. Sizable increases were recorded for steel mill products, fabricated metal products, lumber and wood products, and refined petroleum products. Over the 12 months ending in December, the index for all commodities rose about 4¾ per cent, as industrial commodities advanced about 6½ per cent and farm products and foods declined about 1 per cent.

The average value of the dollar against leading foreign currencies declined in December, but then it recovered somewhat as U.S. market interest rates rose not only in absolute terms but also in relation to rates in European markets. The pound sterling strengthened following negotiation of a $3.9 billion standby arrangement with the International Monetary Fund and subsequent announcement of a plan to seek an orderly reduction in the reserve currency role of sterling.

The U.S. foreign trade deficit increased in November, and the average for October and November was close to the substantial rate for the third quarter. For the 2-month period both exports and imports were somewhat below their high rates in the third quarter.

Total credit at U.S. commercial banks rose little during December after 2 months of sizable increases. Bank holdings of Treasury securities and of mortgages expanded during December, but bank holdings of other securities declined; outstanding loans to businesses contracted slightly following 2 months of appreciable expansion. Over the fourth quarter bank loans to businesses grew

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at an annual rate of about 9½ per cent. However, about one-third of the growth in such loans represented acquisitions of bankers acceptances by some commercial banks.

The volume of commercial paper outstanding rose sharply during December for the second consecutive month. The volume issued by nonfinancial corporations expanded appreciably, after having declined in October and having risen only a little in November. Over the fourth quarter the combined total of nonfinancial commercial paper and business loans at banks grew at an annual rate of almost 10½ per cent.

The narrowly defined money stock (*M*-1),[1] which had grown at an annual rate of almost 14 per cent in October and had been unchanged in November, expanded at a rate of about 8 per cent in December. From the third to the fourth quarter, *M*-1 grew at a rate of 6 per cent. Over the year from the fourth quarter of 1975 to the fourth quarter of 1976, growth had been about 5½ per cent.

Growth in *M*-2 and *M*-3[2]—which had moderated in November but had still remained substantial—accelerated somewhat in December, reflecting the renewal of growth in *M*-1. Inflows of the time and savings deposits included in these broader aggregates were almost as large as in November. Although there had been reports of recent reductions in interest rates paid on these deposits by some institutions, such rates in general remained more attractive than yields available on competing market instruments. From the third to the fourth quarter, *M*-2 and *M*-3 grew at annual rates of about 12 and 14 per cent, respectively. Over the year ending in the fourth quarter of 1976, growth had been 11 per cent for *M*-2 and 12¾ per cent for *M*-3.

At the December meeting, the Federal Open Market Committee had decided to maintain prevailing bank reserve and money market conditions, provided that monetary aggregates appeared to be

[1] *M*-1 is composed of private demand deposits and currency in circulation.

[2] *M*-2 includes *M*-1 and commercial bank time and savings deposits other than large-denomination certificates of deposit. *M*-3 includes *M*-2 and deposits at nonbank thrift institutions (savings and loan associations, mutual savings banks, and credit unions).

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growing at about the rates then expected. Over most of the inter-meeting period incoming data suggested that the aggregates were growing at about the expected rates, and the Manager of the System Open Market Account conducted operations with a view to maintaining the Federal funds rate close to 4⅝ per cent—the level prevailing at the time of the December meeting. Near the end of the inter-meeting period, incoming data began to suggest that over the December–January period growth in *M*-1 would be somewhat above the range that had been specified by the Committee but that growth in *M*-2 would be near the midpoint of its range. With the Committee scheduled to meet in a few days, the Manager continued to aim for a Federal funds rate of about 4⅝ per cent, although with a little greater willingness to tolerate small deviations above that rate than below it.

Interest rates generally changed little during the latter half of December. In early January, however, substantial upward pressures developed, particularly on rates for intermediate-term Treasury issues—in part, apparently, because market expectations of some further decline in the Federal funds rate were not realized. Interest rates also appeared to be influenced by indications of improvement in the outlook for economic activity, by a more rapid rate of growth in *M*-1 than had been generally anticipated, and by announcement of the incoming administration's fiscal proposals. Advances in rates over the inter-meeting period ranged from 10 to 40 basis points for short-term instruments, from 45 to 60 basis points for intermediate-term Treasury issues, and from 10 to 25 basis points for long-term corporate and Treasury bonds.

Gross issues of bonds offered to the public by domestic corporations amounted to nearly $2½ billion in December—more than twice the reduced volume of November—and the total of such issues in January was expected to exceed $3 billion. Most of the new offerings in December had been from lower-rated industrial and finance companies, but in January a number of highly rated industrial companies were also offering new issues, apparently to take advantage of the still relatively favorable interest rates. In addition, several utility companies announced intentions to advance-refund or to call bonds issued in 1969 and 1970 when interest rates on such obligations had been substantially higher.

Although the volume of new State and local government bond

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offerings dropped in December, it was large for the fourth quarter as a whole. Declines in rates on municipal bonds to relatively low levels in the fourth quarter had encouraged State and local governments to pre-refund higher-cost issues, to accelerate offerings that had been scheduled for later dates, and to continue reducing their reliance on short-term issues. In 1976 the volume of new issues of State and local government bonds was nearly 15 per cent larger than in 1975—the previous record year—while the volume of short-term financing declined.

The U.S. Treasury had raised $4 billion of new money in the 5 weeks since the December FOMC meeting, and it was expected to raise a larger amount in the 4 weeks following this meeting. The terms of the Treasury's mid-February refunding were due to be announced on January 26. Of the issues maturing in mid-February, only $2.1 billion were held by the public, and the Treasury was expected to take that occasion to raise several billion dollars of new money.

In primary mortgage markets, rates on new commitments for conventional home loans declined in December and early January. In secondary mortgage markets, rates declined during December by more than in the primary markets, but they turned up in early January along with yields on other market securities.

It appeared likely that over-all demands for funds in securities markets would continue to be sizable during the months just ahead. Cash borrowing by the U.S. Treasury and Federal agencies combined was expected to remain large. Bond issues by business corporations and State and local governments seemed likely to continue heavy, partly because of widespread expectations that interest rates would be advancing later in the year. At the same time, however, it appeared likely that institutional investors would continue to have a sizable volume of funds available for investment in bonds.

In the discussion of the economic situation at this meeting, members of the Committee agreed that the outlook for growth in real output of goods and services had strengthened. Attention was called to the recent surge in retail sales—and the resulting improvement in inventory positions—and to the increasing strength in housing starts. It was suggested that, as a consequence of recent developments, business fixed investment was likely to increase

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more during the coming year than had been expected heretofore and that expansion in over-all economic activity might well accelerate to a relatively rapid pace. It was also observed, however, that even if growth in real GNP during 1977 were significantly greater than projected by the staff, rates of resource use in the fourth quarter of the year still would not appear to be excessive; indeed, unemployment would still be relatively high. Because of the character of the fiscal measures in prospect and for other reasons, one or two members remarked that the rate of expansion in economic activity in 1977 was likely to be uneven.

Although Committee members in general now held a more favorable view of the economic situation and outlook than they had a month or two ago, attention was called to a number of problems. For one, the severity of the winter weather and its impact on the availability of fuels for industrial use posed a threat to output and employment in some parts of the country. Even though the unemployment rate was still unacceptably high, current and prospective rates of inflation also remained a source of major concern.

A measure of concern was also provoked by certain aspects of the Federal budget, after incorporation of assumptions about the new administration's fiscal proposals. It was noted that the high-employment deficit was projected to increase substantially in calendar 1977—to the highest level in relation to GNP since 1976—and that relatively large high-employment deficits tended to tighten financial markets and to exert upward pressures on interest rates. Should intermediate- and long-term interest rates rise significantly during 1977, it was observed, expansion in business fixed investment might well be less than would seem desirable. Concern also was expressed that the proposed second phase of the 2-year package of fiscal measures might overstimulate economic activity at a late stage in the expansion, as had happened at times in the past.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. In early November the Committee had specified the following ranges for growth over the period from the third quarter of 1976 to the third quarter of 1977: *M*-1, 4½ to 6½ per cent; *M*-2, 7½ to 10 per cent; and *M*-3, 9 to 11½ per cent. The associated range for growth in the bank credit proxy was 5 to 8 per cent. The ranges being considered at this

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meeting were for the period from the fourth quarter of 1976 to the fourth quarter of 1977.

In commenting on the ranges for growth in the monetary aggregates over the period from the fourth quarter of 1976 to the fourth quarter of 1977, most members concurred in a suggestion that the existing range for *M*-1 be retained and that the lower limits of the ranges for *M*-2 and *M*-3 be reduced by ½ of a percentage point. Several of these members indicated that they would also be agreeable to retaining the existing ranges for all three monetary aggregates.

In connection with the proposal favored by most members, it was noted that *M*-2 had increased 10.9 per cent over the course of 1976, compared with an average yearly rise of 8.3 per cent in the preceding decade; and that *M*-3 had increased 12.4 per cent over 1976, compared with an average yearly rise of 8.8 per cent in the preceding 10 years. Growth of the broader measures of money over 1976 had been unusually rapid in relation to growth of *M*-1. In large part this reflected ongoing changes in financial markets that reduced reliance on demand deposits for transactions purposes; it also reflected the attractiveness of interest rates paid on time and savings deposits in relation to rates on market instruments.

It was also noted that growth rates of *M*-2 and *M*-3 from the third to the fourth quarter of 1976 had exceeded the ranges adopted by the Committee in early November. For the period ahead, therefore, the ranges favored by most members would imply a moderation of growth in these aggregates.

Several members of the Committee suggested that in the period ahead a significant slowing of growth in the time and savings deposits included in the broader aggregates was likely to develop. They noted that some banks and thrift institutions already had reduced the rates they were offering on such deposits and had taken other steps to slow inflows. Moreover, in 1976 growth in *M*-2 and *M*-3 had been sustained by shifts of funds from outstanding market securities to time and savings deposits, and the effect of such stock adjustments was likely to be less important in 1977. Thus, growth rates of the broader aggregates seemed likely to slow both in absolute terms and in relation to growth of *M*-1.

The downward adjustments of the lower limits of the projected

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ranges for *M*-2 and *M*-3 reflected this possibility. They also reflected the Committee's intention to continue to move gradually toward longer-run rates of monetary expansion consistent with general price stability. In this connection, it was noted that since April 1975, when 1-year growth ranges were first established for the monetary aggregates, the Committee had taken a number of small steps in pursuit of that objective. It was observed that the Committee ought to continue doing so in order to re-establish a foundation for economic stability over the longer term. At the same time, however, it was suggested that retaining the existing range for *M*-1 at this time would be consistent with efforts to accelerate the pace of economic expansion and to reduce unemployment from its unduly high rate.

One member suggested a variation of the proposal concurred in by most members: ½ of a percentage point reduction in the upper, rather than in the lower, limits of the ranges for *M*-2 and *M*-3 along with retention of the existing range for *M*-1. Another member, noting the influence of innovations in financial markets, expressed the view that for some time the Committee's longer-run ranges for *M*-2 and *M*-3 had not been consistent with its range for *M*-1; therefore he suggested reducing the range for *M*-1 to 4 to 6 per cent and making small upward adjustments in the ranges for *M*-2 and *M*-3, leaving the ranges for the broader aggregates still well below the rates of growth from the third to the fourth quarter of 1976. Against the suggestion for a reduction in the range for *M*-1, it was observed that the staff projections of nominal GNP in combination with growth of *M*-1 within the existing range implied a sizable rise in the income velocity of *M*-1 in 1977, even after allowance for further contributions to the rise in velocity from financial innovations.

At the conclusion of its discussion the Committee arrived at a consensus calling for retention of the existing range for *M*-1 and reductions of ½ of a percentage point in the lower limits of the ranges for *M*-2 and *M*-3. The ranges thus were 4½ to 6½ per cent for *M*-1, 7 to 10 per cent for *M*-2, and 8½ to 11½ per cent for *M*-3. The associated range for the rate of growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at

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subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for the year ahead.

> The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the fourth quarter of 1976 to the fourth quarter of 1977: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 10 per cent; and *M*-3, 8½ to 11½ per cent.

> Votes for this action: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes against this action: None.

As to policy for the period immediately ahead, members differed little in their preferences for ranges of growth in the monetary aggregates over the January–February period. For *M*-1, most members favored a range of 3 to 7 per cent; a number of members preferred 3½ to 7½ per cent, and one suggested 4 to 7 per cent. For *M*-2, most members favored a range of 7 to 11 per cent, while some preferred 7½ to 11½ per cent.

Differences of view were somewhat greater concerning the range for the Federal funds rate. A number of members preferred a relatively narrow range, one of ½ or ⅝ per cent, centered on the prevailing level of 4⅝ per cent or on 4¾ per cent—in large part because, in their view, financial markets at present were in a sensitive state. Other members preferred a wider range centered on a rate of 4¾ per cent—specifically, 4¼ to 5¼ per cent—because they believed that additional leeway for System operations should be provided in the event that over the January–February period growth in the aggregates appeared to be deviating significantly from the rates now expected.

One member suggested that the Committee give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting—as it had decided to do at its December meeting—because of the uncertainties associated with projections of growth in monetary aggregates around the year-end. However, most members preferred to have operating decisions in the period ahead based primarily on the behavior of the monetary aggregates.

At the conclusion of the discussion the Committee decided to

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seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead. Specifically, the Committee concluded that growth in *M*-1 and *M*-2 over the January–February period at annual rates within ranges of 3 to 7 per cent and 7 to 11 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of *M*-1 and *M*-2.

It was agreed that until the next meeting the weekly-average Federal funds rate might be expected to vary in an orderly way within a range of 4¼ to 5 per cent. It was also agreed that early in the inter-meeting period the Manager should aim for a Federal funds rate in the area of 4⅝ to 4¾ per cent, with specific operating decisions to depend in part on the state of securities markets. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that growth in real output of goods and services slowed somewhat further in the fourth quarter, mainly because of a sharp decline in the rate of inventory accumulation. In December retail sales increased sharply, following strong gains in the preceding 2 months. Industrial production and total employment rose further, and the unemployment rate declined from 8.1 to 7.9 per cent. The wholesale price index for all commodities rose substantially, reflecting a sharp increase in average prices of farm products and foods; the rise in average prices of industrial commodities slowed, owing largely to declines in prices of fuels. The advance in the index of average wage rates over recent months has remained below the rapid rate of increase during 1975.
>
> The average value of the dollar against leading foreign currencies declined in December but has since recovered somewhat. The pound sterling strengthened following negotiation of an IMF standby arrangement and of a medium-term facility to offset reductions in official sterling balances. In November the U.S. foreign trade deficit

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increased, bringing the October–November average deficit to about the third-quarter rate.

M-1, which was unchanged in November, expanded appreciably in December; from the third to the fourth quarter growth in *M*-1 was moderate. Inflows of the time and savings deposits included in *M*-2 and *M*-3 were almost as large in December as in November, and growth in these broader aggregates was substantial. Interest rates changed little in late December but recently have moved up.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.

> Votes for this action: Messrs. Burns, Volcker, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Vote against this action: Mr. Balles.

Mr. Balles dissented from this action for the following reasons. In view of recent financial market innovations, he believed that the course of real GNP and prices now bore a closer relationship to the behavior of *M*-2 than to that of *M*-1. Therefore, he was concerned about the fact that growth in *M*-2 had been exceeding the Committee's longer-run range and about the consequent implications for future inflation. Accordingly, he thought that in the period ahead the System should aim initially for a Federal funds rate of about 4¾ per cent and should be prepared to aim over the course of the period for a rate as high as 5¼ per cent if the aggregates, especially *M*-2, appeared to be growing at rates significantly higher than the longer-run ranges.

2. Agreements in Connection with Credit Facility Relating to Official Sterling Balances

For some time prior to this meeting discussions had been under way among representatives of central banks of the Group of Ten

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countries and Switzerland in regard to a medium-term standby credit facility relating to official sterling balances for the Bank of England. Concurrently, officials of the U.S. Treasury Department and the Federal Reserve System had been considering arrangements for U.S. participation in such a facility. As announced on January 10, an agreement in principle for a $3 billion facility was reached at a meeting in Basle, Switzerland, by representatives of the Bank for International Settlements (BIS), the Bank of England, and a number of other central banks, including the Federal Reserve. The U.S. share was $1 billion, to be provided through the Federal Reserve System and the U.S. Treasury's Exchange Stabilization Fund (ESF). At this meeting the Committee ratified the agreement reached in Basle and arrangements made with the Treasury Department for Federal Reserve–Treasury participation.

The objective of the Basle agreement was to help the United Kingdom achieve an orderly reduction in the reserve currency role of sterling and thus to avoid the kind of disturbances to the international monetary system that had occurred at times in the past as a result of fluctuations in official sterling balances. In general, the agreement provided for the extension of a $3 billion facility to the Bank of England by the BIS, with backing, as necessary, by the other participants, for a period of 2 years—and for a third year if mutually agreed upon by the participants. For its part, the United Kingdom agreed to reduce official sterling balances to working levels over the "drawdown" period. In exchange for official holdings of sterling, it would offer negotiable bonds denominated in currencies other than sterling and having maturities of 5 to 10 years. The Bank of England would be entitled to draw on the credit facility to the extent necessary to finance reductions in official sterling balances other than those associated with sales of foreign currency bonds. Repayments would begin at the end of the "drawdown" period and would be completed within the succeeding 4 years.

It was understood that eligibility to draw on the standby credit facility would be conditional on continuing eligibility of the United Kingdom to draw on the $3.9 billion credit recently negotiated with the International Monetary Fund (IMF). The facility could also be suspended if the United Kingdom were not making reasonable efforts to achieve reductions in official sterling balances; the

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Managing Director of the IMF was being asked to assist in making a determination on this score.

With respect to U.S. participation, the Federal Reserve and the Treasury had agreed that if the United States were required to provide financing to the BIS in support of the standby facility, the funds would be provided initially by the Federal Reserve through its existing swap arrangement with the BIS, taking the form of a usual 3-month swap, subject to three renewals. Should such financing be required continuously for more than one year, however, it would subsequently be provided by the Treasury, acting through the Exchange Stabilization Fund. Risk associated with such financing, whether provided by the Federal Reserve or the ESF, was to be borne equally by the two.

> Votes for ratification of these agreements: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes against ratification: None.

3. Agreement to "Warehouse" Currencies for the Exchange Stabilization Fund

At this meeting the Committee agreed to a suggestion by the Treasury that the Federal Reserve undertake to "warehouse" foreign currencies held by the ESF—that is, to make spot purchases of foreign currencies from the ESF and simultaneously to make forward sales of the same currencies to the ESF—if that should prove necessary to enable the ESF to deal with potential liquidity strains. Specifically, the Committee agreed that the Federal Reserve would be prepared, if requested by the Treasury, to warehouse up to $1½ billion of eligible foreign currencies, of which half would be for periods of up to 12 months and half for periods of up to 6 months.

In the discussion it was noted that such warehousing operations had proved useful from time to time in the past, on occasions when the resources of the ESF had been inadequate to meet all the demands on them. It was also noted that, while the present agreement to warehouse currencies did not have a specific terminal date, it would be subject to review by the Committee at its

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organizational meeting each March in connection with the regular review of all outstanding authorizations. The members concurred in an observation that no modifications in the warehousing arrangement were likely to be proposed at the next organizational meeting, which was only 2 months away, but that the Committee could decide to reconsider the arrangement at a subsequent organizational meeting.

Votes to approve the warehousing arrangement: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes to disapprove: None.

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MEETING HELD ON FEBRUARY 15, 1977

1. Domestic Policy Directive

Growth in real output of goods and services had slowed to an annual rate of 3.0 per cent in the fourth quarter of 1976—from 3.9 per cent in the third quarter and 4.5 per cent in the second—according to preliminary estimates of the Commerce Department. However, the pace of growth had accelerated as the quarter progressed. The information reviewed at this meeting suggested underlying strength in economic activity, although activity in January and early February had been affected by the unusually severe weather.

The index of industrial production had risen appreciably in November and December, to some extent in recovery from strikes. The index fell in January because of the severe winter weather and also, after midmonth, because of shortages of natural gas for industrial uses. Decreases in output were widespread among durable and nondurable manufacturing industries, and coal mining was curtailed sharply. However, electric and gas utilities expanded production to meet increased demand.

Retail sales had expanded 1¾ per cent in November and about 4 per cent in December. In January, according to the advance report, sales declined 2 per cent, reflecting decreases for most types of stores apparently because of the weather.

The number of new domestic automobiles sold in the first 20 days of January appeared to have held near the annual rate of 9⅓ million recorded in December, when sales were stimulated to some extent by recovery from the strike that had limited output and sales earlier. However, sales fell sharply in the latter part of January, and for the month as a whole the annual rate was about 8¾ million.

Labor market surveys completed by mid-January indicated that employment had continued to expand. In the survey of payroll employment in nonfarm establishments, gains were reported in

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two-thirds of the industries covered, and the total rose substantially for the third consecutive month. By the time of the survey, however, the severe weather had already induced a reduction in employment in construction and a shortening in the length of the average workweek in manufacturing. In the household survey, the unemployment rate was reported to have fallen from 7.8 per cent in December to 7.3 per cent in January. Much of the decline reflected a drop in the number of persons seeking work, which may have been caused in part by the weather.

Personal income had expanded vigorously in the last 2 months of 1976; from the third quarter to the fourth it rose at an annual rate of about 11 per cent. This sizable gain reflected a rebound in manufacturing payrolls after termination of strikes, a recovery in farm income, an increase in Federal pay scales, and the disbursement by corporations of unusually large year-end dividends.

Indicators of residential construction activity had remained strong in the closing months of 1976. In December private housing starts rose sharply to an annual rate of more than 1.9 million units, the highest since the autumn of 1973. The rise was broadly based by region. For the fourth quarter as a whole starts were at an annual rate of about 1.8 million units, up 15 per cent from the third quarter. Starts of multifamily units gained more than 30 per cent from the third quarter to the fourth, reflecting not only a substantial increase in starts of units covered under Federally subsidized programs but also a large rise in units not so subsidized.

Businesses were planning to spend 11.3 per cent more for plant and equipment in 1977 than in 1976, according to the Department of Commerce annual survey conducted in December. New orders for nondefense capital goods in December recovered a part of the sharp decline recorded in November. Contract awards for commercial and industrial buildings—measured in terms of floor space—also had declined sharply in November and then in December recovered a part of the loss.

The staff projections, like those of a month earlier, incorporated assumptions that rebates of Federal income taxes and one-time payments to recipients of social security would be disbursed in the second quarter; that both personal income taxes and corporate taxes would be reduced; and that Federal spending for job-creating programs would be expanded. The projections continued to suggest

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that real GNP would grow at a substantially higher rate in the first half of 1977 than it had in the second half of 1976. As to the first quarter, it was still anticipated that growth in domestic final purchases of goods and services in real terms would be relatively well sustained, despite the severe winter weather, but the rebound in growth in real GNP was now expected to be considerably less than had been anticipated a month earlier. The projections now suggested that the rate of business inventory accumulation would decline further in the first quarter and that imports, specifically of fuels, would rise more than had been anticipated.

It was expected that the weather-induced output losses of the first quarter would soon be made up; for the second quarter, the projections suggested that real final sales would grow at a rapid rate and that business inventory investment would increase. It was anticipated that real GNP would grow at a relatively good rate in the second half of 1977. The projections still suggested that the rate of increase in the fixed-weighted price index for gross business product would change relatively little during this year.

Wage increases provided for in the first year of major collective bargaining agreements negotiated during 1976 were somewhat more moderate than those negotiated in 1975. Moreover, the index of average hourly earnings for private nonfarm production workers advanced 6¾ per cent over the 12 months of 1976, compared with almost 8 per cent during the previous year. In January 1977 the index rose sharply; however, the sharpness of the rise reflected marked increases in the indexes for the construction and service sectors, where rates of change from month to month have been volatile.

The wholesale price index for all commodities rose 0.5 per cent in January, almost the same as the average increase in the last 3 months of 1976. Average prices of industrial commodities rose a little more than in December but less than in the preceding 3 months. Increases were again widespread among industrial commodity groups; as in December, however, a decline was reported for the fuel and power group, reflecting some price reductions that actually had occurred a month or two earlier. Average prices of farm products and foods also rose, but the increase was relatively small.

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The consumer price index rose 0.4 per cent in December, resulting in an increase of 4.8 per cent over the 12 months of 1976; during 1975 the index had risen 7.0 per cent. Average retail prices of foods changed little during 1976, in contrast with a rise of 6.5 per cent over the previous year. Average prices of other commodities and of services rose about 5 and 7 per cent, respectively, compared with increases of about 6 and 8 per cent in 1975.

The average value of the dollar rose somewhat against leading foreign currencies between mid-January and mid-February, with most of the rise occurring in the early part of the period. The value of the dollar increased against most continental European currencies and against the Canadian dollar but declined against the Japanese yen. The pound sterling was subjected to strong upward pressure in reaction to the international agreements concluded in early January to provide the United Kingdom with substantial funds to finance possible future intervention in support of the sterling exchange rate. However, the pound did not rise against the dollar, mainly as a result of exchange market intervention by the Bank of England. The Mexican peso, which had been trading steadily at 5.0 U.S. cents since early December, fell abruptly on January 20 to 4.3 cents; later, it gradually recovered to 4.5 cents.

The U.S. foreign trade deficit increased further in December, and the deficit on an international accounts basis was a little larger in the fourth quarter than in the third. For all of 1976 the trade balance was in deficit by almost $10 billion, whereas for 1975 it had been in surplus by $9 billion.

Total credit at U.S. commercial banks increased considerably in January, following a small rise in December. Data for both months, however, were distorted by special influences—particularly a substantial increase in bank holdings of bankers acceptances late in 1976 that was largely reversed in January. Over the 2 months together, growth of total bank credit—although somewhat above the rather slow pace in the first half of 1976—was significantly below the rates in both the third quarter and the October–November period. Growth of business loans—excluding bankers acceptances—slowed sharply from the rate in the October–November period, and at the same time banks shifted from substantial acquisition to moderate liquidation of securities other than U.S. Treasury issues.

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In the December–January period the outstanding volume of commercial paper issued by nonfinancial corporations rose sharply, after having changed little over the preceding 2 months. Nevertheless, the combined total of nonfinancial commercial paper and business loans at banks (excluding bankers acceptances) grew somewhat less in the latter 2-month period than in the earlier one, when business needs for financing had apparently been augmented to some extent by involuntary accumulation of inventories.

The narrowly defined money stock (*M*-1), which had grown at an annual rate of about 8 per cent in December, slowed to a rate of about 4½ per cent in January. Although the month-to-month expansion in *M*-1 recently had been erratic, the average annual rate of growth over the 6 months ending in January was about 5½ per cent.[1]

Growth in *M*-2 and *M*-3 slowed appreciably in January from the rapid rates evident in December and in the fourth quarter. At banks and thrift institutions, inflows of the time and savings deposits included in the broader aggregates slowed somewhat, apparently because of reductions in interest rates paid on these deposits by some banks and thrift institutions and a rise in rates on competing market securities.

At its January meeting, the Committee had agreed that early in the inter-meeting period the Manager of the System Open Market Account should aim for a Federal funds rate in the area of 4⅝ to 4¾ per cent and that afterwards the weekly-average Federal funds rate might be expected to vary in an orderly way within a range of 4¼ to 5 per cent. Throughout the inter-meeting period incoming data suggested that growth in both *M*-1 and *M*-2 over the January–February period would be well within the ranges that had been specified by the Committee. Accordingly, the Manager continued to direct operations toward maintaining the Federal funds rate in the area of 4⅝ to 4¾ per cent.

Market interest rates—which had risen abruptly after the turn of the year—rose somewhat further in the weeks just after the

[1] Revised measures of monetary aggregates, reflecting new benchmark data for deposits at nonmember banks and revised seasonal factors, were published on February 17, 1977. On the basis of the revised figures, the annual rate of growth in *M*-1 in January and also over the 6 months ending in January was about 5¾ per cent.

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mid-January meeting of the Committee, partly in reaction to the Treasury's announcement of the terms of its mid-February refunding and of cash needs during the first quarter. Later, however, rates backed down to about their mid-January levels. At their levels in mid-February, market interest rates in general were significantly above their December lows, but they were still a little lower than at mid-November.

In the 4 weeks since the January FOMC meeting, the U.S. Treasury had raised $6.5 billion of new cash, including $3.8 billion raised in connection with the mid-February refinancing. New issues in the refinancing included $3.0 billion of 3-year notes, $2.0 billion of 7-year notes, and $750 million of 30-year bonds. The over-all size of the offerings was near the upper limit of market expectations. However, investor interest in the new issues proved to be considerable.

In the market for new corporate bonds, the volume of publicly offered new issues in January was not quite so large as had been expected because increased interest rates had prompted the postponement or cancellation of several issues. Nevertheless, the January volume was substantially above the monthly average in the fourth quarter of 1976. Offerings of new long-term securities by State and local governments rose sharply in January to $3.4 billion—a record for the month. About $500 million of this supply was attributable to the issuance of bonds in advance refundings, and about $700 million represented financing by municipal utilities.

During January yields rose in secondary mortgage markets along with those in other markets, but interest rates on new commitments for conventional home loans edged off somewhat further. At the end of December outstanding mortgage commitments at savings and loan associations had reached another new high, even though mortgage takedowns during the month had remained substantial.

At its January meeting the Committee had agreed that from the fourth quarter of 1976 to the fourth quarter of 1977, average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 10 per cent; and *M*-3, 8½ to 11½ per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were

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specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

In their discussion of recent economic developments and prospects, members of the Committee agreed that the underlying situation was strong and that the losses in output, hours of work, and income resulting from the weather would soon be made up. Most members agreed in general with the staff projections suggesting that growth in real GNP would accelerate to a rapid pace in the second quarter—reflecting not only the recovery from the weather-induced losses but also the disbursement of tax rebates and related payments—and then would continue at a relatively good rate throughout the second half of the year.

However, one or two members expressed concern that the weather disturbance and the tax rebates might cause large swings in business inventory investment and therefore in total GNP. In this connection, it was suggested that more attention should be paid to the behavior of final sales than to that of total output.

Despite the broad consensus on the outlook, several members called attention to actual and possible developments that might cause real GNP to deviate from the projected path. It was observed, for example, that severe weather—while having temporary effects on output, inventories, and incomes much like those of a major strike—would also transfer purchasing power from consumers to sellers of fuels, who most likely had a lower propensity to spend. Partly because of the high fuel bills, it was suggested, the tax rebates and related payments might have less impact on consumer spending than one might have expected on the basis of the 1975 experience with rebates.

Looking to the latter part of 1977 and into 1978, some questions were raised about the adequacy of industrial capacity. In this connection, attention was called to the recent revisions in the Federal Reserve estimates of the rate of capacity utilization in manufacturing in the 1971–76 period. Concern was expressed that the margin of unused plant capacity that could be drawn into production might be low in relation to the amount of unemployed labor. It was also observed that rates of capacity utilization varied considerably among industries and that during business expansions

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bottlenecks begin to spread through the industrial system long before over-all measures of capacity utilization reach relatively high levels.

It was suggested that the rise in prices might become more rapid as activity expanded during the period ahead. Historically, it was noted, average wholesale prices of industrial commodities had begun to rise at about the time that business activity had begun to recover, reflecting increases in prices of raw materials. In the current business expansion, that pattern had been superimposed upon the longer-run trend of inflation in the economy. With respect to the outlook for prices, it was noted also that the severe drought in the western part of the country may sharply reduce crops of fruits and vegetables.

One or two members of the Committee suggested that—although economic prospects appeared to be good—businessmen seemed to have become somewhat more uneasy in recent weeks about the near-term effects of the adverse weather, about the longer-term energy problem, about the possibility of imposition of some form of price controls, about the Government's fiscal policy, and about prospects for inflation. It was felt that this uneasy mood could inhibit decisions to make expenditures for plant and equipment. However, another member noted that some of the uncertainties that had worried businessmen only a few months ago—such as the "pause" in growth of economic activity and the size of the prospective increase in prices of imported oil—had been resolved. In his opinion, businessmen would soon take a more favorable view of the climate for capital investment. Still another member expressed concern about the possibility that business capital investment would rise too strongly at a late stage in the business expansion.

As to policy for the period immediately ahead, Committee members in general advocated continuation of about the current stance. They differed little in their preferences for ranges of growth in the monetary aggregates over the February–March period. For *M*-1, the members endorsed a range of 3 to 7 per cent, although one indicated a mild preference for a range of 3½ to 7½ per cent. For *M*-2, many members favored a range of 7 to 11 per cent. However, some advocated a slightly lower range—6 to 10 per cent—because *M*-2 had grown over recent months at a rate that

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was high relative to the Committee's longer-run range for that aggregate.

Almost all members favored directing operations initially toward the objective of maintaining the Federal funds rate in the area of 4⅝ to 4¾ per cent. However, they differed somewhat in their preferences for the upper and lower limits of the inter-meeting range. The largest number of members preferred to continue the range of 4¼ to 5 per cent that had been specified at the January meeting. Some favored ranges of 4¼ to 5¼ per cent or 4½ to 5¼ per cent, because they believed that additional leeway for System operations should be provided in the event that growth in the aggregates over the February–March period appeared to be significantly faster than now expected.

At the conclusion of the discussion the Committee decided that growth in *M*-1 and *M*-2 over the February–March period at annual rates within ranges of 3 to 7 per cent and 6½ to 10½ per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of *M*-1 and *M*-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average Federal funds rate in the area of 4⅝ to 4¾ per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4¼ to 5 per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests underlying strength in economic activity, although industrial production and retail sales were held down in January by the effects of unusually severe weather. Housing starts rose sharply in December, and labor

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market surveys completed by mid-January indicated a further rise in employment and a decline in the unemployment rate from 7.8 to 7.3 per cent. The wholesale price index for all commodities continued to rise, reflecting increases in the averages both for farm products and foods and for industrial commodities. The index of average wage rates rose sharply in January as a result of marked increases in the volatile construction and service sectors.

The average value of the dollar against leading foreign currencies has risen somewhat over the past month. In December the U.S. foreign trade deficit increased further; in the fourth quarter as a whole the deficit was a little larger than in the third quarter.

M-1, which had expanded appreciably in December, grew at a moderate pace in January. Growth in *M*-2 and *M*-3 also moderated. At banks and thrift institutions, inflows of time and savings deposits other than large-denomination CD's slowed somewhat. Interest rates have changed relatively little on balance since mid-January.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

At its meeting on January 18, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4½ to 6½ per cent, 7 to 10 per cent, and 8½ to 11½ per cent, respectively, from the fourth quarter of 1976 to the fourth quarter of 1977 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the February–March period to be within the ranges of 3 to 7 per cent for *M*-1 and 6½ to 10½ per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly average Federal funds rate of about 4⅝ to 4¾ per cent. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 4¼ to 5 per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly

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inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes against this action: None.

2. Statement of Policy Regarding the Government in the Sunshine Act

From time to time at recent meetings the Committee had discussed the applicability of the Government in the Sunshine Act to its meetings. At this meeting the Committee concurred in an opinion of counsel that the act would not apply because the Committee did not come within the definition of "agency" contained in the act. The Committee further agreed that its present procedures and disclosure policy were already conducted in accordance with the intent and spirit of the act and that its current practices in that regard would be continued.

After reaching these judgments, the Committee approved the following statement of policy:

On September 13, 1976, there was enacted into law the Government in the Sunshine Act, Pub. L. No. 94-409, 90 Stat. 1241 ("Sunshine Act"), established for the purpose of providing the public with the "fullest practicable information regarding the decisionmaking processes of the Federal Government . . . while protecting the rights of individuals and the ability of the Government to carry out its responsibilities."[2] The Sunshine Act applies only to those Federal agencies that are defined in Section 552(e) of Title 5 of the United States Code and "headed by a collegial body composed of two or more individual members, a majority of whom are appointed to such position by the President with the advice and consent of the Senate, and any subdivision thereof authorized to act on behalf of the agency."[3]

The Federal Open Market Committee ("FOMC") is a separate

[2] Government in the Sunshine Act, Public Law 94-409, §2, 90 Stat. 1241 (1976).
[3] Ibid., §3(a), 1241.

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and independent statutory body within the Federal Reserve System. In no respect is it an agent or "subdivision" of the Board. It was originally established by the Banking Act of 1933 and restructured in its present form by the Banking Act of 1935 and subsequent legislation in 1942 (generally see 12 U.S.C. §263(a)). The FOMC's membership is composed of the seven members of the Board of Governors of the Federal Reserve System ("Board of Governors") and five representatives of the Federal Reserve Banks who are selected annually in accordance with the procedures set forth in Section 12A of the Federal Reserve Act, 12 U.S.C. §263(a). Members of the Board of Governors serve in an *ex officio* capacity on the FOMC by reason of their appointment as Members of the Board of Governors, not as a result of an appointment "to such position" (the FOMC) by the President. Representatives of the Reserve Banks serve on the FOMC not as a result of an appointment "to such position" by the President, but rather by virtue of their positions with the Reserve Banks and their selection pursuant to Section 12A of the Federal Reserve Act. It is clear therefore that the FOMC does not fall within the scope of an "agency" or "subdivision" as defined in the Sunshine Act and consequently is not subject to the provisions of that Act.

As explained below, the Act would not require the FOMC to hold its meetings in open session even if the FOMC were covered by the Act. However, despite the conclusion reached that the Sunshine Act does not apply to the FOMC, the FOMC has determined that its procedures and timing of public disclosure already are conducted in accordance with the spirit of the Sunshine Act, as that Act would apply to deliberations of the nature engaged in by the FOMC.

In the foregoing regard, the FOMC has noted that while the Act calls generally for open meetings of multi-member Federal agencies, 10 specific exemptions from the open meeting requirement are provided to assure the ability of the Government to carry out its responsibilities. Among the exemptions provided is that which authorizes any agency operating under the Act to conduct closed meetings where the subject of a meeting involves information "the premature disclosure of which would—in the case of an agency which regulates currencies, securities, commodities, or financial institutions, be likely to lead to significant financial speculation in currencies, securities, or commodities."[4]

[4] Ibid., 1242.

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As to meetings closed under such exemption, the Act requires the maintenance of either a transcript, electronic recording or minutes and sets forth specified, detailed requirements as to the contents and timing of disclosure of certain portions or all of such minutes. The Act permits the withholding from the public of the minutes where disclosure would be likely to produce adverse consequences of the nature described in the relevant exemptions.

The FOMC has reviewed the agenda of its monthly meetings for the past three years and has determined that all such meetings could have been closed pursuant to the exemption dealing with financial speculation or other exemptions set forth in the Sunshine Act. The FOMC has further determined that virtually all of its substantive deliberations could have been preserved pursuant to the Act's minutes requirements and that such minutes could similarly have been protected against premature disclosure under the provisions of the Act.

The FOMC's deliberations are currently reported by means of a document entitled "Record of Policy Actions" which is released to the public approximately one month after the meeting to which it relates. The Record of Policy Actions complies with the Act's minutes requirements in that it contains a full and accurate report of all matters of policy discussed and views presented, clearly sets forth all policy actions taken by the FOMC and the reasons therefor, and includes the votes by individual members on each policy action. The timing of release of the Record of Policy Actions is fully consistent with the Act's provisions assuring against premature release of any item of discussion in an agency's minutes that contains information of a sensitive financial nature. In fact, by releasing the comprehensive Record of Policy Actions to the public approximately a month after each meeting, the FOMC exceeds the publication requirements that would be mandated by the letter of the Sunshine Act.

Recognizing the congressional purpose underlying enactment of the Sunshine Act, the FOMC has determined to continue its current practice and timing of public disclosures in the conviction that its operations thus conducted are consistent with the intent and spirit of the Sunshine Act.

Votes for this action: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes against this action: None.

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3. Amendment to Rules Regarding Availability of Information

At this meeting, the Committee approved an amendment, effective March 12, 1977, to Section 271.6(a) of its rules regarding availability of information to implement an amendment to the Freedom of Information Act effected by the Government in the Sunshine Act. After incorporating this amendment the Section read as follows:

§271.6 Information not Disclosed
Except as may be authorized by the Committee, information of the Committee that is not available to the public through other sources will not be published or made available for inspection, examination, or copying by any person if such information

(a) is specifically exempted from disclosure by statute (other than section 552b of Title 5 United States Code), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld; or is specifically authorized under criteria established by an executive order to be kept secret in the interest of national defense or foreign policy and is in fact properly classified pursuant to such executive order.

Votes for this action: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes against this action: None.

4. Revision of Guidelines for Operations in Federal Agency Issues

At this meeting the Committee amended number 4 of the guidelines for the conduct of System operations in Federal agency issues to take account of the operations of the Federal Financing Bank. The change, which was effective immediately, limits Federal Reserve purchases of Federal agency securities to issues of those agencies that are not eligible to borrow funds from the Federal Financing Bank, which began operations in mid-1974. Securities of the Bank itself are eligible for purchase by the System, although none is outstanding at present. Securities of Government-sponsored agencies—such as the Federal home loan banks, the Federal National

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Mortgage Association, Federal land banks, Federal intermediate credit banks, and the banks for cooperatives—will continue to be eligible for System purchase under the new rules.

As amended, guideline number 4 read as follows:

> Purchases will be limited to fully taxable issues, not eligible for purchase by the Federal Financing Bank, for which there is an active secondary market. Purchases will also be limited to issues outstanding in amounts of $300 million or over in cases where the obligations have a maturity of five years or less at the time of issuance, and to issues outstanding in amounts of $200 million or over in cases where the securities have a maturity of more than five years at the time of issuance.

Votes for this action: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn. Votes against this action: None.

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MEETING HELD ON MARCH 15, 1977

1. Domestic Policy Directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the first quarter of 1977 had increased from the pace in the fourth quarter of 1976—now indicated by revised estimates of the Commerce Department to have been at an annual rate of 2.4 per cent, compared with 3.9 per cent in the third quarter and 4.5 per cent in the second. The rise in average prices—as measured by the fixed-weighted index for gross domestic business product—appeared to have been faster than the annual rate of 4.9 per cent estimated for the fourth quarter of last year, in part because of the adverse effects of severe winter weather on prices of foods.

Staff projections suggested that real GNP would grow at a considerably better rate in the current quarter than had appeared likely a month earlier. The rate of inventory investment—which had fallen sharply in the fourth quarter of 1976, according to the revised estimates—was now expected to increase, whereas a month earlier it had been projected to decline further. Moreover, the gain in business fixed investment was now anticipated to be larger. On the other hand, the new projections suggested less growth in residential construction and in government purchases of goods and services.

The staff projections for subsequent quarters, like those of a month earlier, incorporated assumptions that rebates of Federal income taxes and one-time payments to recipients of social security would be disbursed in the second quarter; that both personal income taxes and corporate taxes would be reduced; and that Federal spending for job-creating programs would be expanded. Reflecting these assumptions as well as expectations of continuing recovery from the effects of the severe weather, real GNP was projected

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to grow at a rapid rate in the second quarter and at a more moderate—but still rather substantial—pace in succeeding quarters. It was expected that the fixed-weighted price index for gross business product would rise less rapidly than in the first quarter.

During February economic activity rebounded following the disruptions caused by the severe winter weather and shortages of natural gas. The index of industrial production for the month as a whole rose 1 per cent and recovered to about the December level—reflecting widespread gains among consumer goods, business equipment, and industrial materials.

Retail sales also rebounded in February, recovering almost to the advanced level reached in December. The number of new automobiles sold was at an annual rate of about 10¾ million, compared with 10½ million in January and about 11 million in December; during those 3 months sales were higher than for any other 3-month period in the current business expansion.

Payroll employment in nonfarm establishments expanded considerably further in February, even though plant shutdowns and energy-related layoffs were still numerous in the week ending February 12—the reference week in the month for the labor market surveys. Increases in employment were reported by three-fifths of the industries in the establishment survey. Employment in manufacturing was unchanged, after having expanded appreciably over the month ending in early January, but the average workweek increased much more than it had declined in January. In the household survey, the unemployment rate rose from 7.3 to 7.5 per cent, as the civilian labor force more than recovered its decrease in January; however, the rate remained below the 7.8 per cent of December.

Personal income increased little in January, following 3 months of sizable gains. The slowing of growth was attributable to three main causes: a weather-related loss of wages and salaries; a drop in disbursements of corporate dividends from an unusually large December volume; and an increase in deductions for social security taxes levied on employees. For February, the labor market surveys and other information suggested a strong gain in over-all personal income.

Indicators of residential construction had been strong in the closing months of 1976, but activity was curtailed in January by

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the severe weather, especially in the Northeast and North Central regions of the country. In January private housing starts were more than one-fifth below the advanced average for the fourth quarter, and according to estimates of the Bureau of the Census, residential construction outlays were nearly one-tenth below the December level. At the same time, however, sales of new and existing houses remained strong, mortgage commitments outstanding at savings and loan associations at the end of January were close to the record high level of a month earlier, and through the end of 1976 rental markets continued to tighten in most areas.

Businesses were planning to spend 11.7 per cent more for plant and equipment in 1977 than in 1976—according to the latest Department of Commerce survey, conducted in late January and early February. The Department's first survey for 1977, conducted in December, had suggested a rise of 11.3 per cent. Current indicators suggested improvement in business demands for fixed capital. New orders for nondefense capital goods rose substantially more in December than had been estimated earlier, and a further modest increase was reported for January. Contract awards for commercial and industrial buildings—measured in terms of floor space—declined somewhat in January, but they were still slightly above the monthly average for the fourth quarter of 1976.

The index of average hourly earnings for private nonfarm production workers was essentially unchanged in February, after having risen sharply in January. Over the first 2 months of 1977, the index advanced at an annual rate of about 5¾ per cent, compared with a rise of about 7 per cent over the 12 months of 1976.

The wholesale price index for all commodities rose 0.9 per cent in February, compared with an average increase of about 0.6 per cent in the preceding 5 months. Average prices of farm products and foods rose sharply in February, in part because of the effects of the cold weather on supplies of fresh fruits and vegetables and of drought on prospective supplies of grains and cotton. The price index for industrial commodities continued upward at about the average pace of recent months, reflecting mainly a sizable increase in the index for fuels and power following decreases in the preceding 2 months. The advance was especially large for natural gas; because of a 2-month lag in reporting natural gas prices, the

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February index reflected increases that had been effected last December.

The consumer price index rose 0.8 per cent in January, compared with 0.4 per cent in December and also with 0.4 per cent on the average during the second half of 1976. Retail prices of foods rose substantially, even though the prices in the index were recorded early in January and did not show in full the effects of the bad weather. Among nonfood items, increases were reported for used automobiles, fuel oil, medical care services, property taxes, and water and sewage rates.

The average value of the U.S. dollar against leading foreign currencies, on a trade-weighted basis, changed little over the period between the February and March meetings of the Committee, continuing the relative stability that dated from April 1976. In the latest 4-week period it appreciated against the Canadian dollar, the Italian lira, and the Swiss franc and depreciated against the Japanese yen and the currencies associated in the European "snake" arrangement.

The U.S. foreign deficit increased further in January to a record rate. Exports declined a little from the rate in the fourth quarter of 1976 because shipments of coal and perhaps of other commodities were slowed by the weather, and exports of wheat were reduced by expectations of ample supplies; exports of other agricultural commodities expanded. Imports were up substantially from the fourth-quarter rate, reflecting increases for iron and steel products and a number of finished industrial products. Imports of foods also expanded, owing to price increases for coffee and cocoa.

Total credit at U.S. commercial banks rose more in February than in any other month since the summer of 1974. Acquisitions of U.S. Treasury securities were especially large, holdings of other securities rose somewhat for the first time since November, and total loans continued to expand.

Business demands for short-term credit strengthened further in February, both at banks and in the commercial paper market, but business financing in the capital market slowed. Over the January–February period the combined total of business loans at banks (excluding bankers acceptances) and the outstanding volume of commercial paper issued by nonfinancial corporations expanded at an annual rate of about 16½ per cent, compared with a rate of

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7 per cent in the fourth quarter of 1976 and a small decline over the preceding three quarters. In the most recent period, business demands for short-term credit may have been swelled temporarily by the weather-induced disruptions to production and distribution and by "bridge" financing associated with advance refundings of some high-yielding issues of corporate bonds.

Growth in the narrowly defined money stock (*M*-1) slowed sharply to an annual rate of a little less than 1 per cent in February from the revised rate of about 5½ per cent in January. Nevertheless, *M*-1 had grown at an annual rate of about 5 per cent over the latest 6 months and by about 5¾ per cent over the past year.

Expansion in *M*-2 and *M*-3 also slowed sharply in February—to annual rates of about 6½ and 8¾ per cent, respectively, from rates of about 9¼ and 11¼ per cent in January. In addition to the weakness of growth of *M*-1, flows into savings and small-denomination time deposits at both banks and nonbank thrift institutions continued to moderate. Over the 6 months ending in February, *M*-2 and *M*-3 grew at annual rates of about 11 and 13 per cent, respectively.

The continuing slowdown in growth of savings and small-denomination time deposits at banks and other thrift institutions was attributable in part to reductions in interest rates offered on these deposits by some institutions and to the firming of market interest rates after the turn of the year. In addition, deposit inflows may have been adversely affected by the weather-related reductions in wage and salary payments and by increases in fuel bills of households.

At its February meeting the Committee had decided that growth in *M*-1 and *M*-2 over the February–March period at annual rates within ranges of 3 to 7 per cent and 6½ to 10½ per cent, respectively, would be appropriate, and it had judged that such growth rates were likely to be associated with a weekly-average Federal funds rate in the area of 4⅝ to 4¾ per cent. The Committee also had agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4¼ to 5 per cent.

Throughout the interval since the February meeting, the Manager

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of the System Open Market Account had continued to aim for a Federal funds rate in the area of 4⅝ to 4¾ per cent. In the early weeks of the interval, incoming data had suggested that growth in both *M*-1 and *M*-2 over the February–March period would be close to the midpoints of the specified ranges. Estimates of the 2-month growth rates subsequently were revised downward, but they remained reasonably well within their specified ranges.

Short-term market interest rates in general changed little during the inter-meeting period, in part because of the continued relative stability in the Federal funds rate and in part because money market participants inferred—on the basis of the behavior of the aggregates—that a near-term rise in the funds rate was unlikely. However, yields on most longer-term bonds edged higher, apparently in response to signs that economic activity was rebounding from the weather-induced slowdown more vigorously than had been anticipated and also to greater apprehension about prospects for the rate of inflation engendered in part by the price indexes released during the period.

In February the U.S. Government borrowed $9.1 billion of new money from the public, including $7.5 billion through auctions of marketable notes and bonds. No additional market financing occurred during the first half of March, but a 2-year note auction involving $450 million of new money had been announced for later in the month. In congressional testimony Treasury officials reported a sizable downward revision in their estimate of near-term cash needs based on evidence of a continuing substantial shortfall of Federal spending from projected levels.

In the corporate bond market the volume of new securities offered publicly in February was less than half that in each of the two preceding months. Some potential issuers, particularly those with higher bond ratings, had apparently been discouraged by the January rise in bond yields. In addition, underwriters reported that some lesser-rated corporations were electing to place debt issues privately rather than publicly—an option that was apparently facilitated by the continued availability of a large supply of investable funds at life insurance companies.

Offerings of new long-term State and local government securities rose to an estimated volume of about $3 billion in February—a record for the month and about 15 per cent above the volume sold

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in February 1976. A significant part of this supply was attributable to the issuance of bonds in advance of refundings of issues bearing higher interest rates. To preserve the tax-exempt status of such new bonds under current Treasury regulations, many of the issuers place the proceeds in special Treasury obligations until the existing State and local issues are called. Accordingly, these financings accounted for a large proportion of the sales of nonmarketable securities by the Treasury.

Yields in secondary mortgage markets increased a little during February along with bond yields, but interest rates on new commitments for conventional home mortgages continued to edge down. Takedowns of mortgages by savings and loan associations slowed during January, probably due in part to the weather, but the volume was still relatively large.

It appeared likely that over-all credit demands would remain strong in the period immediately ahead. The forward calendars of new issues suggested that offerings of corporate bonds would rise substantially in March from the reduced level in February and that offerings of State and local government bonds would continue to be large. In addition, the Treasury was expected to raise a sizable amount of new money during the period up to the mid-April date for payment of taxes, although a significant share of the required funds was expected to be raised through short-term instruments. It appeared likely that business demands for bank credit would remain moderately strong but that the over-all expansion in outstanding business loans might be held down for a time by repayments with proceeds from capital market financings.

At its January meeting the Committee had agreed that from the fourth quarter of 1976 to the fourth quarter of 1977, average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 10 per cent; and *M*-3, 8½ to 11½ per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

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In the discussion of the economic situation at this meeting, members of the Committee were in general agreement with the staff projection that real GNP would expand at a rapid rate in the second quarter of 1977 and at a more moderate, but still rather substantial, rate in subsequent quarters. However, one member expressed the opinion that the strength in the outlook derived from factors other than the expected fiscal policy measures; in his view, the stimulative effects of those measures would be largely offset over the longer run by their tendency to raise interest rates and to increase inflationary expectations. Another member reported that in some parts of the West economic prospects were viewed with pessimism as a result not only of declines in prices of some farm products and increases in farm costs but also of the severe winter and drought.

One or two members expressed the belief that the behavior of real GNP during the second half might differ somewhat from that portrayed by the staff projections: specifically, expansion might be somewhat more rapid than that projected for the third quarter but then might taper off. Another member suggested that throughout the second half of the year the pace of economic activity might be stronger than projected by the staff, reflecting a larger rise in business investment in both fixed capital and inventories, stimulated in part by growing confidence in the economic outlook. Moreover, he thought that some of the shortfall in Federal expenditures that had developed in the first 2 months of 1977 might well be made up in the months ahead.

Several members expressed concern about the recent and prospective behavior of prices. It was noted that over the past few months price increases had been relatively large for a number of commodities, and that the extent to which increases seemed to be spreading among industrial materials might well be intensifying upward pressures on prices of industrial products in general. Moreover, businessmen appeared to have become more concerned about inflation within the past month or so.

One member noted that large increases over recent months in prices for some commodities—such as coffee, cocoa, and fuels—reflected special problems having little to do with more general influences on the behavior of prices. With respect to the influence of aggregate demand, he noted that the substantial margin of unused

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capacity and the high rate of unemployment at this time should tend to limit the rate of increase in wage rates and in the broad measures of prices.

It was observed during the discussion that, given the longer-run ranges for growth in the monetary aggregates adopted at the January meeting, the projected rates of increase in nominal GNP implied a rise in the income velocity of money that was large for this stage of a business expansion. In that connection it was noted that significant upward pressures on interest rates might develop later in the year, particularly if prices should rise more rapidly than projected or if inflationary expectations should strengthen. On the other hand, one member remarked that, while interest rates played a role, the predominant determinant of velocity changes was the state of confidence. On the basis of his judgment that confidence was improving, he thought it was likely that the rate of increase in velocity would be quite high. Another member observed that in almost every business expansion since World War II, the rate of increase in velocity had reached a primary peak, then dropped back before reaccelerating to a secondary peak not quite so high as the first one.

As to policy for the period immediately ahead, members of the Committee did not differ greatly in their preferences for ranges of growth for the monetary aggregates over the March–April period. It was suggested that the forces that had contributed to particularly slow growth in the monetary aggregates in February might be reversed and might contribute to rapid growth in March, and that such a development should not necessarily cause concern. It was also observed that the upward momentum of economic activity in the weeks ahead would tend to expand demands for transactions balances and thus to exert some upward pressure on growth rates for the monetary aggregates. For *M*-1, most members favored a range of 4½ to 8½ per cent; some sentiment was expressed for ranges of 4 to 8 per cent and 4 to 9 per cent. For *M*-2, most members favored a range of 7 to 11 per cent, but some preferences were expressed for 6½ to 10½ per cent and 6 to 10 per cent.

The members in general favored directing initial operations during the coming inter-meeting interval toward the objective of maintaining the Federal funds rate in the area of 4⅝ to 4¾ per cent. A few members suggested that the Federal funds rate should

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be permitted to drift up over coming weeks to 4¾ or 4⅞ per cent even if the aggregates appeared to be growing at rates near the midpoints of their specified ranges, but the majority did not favor this course. The members also differed somewhat with respect to the degree of leeway that should be provided for System operations during the inter-meeting period in the event that growth in the aggregates appeared to be deviating significantly from the midpoints of the specified ranges. The largest number of members preferred to specify an inter-meeting range for the Federal funds rate of 4¼ to 5¼ per cent; a few favored retaining the range of 4¼ to 5 per cent that had been specified at the preceding two meetings; and some sentiment was expressed for a range of 4½ to 5¼ per cent.

At the conclusion of the discussion the Committee decided that growth in *M*-1 and *M*-2 over the March–April period at annual rates within ranges of 4½ to 8½ per cent and 7 to 11 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of *M*-1 and *M*-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average Federal funds rate in the area of 4⅝ to 4¾ per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4¼ to 5¼ per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that growth in real output of goods and services has increased in the current quarter from the reduced pace in the fourth quarter of 1976. In February industrial output and retail sales expanded substantially after being held down for a time by the effects of unusually severe

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weather. Employment rose considerably further; the unemployment rate increased somewhat to 7.5 per cent—as the labor force more than recovered the decline of January—but it remained below the 7.8 per cent of December. The wholesale price index for all commodities rose substantially in February, reflecting large increases for farm products and foods and for fuels and power. The index of average wage rates rose more moderately over the first 2 months of 1977 than it had on the average during 1976.

The average value of the dollar against leading foreign currencies has changed little over the past month. In January the U.S. foreign trade deficit increased further; exports were down a little from the fourth-quarter rate and imports were substantially higher.

Growth in *M*-1 slowed sharply in February from the moderate pace in January. At banks and thrift institutions, inflows of time and savings deposits other than large-denomination CD's continued to slacken. Business demands for short-term credit appear to have strengthened further in early 1977. Since mid-February short-term market interest rates have changed little on balance, but most longer-term rates have edged higher.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

At its meeting on January 18, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4½ to 6½ per cent, 7 to 10 per cent, and 8½ to 11½ per cent, respectively, from the fourth quarter of 1976 to the fourth quarter of 1977 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the March–April period to be within the ranges of 4½ to 8½ per cent for *M*-1 and 7 to 11 per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly-average Federal funds rate of about 4⅝ to 4¾ per cent. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 4¼ to 5¼ per cent.

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If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

2. Authorization for Domestic Open Market Operations

At this meeting the Committee amended, effective immediately, paragraph 1(b) of the authorization for domestic open market operations, relating to outright purchases and sales of bankers acceptances. The words "when appropriate" were added at the beginning of the paragraph and the dollar limit on holdings of bankers acceptances specified at the end of the paragraph was reduced from $1 billion to $100 million.

As amended, paragraph 1(b) read as follows:

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

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

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This action reflected a decision by the Committee that the System should permit its existing holdings of bankers acceptances to mature and that it should no longer purchase these instruments outright under ordinary circumstances. It was noted that present System holdings were in excess of the newly established limit of $100 million, but it was anticipated that maturities within the next 2 months would reduce holdings below that level. The Committee also agreed that the Federal Reserve should remain an active participant in the market for bankers acceptances by continuing to make with dealers repurchase agreements that are secured by bankers acceptances and by continuing to serve as agent in buying and selling acceptances for the accounts of foreign central banks.

In taking this action, the Committee noted that the market for bankers acceptances was well developed and efficient and no longer in need of support through Federal Reserve participation. Also, outright purchases and sales of acceptances had not been of sufficient size to contribute materially to the needed volume of open market operations in recent years. However, repurchase agreements in acceptances had been a useful tool in meeting short-term needs for bank reserves.

3. Review of Continuing Authorizations

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1977, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The Committee reaffirmed the paragraphs of the authorization for domestic open market operations not affected by the preceding action, the authorization for foreign currency operations, and the foreign currency directive, in the forms in which they were presently outstanding. The Committee also reaffirmed the procedural instructions with respect to proposed or ongoing operations under the foreign currency documents and the special authorization relating to System obligations in Swiss francs, in the forms adopted effective December 28, 1976.

Votes for these actions: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against these actions: None.

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In reviewing the authorization for domestic open market operations, the Committee took special note of paragraph 3, which authorizes the Reserve Banks to engage in the lending of U.S. Government securities held in the System Open Market Account under such instructions as the Committee might specify from time to time. That paragraph had been added to the authorization on October 7, 1969, on the basis of a judgment by the Committee that in the existing circumstances such lending of securities was reasonably necessary to the effective conduct of open market operations and to the effectuation of open market policies, and on the understanding that the authorization would be reviewed periodically. At this meeting the Committee concurred in the judgment of the Manager that the lending activity in question remained reasonably necessary and that, accordingly, the authorization should remain in effect subject to periodic review.

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MEETING HELD ON APRIL 19, 1977

Domestic Policy Directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the first quarter of 1977 had increased from the pace in the fourth quarter of 1976—now indicated by revised estimates of the Commerce Department to have been at an annual rate of 2.6 per cent, compared with 3.9 per cent in the third quarter and 4.5 per cent in the second. The rise in average prices—as measured by the fixed-weighted index for gross domestic business product—appeared to have been appreciably faster than the annual rate of 4.9 per cent estimated for the fourth quarter of last year, in part because of the adverse effects of severe winter weather on prices of foods.

According to staff estimates, growth in real GNP had been at a slightly higher rate in the first quarter than had been projected a month earlier. It now appeared that the expansion in consumer purchases of goods and services was substantially stronger than had been anticipated; that the gain in business outlays for equipment was larger; and that the rebound in business inventory investment from the sharply reduced rate in the fourth quarter of 1976 was greater. On the other hand, growth in construction outlays slowed somewhat more than had been expected, and the deterioration in net exports was more pronounced.

The staff projections for subsequent quarters incorporated revised assumptions for fiscal policy, as a result of the President's announcement on April 14 of changes in his package of measures designed to stimulate growth in economic activity. The revised assumptions excluded rebates of Federal income taxes and related payments and any increase in the business investment tax credit. It was still assumed that personal income taxes would be reduced and that Federal spending for job-creating programs and for public

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works would be expanded. No assumptions were made with respect to the administration's energy program, which was to be the subject of an address by the President to the Congress on April 20.

Growth in real GNP over the next few quarters was still projected to be substantial, reflecting strength in consumer demands and expansion of business investment in both fixed capital and inventories. The projections continued to suggest that the rise in the fixed-weighted price index for gross business product would be less rapid in the quarters immediately ahead than in the first quarter, when it had accelerated because of the adverse effects of severe weather. Upward price pressures over the next several quarters were nonetheless expected to be somewhat greater than had been anticipated earlier, partly because of further deterioration in the outlook for prices of some foods and partly because of the prospect of another increase in the minimum wage soon after midyear.

In March economic activity continued to gain in strength. Industrial production—which had risen 1 per cent in February, recovering to the December level—expanded about 1½ per cent further in March. About one-third of the gain was attributable to a substantial rise in production of motor vehicles, but increases in output were widespread among other types of consumer durable goods and business equipment and among construction supplies and materials. For the first quarter as a whole, industrial production expanded almost twice as much as in the preceding quarter, despite the adverse effects of the weather in January and early February.

Rates of capacity utilization rose in March to about 82 per cent in manufacturing as a whole and to about 81 per cent in the materials-producing industries. However, these utilization rates were still 6 and 10 percentage points, respectively, below the peaks in the previous business expansion, when capacity constraints in a number of materials-producing industries limited growth in output.

Private housing starts, following their weather-related drop in January, rebounded in February and rose sharply further in March to an annual rate of about 2.1 million units—the highest rate in nearly 4 years. For the first quarter as a whole, starts about equaled the total for the fourth quarter of 1976 and remained more than one-tenth above that for the third quarter.

Developments in the labor market in recent months reflected

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the strengthening in economic activity. Payroll employment in nonfarm establishments rose sharply in March, after having increased considerably in each of the preceding 4 months. Employment gains in March were widespread by industry and were particularly large in the manufacturing, construction, and service-producing industries. The labor force also increased sharply further in March; nevertheless, the unemployment rate declined from 7.5 to 7.3 per cent, returning to the January level.

Personal income, which had changed little in January, rose substantially in February. The rise was concentrated in wage and salary disbursements and for the most part reflected further gains in employment and recovery in the average length of the workweek from the adverse effects of the weather in January. The gain in employment in March suggested that wage and salary payments continued to grow at a rapid pace.

Expansion in retail sales had been quite strong recently. Sales for February had been revised upward, and in March they rose substantially further, reflecting widespread increases among types of retail outlets.

Sales of new domestic and foreign automobiles surged upward in March to an annual rate of about 12¼ million units, compared with rates of about 10¾ million in February and 10 million in the fourth quarter of 1976. The rate in March was the highest since the spring of 1973, and it suggested improvement in consumer confidence and a strong underlying demand for automobiles stemming in part from postponed replacement needs. The gains were impressive for foreign as well as for domestic models; sales of foreign models reached a new record annual rate of 2 million units.

Business capital outlays appeared to have strengthened in the first 2 months of 1977, although much of the improvement reflected recovery in shipments of trucks, automobiles, and farm equipment from the effects of strikes in the fourth quarter of 1976. The value of private nonresidential construction put in place rebounded in February, but it remained below the peak attained last September.

New orders for nondefense capital goods—which, according to revised data, had risen somewhat more in January than had been reported earlier—declined in February. However, the average for the 2 months was significantly higher than the monthly average for the fourth quarter of 1976. Unfilled orders for such goods edged

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up over the January–February period. Contract awards for commercial and industrial buildings—measured in terms of floor space—declined in February, and the average for the first 2 months of 1977 was unchanged from that for the fourth quarter of 1976. The Commerce Department had reported in mid-March that businesses were planning to spend 11.7 per cent more for plant and equipment in 1977 than in 1976.

The index of average hourly earnings for private nonfarm production workers rose at an annual rate of about 5 per cent in March. Indexes for January and February had been revised upward appreciably, however, with the result that the rise over the 3 months was at an annual rate of 7½ per cent—somewhat faster than the pace during 1976. Much of the acceleration in the first quarter was attributable to an increase in the minimum wage at the beginning of 1977, which had affected rates of pay in the service and trade industries in particular.

The wholesale price index—which had risen 0.9 per cent in February, after having increased 0.6 per cent on the average in the preceding 5 months—rose 1.1 per cent in March, the largest monthly increase since late 1975. Average prices of farm products and foods rose 2.1 per cent in March, reflecting especially sharp increases for coffee, cocoa, tea, soybeans, fresh fruits and vegetables, and sugar. Average prices of industrial commodities rose 0.8 per cent—somewhat more than in the immediately preceding months—reflecting large increases for metals and metal products, transportation equipment, textiles and apparel, and fuels and power.

The consumer price index went up 1.0 per cent in February, compared with 0.8 per cent in January and with 0.4 per cent on the average during the second half of 1976. Retail prices of foods rose sharply in February, led by increases in fresh fruits and vegetables and coffee. Among nonfood items, substantial increases were reported for fuel oil, gasoline, and used cars.

The average value of the dollar against leading foreign currencies had declined about ½ per cent since mid-March, returning to about its level at the beginning of the year. The depreciation of the dollar in the recent period was accounted for mainly by an appreciation of the Japanese yen, which rose 4 per cent in response to intensified demands for that currency. Demands also intensified for the U.K. pound, but exchange market intervention by the Bank of England

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kept the pound from appreciating. The average value of the currencies associated in the European "snake" arrangement changed little against the dollar.

The U.S. foreign trade deficit remained large in February, and the average for the first 2 months of the year was sharply higher than that for the fourth quarter of 1976. In the January–February period, as compared with the fourth quarter, the value of imports of foods rose sharply—as more coffee entered the country at higher prices—and imports of a variety of other consumer goods increased. The over-all value of exports declined slightly; exports of agricultural commodities were sustained—as their average unit values advanced while the physical quantity declined—but exports of other goods declined somewhat. Since the middle of 1976 exports of nonagricultural commodities had shown little net growth, reflecting sluggishness in the economies of other major industrial countries.

At U.S. banks, growth in total credit was somewhat less rapid in March than in February. Total loans expanded at an accelerated pace, but holdings of Treasury securities increased much less than in February and holdings of other securities declined. Over the first quarter, expansion in total bank credit was greater than in any other quarter in 2½ years.

Business credit demands remained generally strong. Business loans at banks rose during March at about the average rate for the preceding 5 months. At the same time the outstanding volume of commercial paper issued by nonfinancial corporations declined, as such corporations relied to a greater extent than in other recent months on internal sources of funds and on the proceeds of the sizable amount of securities sold in the capital market during the month.

The narrowly defined money stock (*M*-1), which had increased little in February, rose at an annual rate of about 6 per cent in March. From the fourth quarter of 1976 to the first quarter of 1977, *M*-1 grew at a rate of about 4¾ per cent. Weekly data suggested that *M*-1 had expanded substantially in early April.

Reflecting the pick-up in growth of *M*-1, the annual rate of growth in *M*-2 increased to about 8¼ per cent in March from about 6¾ per cent in February. Inflows to banks of time and savings deposits other than large-denomination CD's continued to slacken in March, mainly because of a contraction in savings deposits held

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by State and local governments. Inflows of deposits to nonbank thrift institutions also continued to slow, but the rate of growth in *M*-3 edged up. From the fourth quarter of 1976 to the first quarter of 1977, *M*-2 and *M*-3 grew at rates of about 9½ and 11 per cent, respectively.

At its March meeting the Committee had decided that growth in *M*-1 and *M*-2 over the March–April period at annual rates within ranges of 4½ to 8½ per cent and 7 to 11 per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate in the area of 4⅝ to 4¾ per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4¼ to 5¼ per cent.

Over most of the interval between the March and April meetings, incoming data suggested that the 2-month growth rates for *M*-1 and *M*-2 would be well within their respective ranges. Consequently, the Manager of the System Open Market Account continued to aim for a Federal funds rate in the area of 4⅝ to 4¾ per cent. Near the end of the period, however, it appeared that growth in *M*-1 would exceed the upper limit of its 2-month range and that growth in *M*-2 would be in the upper part of its range. In those circumstances, the Manager aimed for a Federal funds rate of around 4¾ per cent.

Market interest rates changed little over most of the inter-meeting period, but they generally moved lower late in the period when the President's intention to drop the tax rebates and related payments from his fiscal program became known. Yields on medium-term Treasury notes declined more than other rates, because market participants had anticipated that most of the Treasury borrowing in the second quarter to finance the rebates and related payments would follow the pattern of recent borrowings and would be concentrated in the medium-term area.

The Treasury raised $3.7 billion of new money in securities markets during March, largely through sales of 2- and 4-year notes. For the first quarter as a whole, the Treasury sold $14 billion of marketable securities—considerably less than the $20 billion to $23

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billion it had projected in January. The difference was attributable to several factors: The Federal deficit in the first quarter was not so large as had been anticipated, chiefly because of a shortfall in outlays; the Treasury sold substantially more nonmarketable securities than had been expected—primarily to State and local governments undertaking advance refundings of their own securities; and the Treasury had drawn down its cash balance to a level at the end of March that was $3 billion below the amount projected in late January. In early April the Treasury sold $4.5 billion of short-dated cash-management bills in order to bridge a low point in its cash balance prior to the mid-April date for tax payments.

In the corporate bond market the volume of new securities offered publicly expanded more than seasonally during March, reflecting large offerings by utilities—for the most part telephone companies. For the first quarter of 1977 as a whole, however, offerings were about the same as those for the final quarter of 1976 and were below those for the first quarter of that year.

In the market for State and local government bonds, offerings of new issues reached a record of $4 billion in March, and the total for the first quarter substantially exceeded offerings in the final quarter of 1976. In March, however, investment interest from property-casualty insurance companies and from investment companies remained substantial, and yields on tax-exempt securities moved lower during the month and in early April, even before the withdrawal of the proposed rebate of Federal taxes. About one-third of the new issues in March were associated with advance refundings.

Interest rates on new commitments for primary conventional home mortgages at savings and loan associations rose somewhat during March and early April from recent lows in late February and early March, as demands for mortgages remained strong. In February outstanding commitments of savings and loan associations to acquire mortgage loans had returned to record levels after having edged down a little in January. Over the past two quarters the ratio of commitments to total cash inflows at these institutions had risen noticeably.

For the period immediately ahead, the principal new factor in the outlook for credit demands was the prospective shift in the position of the U.S. Treasury from a sizable net borrower to a

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temporary repayer of debt. At the same time, however, business demands for credit were still expected to expand as a result of continuing improvement in economic activity. Projections of consumer expenditures implied a continued high rate of growth in consumer credit outstanding, and expansion of mortgage debt was anticipated to remain large. State and local government borrowing was also expected to remain sizable.

In the discussion of the economy at this meeting, it was suggested that for some time the situation in general had been strengthening, and that—in the light of the housing starts figures for March, which had been released just the day before—residential construction activity might prove to be even stronger than had been projected by the staff. It was emphasized that developments were taking place in the sphere of governmental economic policy that could have important consequences for the course of economic activity and prices—including the recent changes in the administration's fiscal policy proposals, the President's announcement on April 15 of a series of measures aimed at controlling and reducing inflation, and the energy program to be presented to the Congress on the day after this meeting.

With respect to the consequences of the changes in fiscal policy, it was suggested that elimination of the proposal to raise the investment tax credit from 10 to 12 per cent was not of much significance, because an increase of 2 percentage points would have at best only a small effect on business fixed investment—especially in view of the rate at which prices of plant and equipment were rising. Insofar as an increase in the tax credit would add to investment outlays, the effect of its elimination was likely to be offset by another consequence of the changes in fiscal policy proposals: the favorable effect on interest rates to be expected from the reduction in the prospective Federal deficit. It was observed that business investment also would be encouraged by one of the measures proposed to reduce the rate of inflation—specifically, the development of procedures to speed up the issuance of construction permits by government agencies.

Withdrawal of the proposal for tax rebates was thought to be of considerable significance. Some members expected that this change, especially in conjunction with the measures aimed at reducing inflation, would contribute to improvement in business

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and consumer confidence and in that way would add strength to the economic outlook.

The details of the energy program had not yet been announced, but its probable major features had already been described in the press. It was observed that the program was extensive and complex; that its effects were difficult to appraise; and that uncertainties would be heightened during the long period that was likely to be consumed in legislating the actual measures. Although the need for such a program appeared clear, the suggestion was made that it could have some negative consequences for economic activity in the short run—chiefly, perhaps, if uncertainties led to a dampening of growth in business capital investment—and that over time it would tend to exert some upward pressure on prices.

Attention was drawn to other potentially troublesome aspects of the developing economic situation. Thus, one member commented that growth in nominal GNP over the quarters ahead at the rate indicated in the staff projections—which did not take the energy program into account—might well be accompanied by considerable strain in financial markets. Another member suggested that the economic expansion had become unbalanced in the sense that growth in business fixed investment had lagged that in other major sectors of demand. The question was raised whether in this expansion—in contrast with earlier ones—an acceleration in business capital outlays might not be delayed until capacity utilization reached a relatively high rate and shortages were developing. With respect to the degree of balance during this upswing, it was also pointed out that net exports had deteriorated sharply since 1975 and had exerted a drag on the expansion in over-all activity in this country.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its January meeting the Committee had specified the following ranges for growth over the period from the fourth quarter of 1976 to the fourth quarter of 1977: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 10 per cent; and *M*-3, 8½ to 11½ per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. The ranges being considered at this meeting were for the period from the first quarter of 1977 to the first quarter of 1978.

In the discussion of the ranges for growth in the aggregates over

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the year ahead, members of the Committee were almost unanimous in believing that a reduction of some kind would be appropriate at this time as another step toward the ultimate objective of achieving longer-run rates of monetary expansion consistent with general price stability. However, opinions differed as to the specific reduction to be made.

In advocating a further reduction in the longer-run ranges for monetary growth, a few members noted that the economic situation had strengthened over recent months and that less stimulus from monetary policy was required now, even though the administration's proposals for fiscal stimulus had been scaled down. At the same time, it was observed, inflationary forces appeared to have increased. One member expressed the view that advances in prices attributable to exogenous forces—such as an increase in the price of oil—should not be fully accommodated in establishing appropriate rates of monetary growth; but neither should they be wholly unaccommodated because that could create a high degree of monetary stringency.

In the current circumstances, it was observed, a further step in the gradual process of reducing the longer-run ranges would make a useful contribution to rebuilding confidence in economic prospects. It was suggested, moreover, that continuation of that process would be consistent with the President's announced objective of achieving a 2-percentage-point reduction in the rate of inflation by the end of 1979.

In support of some reduction in the longer-run ranges, it was noted that from the first quarter of 1976 to the first quarter of 1977 growth in *M*-1—at 6.2 per cent—was more rapid than in any four-quarter period since April 1975 when the Committee had begun to adopt 1-year ranges, and that rates of growth for *M*-2 and *M*-3 had been relatively high as well. Over the most recent two quarters, growth in *M*-1—at an annual rate of about 5¾ per cent—had been well within its range, but growth in both *M*-2 and *M*-3 had been above the upper limits of their ranges.

Partly because of the uncertainties associated with the energy program, there was little sentiment for making more than small reductions in the longer-run ranges at this time. Most members were inclined to favor retaining the existing 4½ to 6½ per cent range for *M*-1 while reducing the upper limit—in some cases, both

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limits—of the ranges for *M*-2 and *M*-3 by ½ of a percentage point. In this connection, it was noted that growth in the interest-bearing deposits included in *M*-2 and *M*-3 had slackened in recent months. However, there also was some sentiment for reducing the lower limit of the range for *M*-1 by ½ of a percentage point—either alone or in combination with some reduction in the ranges for *M*-2 and *M*-3.

At the conclusion of its discussion the Committee arrived at a consensus calling for retention of the existing range for *M*-1 and reductions of ½ of a percentage point in the upper limits of the ranges for *M*-2 and *M*-3. The ranges thus were 4½ to 6½ per cent for *M*-1, 7 to 9½ per cent for *M*-2, and 8½ to 11 per cent for *M*-3. The associated range for the rate of growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It was also understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for the year ahead.

> The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the first quarter of 1977 to the first quarter of 1978: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 9½ per cent; and *M*-3, 8½ to 11 per cent.

> Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Roos, and Wallich. Vote against this action: Mr. Partee.

Mr. Partee—although he agreed in principle with the longer-term objective of reducing the ranges—dissented from this action because he opposed any adjustment at this particular juncture. He noted that the administration had just withdrawn its proposal for the tax rebate; that the forthcoming energy program, by raising the price structure, might tend to dampen economic expansion; and that very large increases in the velocity of the various monetary aggregates would have to occur over the next year if nominal GNP were to grow at the rate projected by the staff and good progress were thus to be made in reducing unemployment.

As to policy for the period immediately ahead, the Committee

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members were willing to tolerate growth in the monetary aggregates over the April–May period within ranges that were higher than those adopted for the year ahead because of the expectation that the forces contributing to rapid expansion in *M*-1 in early April would prove to be transitory and that the bulge in growth for the month as a whole would for the most part be offset by slower growth later on.

Members of the Committee did not differ greatly in their preferences for ranges of growth for the monetary aggregates over the April–May period. For *M*-1, most of them favored a range of 6 to 10 per cent, but a number expressed a preference for a slightly lower range—specifically, 5½ to 9½ per cent. For *M*-2, most members favored a range of 8 to 12 per cent; a few preferred 7½ to 11½ per cent.

Almost all of the members favored directing operations initially toward the objective of maintaining the Federal funds rate at its current level of about 4¾ per cent, but one or two members suggested that initial operations be directed toward achieving a slightly higher rate. With respect to the degree of leeway for operations during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges, almost all of the members preferred to specify a range for the funds rate of 4½ to 5¼ per cent. However, one expressed a preference for a range of 4¼ to 5¼ per cent and another for 4½ to 5½ per cent. The member who proposed the latter range also advocated directing operations toward moving the funds rate slowly toward 5 per cent even if the aggregates appeared to be growing at rates near the midpoints of their specified ranges, primarily because he thought that the recent acceleration in growth of *M*-1 might reflect fundamental forces to a greater extent than was generally assumed.

At the conclusion of the discussion the Committee decided that growth in *M*-1 and *M*-2 over the April–May period at annual rates within ranges of 6 to 10 per cent and 8 to 12 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of *M*-1 and *M*-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average

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Federal funds rate of about 4¾ per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4½ to 5¼ per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that growth in real output of goods and services increased in the first quarter from the reduced pace in the fourth quarter of 1976. In March industrial output, retail sales, and employment expanded substantially further. Although the labor force also increased sharply, the unemployment rate declined from 7.5 to 7.3 per cent. The wholesale price index for all commodities again rose substantially; increases were particularly sharp among farm products and foods, and there were sizable advances for many industrial commodities. The index of average wage rates rose in the first quarter of 1977 at a somewhat faster pace than it had on the average during 1976, reflecting largely an increase in the minimum wage.
>
> The average value of the dollar against leading foreign currencies has declined somewhat over the past month, returning to about the level at the beginning of the year. Demand for the Japanese yen and the U.K. pound intensified. The U.S. foreign trade deficit continued large in February.
>
> *M*-1 grew at a moderate pace in March but increased substantially in early April. At banks and thrift institutions, inflows of time and savings deposits other than large-denomination CD's continued to slacken in March. Market interest rates declined considerably in mid-April, after having changed little since mid-March.
>
> In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.
>
> Growth in *M*-1, *M*-2, and *M*-3 within ranges of 4½ to 6½ per cent, 7 to 9½ per cent, and 8½ to 11 per cent, respectively, from

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the first quarter of 1977 to the first quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the April–May period to be within the ranges of 6 to 10 per cent for *M*-1 and 8 to 12 per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly-average Federal funds rate of about 4¾ per cent. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 4½ to 5¼ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

Subsequent to the meeting, on May 5, nearly final estimates indicated that in April *M*-1 had grown at a record annual rate of 19.4 per cent and that *M*-2 had grown at the substantial rate of 13.0 per cent. For the April–May period staff projections suggested that the annual rate of growth in *M*-1 would be well above the upper limit of the 6 to 10 per cent range specified by the Committee in the next-to-last paragraph of the domestic policy directive issued at the April meeting. Growth in *M*-2 for the 2-month period was projected to be close to the midpoint of the Committee's range of 8 to 12 per cent for that aggregate.

The Federal funds rate had averaged 5.15 per cent in the statement week ended May 4, about 40 basis points above the average for the preceding 3 weeks. The Manager of the System Open Market Account was currently aiming at a funds rate of 5¼

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per cent, the upper limit of the inter-meeting range specified in the directive.

Against that background, Chairman Burns recommended on May 5 that the upper limit of the range for the Federal funds rate be increased to 5½ per cent, on the understanding that the Manager would use the additional leeway only if new data becoming available before the meeting scheduled for May 17 suggested that the aggregates were strengthening significantly further on balance.

On May 6, 1977, the Committee modified the inter-meeting range for the Federal funds rate specified in the next-to-last paragraph of the domestic policy directive issued on April 19, 1977, by increasing the upper limit from 5¼ to 5½ per cent.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Morris, Partee, Roos, Wallich, and Winn. Votes against this action: None. Absent and not voting: Mr. Mayo. (Mr. Winn voted as alternate for Mr. Mayo.)

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MEETING HELD ON MAY 17, 1977

Domestic Policy Directive

The information reviewed at this meeting suggested that real output of goods and services—which had increased at an annual rate of 5.2 per cent in the first quarter, according to preliminary estimates of the Commerce Department—was expanding at a rapid pace in the current quarter. The rise in average prices—as measured by the fixed-weighted price index for gross domestic business product—appeared to have slowed somewhat from the annual rate of 6.8 per cent estimated for the first quarter.

According to staff estimates, real output was growing at a significantly faster pace in the current quarter than had been projected a month earlier. It now appeared that the expansion in consumer purchases of goods and services would be considerably stronger than had been anticipated, although still not so strong as in the first quarter; that the gain in business fixed investment would be larger than had been expected and that the recovery in net exports of goods and services would be greater, following a much larger decline in the first quarter than had been estimated a month ago.

The staff projections for the second half of 1977 differed little from those made just before the previous meeting, which had incorporated assumptions about Federal fiscal measures that were later enacted or funded. Specifically, the assumptions included the increase in the standard deduction for personal income taxes passed by the Congress on May 16 and the expansion in outlays for public service employment, for local public works, and for countercyclical revenue sharing.

Growth in real GNP for the second half was projected to be substantial, although not so rapid as in the second quarter. It was anticipated that increases in Federal purchases of goods and services would be larger; that expansion of business investment would

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remain relatively strong; and that investment in inventories would accelerate. At the same time, however, it was expected that growth in consumption expenditures would slow somewhat further; that the pace of the expansion in residential construction would moderate; and that net exports of goods and services would change relatively little from the second-quarter level.

In April, expansion in economic activity remained vigorous. Industrial production rose by 0.8 per cent, following a gain of 1.4 per cent in March. Relatively large increases in output were widespread among both final products and materials. However, assemblies of automobiles declined somewhat, both because of strikes at a few motor vehicle plants and because of efforts to reduce the excessive inventories of small-model cars.

The rate of capacity utilization in April remained at 82 per cent for manufacturing as a whole and increased from 81 to 82 per cent for the materials-producing industries. These utilization rates were about 6 and 10 percentage points, respectively, below the peaks in the previous business expansion, when capacity restraints in a number of materials-producing industries limited growth in output and contributed to upward pressures on prices.

The number of private housing units started in April had not been made public by the time of this meeting. In March, as reported just before the last meeting, starts had risen sharply further to an annual rate of about 2.1 million units—the highest rate in nearly 4 years. For the first quarter as a whole, starts were about the same as for the fourth quarter of 1976 and more than one-tenth above the total for the third quarter. Sales of new and existing homes combined remained vigorous in March, and nonbank thrift institutions continued to supply a substantial volume of mortgage credit with little change in interest rates, despite reduced inflows of deposits.

Developments in labor markets continued to reflect the strength in economic activity. Payroll employment in nonfarm establishments expanded considerably in April, after a sharp rise in March; the increase since December—amounting to 1.3 million persons—was unusually large for a 4-month period. The unemployment rate declined further in April, by 0.3 of a percentage point, to 7.0 per cent. During the second half of 1976 the rate had fluctuated between 7.8 and 8.0 per cent.

Growth in total personal income accelerated to an annual rate of

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20 per cent in March from about 17 per cent in February, reflecting in large measure faster expansion in private wage and salary payments. The employment statistics suggested that wage and salary payments continued to grow in April, although at a less rapid pace than in the two preceding months.

Consumer demands remained strong. In April total retail sales held at the advanced level reached in March and were 2¼ per cent above the monthly average for the first quarter. Sales of new automobiles declined somewhat, after having surged upward in March. However, sales of other consumer items rose by about 1 per cent, equaling the gain in the preceding month.

New orders for nondefense capital goods rose as much in March as they had declined in February, and for the first quarter as a whole they were up about 6 per cent from the preceding quarter. Unfilled orders for such goods edged up during the first quarter. Contract awards for commercial and industrial buildings—measured in terms of floor space—shot upward in March, and the total for the first quarter was 8½ per cent above that for the preceding quarter. A private survey, conducted in late March and early April, indicated that businesses were planning to spend significantly more for plant and equipment in 1977 than had been shown by surveys taken in February and in the autumn of 1976.

The index of average hourly earnings for private nonfarm production workers rose at an annual rate of 6.8 per cent in April, about the same as the average increase during 1976; over the first quarter the rise had accelerated to a rate of 7.3 per cent, in large part because of an increase in the minimum wage at the beginning of 1977. Major collective bargaining settlements in the first quarter provided for first-year increases in wages averaging 7.6 per cent, compared with an average of 8.4 per cent for the first-year adjustments under contracts negotiated during 1976. However, compensation per hour for all persons in the nonfarm business sector of the economy rose at an annual rate of about 10 per cent in the first quarter, up from 7 per cent in the preceding quarter and from an average of about 8 per cent over the four quarters of 1976. The rise reflected not only the increase in the minimum wage but also an increase in taxes on employers for social security and unemployment insurance.

The wholesale price index rose 1.1 per cent in April, marking the third consecutive month of increases of about 1.0 per cent. The

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index had risen 0.5 per cent on the average during the 6 months ending in January. The acceleration in the latest 3 months was attributable to sharp increases in prices of farm products and foods. At the same time, however, there were sizable advances among industrial commodities; the average for such commodities rose 2.0 per cent over the 3-month period.

The consumer price index increased 0.6 per cent in March—less than in January and February but still somewhat more than the average during the second half of 1976. In March price increases averaged 0.6 per cent for foods, 0.4 per cent for nonfood commodities, and 0.8 per cent for services.

The average value of the dollar against leading foreign currencies changed little on balance over the inter-meeting period. The dollar rose against the Japanese yen, but it declined against the currencies associated in the European "snake" arrangement. The change in the dollar/yen rate reflected a sharp decline in short-term interest rates in Japan and market reaction to a decision by the U.S. Customs Court requiring the imposition of countervailing duties on imports of electronic products from Japan. Despite its recent weakening, the yen was nearly 6 per cent higher against the dollar than it had been at the end of 1976.

The U.S. foreign trade deficit, already large in January and February, was still larger in March. The deficit for the first quarter as a whole was almost twice that for the final quarter of 1976, as imports rose 10 per cent and exports were virtually unchanged. Among imports, increases in the first quarter were largest for fuels, foods, automobiles from Canada, and consumer durable goods other than autos. The net outflow on bank-reported capital transactions declined sharply in the first quarter.

At U.S. banks, growth in total credit accelerated during April from the already brisk pace of the first quarter. All major loan categories expanded significantly further, and holdings of tax-exempt securities increased sharply for the first time since November. A sizable part of bank acquisitions of such securities consisted of tax-anticipation notes—particularly those issued by New York State—but banks in most areas of the country increased their holdings of long- as well as of short-term municipal issues. Bank holdings of U.S. Government securities declined.

In April the strength in business credit at banks was concentrated

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at smaller institutions. The relative weakness of business loan demand at large banks apparently reflected a preference of large corporations to cover their increased requirements for short-term financing at the lower interest costs prevailing in the commercial paper market. As a result, commercial paper issued by such corporations rose by the largest amount in 2½ years.

Growth in the narrowly defined money stock (*M*-1) accelerated to a record annual rate of nearly 20 per cent in April. Temporary influences contributed to this rapid growth, and data for early May indicated some shrinkage in money balances. In addition, however, the rapid expansion in economic activity appeared to have been raising transactions demands for money. Over the 12 months ending in April, *M*-1 grew about 6½ per cent.

Inflows of the time and savings deposits included in *M*-2 and *M*-3 continued to moderate in April. However, the large increase in *M*-1 produced a marked acceleration of growth in the broader aggregates in that month. Over the 12 months ending in April, *M*-2 grew about 10½ per cent and *M*-3 about 12¼ per cent.

At its April meeting the Committee had decided that growth in *M*-1 and *M*-2 in the April–May period at annual rates within ranges of 6 to 10 per cent and 8 to 12 per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 4¾ per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4½ to 5¼ per cent.

Data that had become available in the days immediately after the April meeting suggested that over the April–May period both *M*-1 and *M*-2 would grow at rates well within their specified ranges, although it appeared that growth in April would be strong. Accordingly, the Manager of the System Open Market Account sought to maintain the Federal funds rate at about 4¾ per cent or a shade higher. By late April, however, incoming data suggested that over the 2-month period *M*-1 was likely to grow at a rate considerably above the upper limit of its specified range and that *M*-2 was likely to grow at a rate close to the midpoint of its range. In those circumstances System operations in late April and early May were

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conducted with a view to raising the Federal funds rate toward 5¼ per cent, the upper limit of its specified range.

On May 6 the Committee voted to increase the upper limit of the range for the Federal funds rate from 5¼ to 5½ per cent, with the understanding that the Manager would use the additional leeway only if new data becoming available before May 17, the date for this meeting, suggested that the aggregates were strengthening significantly further on balance. Such additional strength did not develop in that period, and the Manager continued to aim for a funds rate of around 5¼ per cent. In the final days of the period, the rate actually fluctuated between 5¼ and 5⅜ per cent.

Short-term market interest rates rose generally by ½ to ⅝ of a percentage point during the inter-meeting period. The rate on 3-month commercial paper rose from 4¾ to 5⅝ per cent, and near the end of the period most major banks increased their prime interest rate on business loans from 6¼ to 6½ per cent. Upward pressures on short-term rates were tempered by a significant reduction during the period in the outstanding volume of Treasury bills.

Yields also rose somewhat in the longer-term markets, but—as in the short-term markets—upward pressures were moderated by Treasury operations. In its mid-May refinancing the Treasury reduced its outstanding debt by about $400 million. Moreover, it announced that it planned to reduce the debt by an additional $450 million when $2.0 billion of 2-year notes matured later in the month.

In the corporate bond market, rate pressures were tempered by a significant drop in public offerings of new issues in April. Private placements of corporate issues were estimated to have remained large, but insurance companies continued to bid aggressively for privately placed securities. Bond offerings by State and local governments also were large in April.

Net mortgage lending during the first quarter of 1977 was near the record rate of the previous quarter, and the volume apparently remained large in April. Issues of GNMA-guaranteed, mortgage-backed securities in April were close to the strong pace of the first quarter, and mortgage loans outstanding at commercial banks also continued to grow at a rapid rate. In March, the latest month for which data were available, mortgage commitments outstanding at savings and loan associations rose further to another new high. Average interest rates on new commitments for conventional home

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mortgages continued to edge higher in April, and yields in the secondary mortgage market for FHA/VA loans changed little on balance over the month.

It appeared likely that the Treasury would be able to make additional reductions in the volume of bills outstanding over the rest of the current quarter but that it would need to raise a large volume of new money later in the year. At the same time, business demands for credit—especially for short-term credit—were expected to remain relatively large as a result of continuing improvement in economic activity. Projections of consumer expenditures implied a sustained high rate of growth in consumer credit and mortgage debt.

At its April meeting the Committee had agreed that from the first quarter of 1977 to the first quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 9½ per cent; and *M*-3, 8½ to 11 per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

With respect to the economic situation and outlook, members of the Committee generally were of the view that the expansion in business activity was quite strong. In particular, they expected over-all growth to remain substantial for a number of quarters ahead.

While not disagreeing with that view, a few members indicated that they would not exclude the possibility that growth in output would prove to be slower than generally expected. Two of these members focused on the possibility that a slowing of growth in consumption expenditures might be accompanied by inadequate expansion in other sectors. Specifically, it was suggested that substantial increases in business investment in fixed capital and inventories were not assured in the current business expansion, which was now in its third year and rather old by historical standards. It was also noted in this context that, according to statistics released a day or two ago, the level of inventories at the end of March had been higher than assumed, and that in the spring of

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1976 inventory demands had weakened rather promptly after the rise in retail sales had slowed. One member expressed concern that inventory demands might be unsustainably high in the quarters immediately ahead, leading first to relatively rapid growth in over-all activity and then to a slowing down.

Other members felt that if anything the probabilities favored expansion at a faster rather than at a slower rate than generally expected. It was suggested that business confidence in the outlook for economic activity appeared to have increased considerably. One member expressed the opinion that there was nothing particularly abnormal about the current business expansion, despite the pick-up in the rate of increase in prices and the existence of various uncertainties.

The recent acceleration in the rate of price rise was a source of concern. One member remarked that the sustainability of the expansion could be threatened by intensified upward pressures on labor costs and prices. The observation was made that the administration's proposals for increases in social security taxes on employers beginning in 1979 would raise unit labor costs substantially. It was felt that the prospects of such increases—especially in conjunction with certain features of the proposed energy policy—had contributed to business uncertainties.

It was reported in the discussion that there had been a considerable volume of speculation in real estate in some parts of the country, accompanied by rapidly rising prices. While speculation was described as being greatest in residential properties on the West Coast—with turnovers at rising prices financed by credit from banks and savings and loan associations—it was also reported to be occurring in farmland in some other areas of the country. It was observed that, heretofore, the present business expansion had been free of the sort of speculation that had the potential to cause problems later on.

As to policy for the period immediately ahead, members of the Committee thought that relatively slow growth in monetary aggregates over the May–June period would be appropriate in order to compensate at least in part for the exceptionally rapid growth in April. In considering the ranges of growth to be specified for the 2-month period, they took account of a staff analysis that suggested that the extremely large expansion in M-1 in April appeared to have

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raised the money stock sufficiently to accommodate much of the public's need for additional transactions balances in the second quarter and, consequently, that monetary growth was likely to be slow.

The members did not differ a great deal in their preferences for ranges of growth in the monetary aggregates over the May–June period. For *M*-1, most of them favored a range of 0 to 4 per cent for the annual rate of growth over the 2-month period. Some sentiment was expressed for slightly different ranges: –1 to 4 per cent, 0 to 5 per cent, and 1 to 5 per cent. For *M*-2, most members favored a range of either 3 to 7 per cent or 4 to 8 per cent, but those who favored the wider ranges for *M*-1 preferred comparably wider ranges for *M*-2.

Differences of view were somewhat greater concerning the Federal funds rate, and they turned in large part on the degree of leeway that should be provided for operations during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges. In view of the rapid monetary growth in April, several members suggested that it would be desirable in the coming period to avoid any significant decline in the weekly-average Federal funds rate from its current level of 5¼ to 5⅜ per cent even if growth in the aggregates appeared to be significantly below the midpoints of the specified ranges. Other members were prepared to accept a decline in the funds rate to 5 per cent under those circumstances.

Most Committee members did not wish to see a rise in the weekly-average Federal funds rate above 5¾ per cent during the inter-meeting period—at least not without further consultation. In addition to advocating an upper limit of 5¾ per cent for the inter-meeting range, these members generally favored maintaining the funds rate at the outset of the period in the area of 5¼ to 5⅜ per cent or permitting it to rise only slightly. In support of constraining the upper limit to 5¾ per cent, it was suggested that a further rise of 50 to 60 basis points—roughly the magnitude of the increase since the April meeting—was likely to have more significant repercussions on financial markets and that considerable uncertainty existed about the underlying strength of the monetary aggregates. A few members of the Committee suggested an upper limit of 6 per cent for the funds rate range and an initial objective of 5½ or 5⅝ per cent, because they

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viewed the economic situation as quite strong and they thought such a course would be helpful in restraining excessive growth in the aggregates later on.

At the conclusion of the discussion the Committee decided that growth in *M*-1 and *M*-2 over the May–June period at annual rates within ranges of 0 to 4 per cent and 3½ to 7½ per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of *M*-1 and *M*-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average Federal funds rate of about 5⅜ per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5¼ to 5¾ per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services is growing at a rapid rate in the current quarter. In April industrial output and employment continued to expand at a substantial pace, and the unemployment rate declined from 7.3 to 7.0 per cent. Total retail sales remained at the advanced level reached in March. The wholesale price index for all commodities rose substantially in April for the third consecutive month; increases again were particularly sharp among farm products and foods, and they remained sizable for industrial commodities.
>
> The average value of the dollar against leading foreign currencies has changed little on balance over the past month. The U.S. foreign trade deficit widened further in March; for the first quarter as a whole the deficit was twice as large as for the preceding quarter.
>
> The increase in *M*-1, which had been moderate in the first quarter, was exceptionally large in April. Inflows of the time and savings deposits included in the broader aggregates were slower than earlier in the year, but because of the rapid expansion in *M*-1, growth in *M*-2 and

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M-3 accelerated. Business short-term borrowing expanded sharply while corporate financing in the capital markets was reduced. Market interest rates have risen in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

At its meeting on April 19, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4½ to 6½ per cent, 7 to 9½ per cent, and 8½ to 11 per cent, respectively, from the first quarter of 1977 to the first quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the May–June period to be within the ranges of 0 to 4 per cent for *M*-1 and 3½ to 7½ per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly average Federal funds rate of about 5⅜ per cent. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 5¼ to 5¾ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

> Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

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MEETING HELD ON JUNE 21, 1977

Domestic Policy Directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the current quarter had been close to the pace in the first quarter, now indicated by revised estimates of the Commerce Department to have been at an annual rate of 6.9 per cent. The rise in average prices—as measured by the fixed-weighted price index for gross domestic business product—appeared to have been somewhat faster than the annual rate of 6.5 per cent estimated for the first quarter, owing in large part to substantial increases in prices of foods. Staff projections suggested that in the second half of 1977 and in early 1978 the rate of growth in real GNP would be fairly rapid, although significantly less so than in the first half of this year. The projections also suggested that the rate of increase in prices would moderate from that in the first half but would remain comparatively high.

In the current quarter, according to staff estimates, growth in personal consumption expenditures had slowed somewhat from the high rate in the first quarter. The expansion in business fixed investment also had moderated—from an especially rapid pace in the first quarter induced by recovery from strikes. On the other hand, residential construction activity had expanded sharply in the current quarter, after having been adversely affected in the first quarter by severe winter weather; State and local government purchases of goods and services had turned up; and business inventory investment had increased moderately further.

Staff projections for the second half of the year suggested that growth in consumption expenditures would slow somewhat further and that the pace of expansion in residential construction would moderate. At the same time, however, it was expected that increases in Federal purchases of goods and services would be substantial; that growth in State and local government purchases would be sustained at a high rate; that expansion of business

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investment would remain relatively strong; and that the rate of inventory accumulation would continue to increase.

In May economic activity continued to expand at a rapid pace. Industrial production rose by 1.1 per cent, following gains of 1.5 per cent and 0.8 per cent in March and April, respectively. As in other recent months, increases in output were widespread among both final products and materials; such increases were especially large for business equipment and for some durable goods materials. However, assemblies of automobiles declined slightly for the second consecutive month.

Rates of capacity utilization rose in May to about 83 per cent both for manufacturing as a whole and for the materials-producing industries. These utilization rates were significantly above those of last autumn and winter, but they remained well below the peaks in the previous business expansion when capacity constraints in a number of materials-producing industries limited growth in output and contributed to upward pressures on prices.

Private housing starts—which had risen sharply in March to an annual rate of 2.1 million—were at a rate of about 1.9 million in both April and May. At that level, starts were about 10 per cent above the average for both the first quarter of 1977 and the fourth quarter of 1976. Mortgage lending activity had remained strong in recent months. At savings and loan associations, outstanding commitments to acquire mortgage loans reached a new high in April—the latest month for which data were available—and holdings of mortgage loans increased by a record amount during the month.

Developments in labor markets continued to reflect the strength in economic activity. Payroll employment in nonfarm establishments increased by 190,000 persons in May—bringing the cumulative increase in the first 5 months of the year to almost 1.5 million, about one-third of which was in manufacturing. The unemployment rate edged down from 7.0 to 6.9 per cent. During the second half of 1976 it had fluctuated between 7.8 and 8.0 per cent.

Personal income expanded considerably less in April and May than in the preceding 2 months when increases had been especially large owing to the rebound in wage and salary payments from the weather-reduced level in January and to disbursements by the Federal Government of earned-income credits to low-income families. Wage and salary payments rose about 1 per cent in both

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April and May, close to the average monthly increase for the first quarter.

Gains in employment and income continued to strengthen consumer demands. In May total retail sales increased further to a level about 3¼ per cent above the monthly average for the first quarter. Sales of new automobiles—at a relatively high annual rate of 11.7 million units—were unchanged from April and were moderately above the first-quarter pace. Sales of foreign models, at an annual rate of 2.6 million units in May, set a record for the third successive month. Data available for domestic models indicated an appreciable rise in sales in the first 10 days of June.

Data reflecting business commitments to spend for certain kinds of plant and equipment suggested a vigorous expansion in outlays over the near term. New orders for nondefense capital goods rose nearly 2 per cent further in April, and the average for the first 4 months of the year was about 6½ per cent above the average for the last 3 months of 1976. Unfilled orders for such goods at the end of April were 3 per cent above the level at the end of 1976. Contract awards for commercial and industrial buildings—measured in terms of floor space—declined in April, but the March–April average was sharply above the averages for the first 2 months of the year and for the last 3 months of 1976.

However, the latest Commerce Department survey of business plans, taken in May, suggested that in the third and fourth quarters of the year increases in spending for plant and equipment would be small and perhaps no more than the rise in prices for such goods. The survey suggested that for 1977 as a whole, businesses would spend 12.3 per cent more than in 1976, only 0.6 of a percentage point above the year-to-year increase suggested by the survey taken in February.

The index of average hourly earnings for private nonfarm production workers—which had advanced at an annual rate of 7.6 per cent in April, according to revised data—rose at a rate of 5.7 per cent in May. Over the first quarter the index had increased at a rate of 7.4 per cent, including the effects of the January increase in the minimum wage. In addition, labor costs had been raised in the first quarter by an increase in taxes on employers for social security and unemployment insurance.

The rise in the wholesale price index slowed to 0.4 per cent in May

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from about 1.0 per cent in each of the preceding 3 months. Average prices for farm products declined in May while those for processed foods rose further, and the average for the two groups changed little following 3 months of large increases. In May average prices of industrial commodities also rose less than in the immediately preceding months; increases continued to be substantial for fuels and power and were larger than in the preceding months for machinery and equipment, but prices of scrap metals and some other materials either declined or rose less rapidly than earlier.

The consumer price index rose 0.8 per cent in April, and the average increase over the first 4 months of the year also was 0.8 per cent—considerably larger than the average increase during the second half of 1976. Average prices of foods jumped 1.5 per cent in April, reflecting relatively large increases in almost all categories. Over the first 4 months of the year, food prices rose 5 per cent, after having changed little on balance over the 12 months of 1976. It was reported during the course of this meeting that the consumer price index for May—which had just been released—was 0.6 per cent above the index for April.

The U.S. foreign trade deficit, which had increased sharply in each month of the first quarter, was about the same in April as in March (estimated on the international accounts basis). Over the 5 weeks between the May and June meetings of the Committee, the average value of the dollar against leading foreign currencies had changed little on balance—despite the publication in late May of the U.S. trade deficit for April, which was larger than had been expected. The impact on exchange rates of the large deficit was moderated in part by declines in interest rates abroad relative to those in the United States. On balance over the 5-week period, moreover, foreign central banks purchased dollars in the exchange markets.

At U.S. banks, growth in total credit slowed somewhat in May from the relatively rapid pace of April, but the rate was close to the average for the January–April period. The slowing of growth in May was attributable almost entirely to a drop in the expansion of business loans to less than half the high rate of April. Over the first 5 months of the year, growth in business loans (excluding bankers acceptances) was substantially faster than over the fourth quarter of 1976.

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The narrowly defined money stock (*M*-1) increased at an annual rate of only 1.1 per cent in May, after having grown at a record rate of nearly 20 per cent in April. Typically, in recent years rapid monetary growth in one month has been followed by slow growth for a month or two. For April and May combined, growth was at an annual rate of 10.4 per cent, compared with a rate of 4.8 per cent in the first quarter.[1]

Growth in the more broadly defined measures of money (*M*-2 and *M*-3) also slowed sharply in May—to annual rates of 4.6 and 6.9 per cent, respectively—mainly as a result of the slowing in *M*-1. However, inflows of the time and savings deposits included in *M*-2 continued to slacken in response to earlier increases in market interest rates relative to offering rates on deposits. Inflows to nonbank thrift institutions, on the other hand, remained at about the pace of recent months. Over the first 5 months of 1977, *M*-2 grew at an annual rate of 8.3 per cent; and *M*-3, at a rate of 9.6 per cent.[2]

At its May meeting the Committee had decided that growth in *M*-1 and *M*-2 in the May–June period at annual rates within ranges of 0 to 4 per cent and 3½ to 7½ per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 5⅜ per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5¼ to 5¾ per cent.

In the days immediately preceding the May meeting the Manager of the System Open Market Account had aimed for a Federal funds rate of around 5¼ per cent, and the rate actually had fluctuated between 5¼ and 5⅜ per cent. In the days just after the meeting the Manager began to implement the Committee's directive by seeking a weekly-average rate of 5⅜ per cent for Federal funds. Throughout

[1]Revised measures of the monetary aggregates, reflecting new benchmark data for deposits at nonmember banks, were published on June 23, 1977. On the basis of these revised figures, the annual rate of growth in *M*-1 was 0.8 per cent in May; 19.4 per cent in April; and 4.2 per cent in the first quarter.

[2]Revised figures for *M*-2 and *M*-3, respectively, were 4.7 and 7.1 per cent for May, and 8.7 and 9.8 per cent for the first 5 months of 1977.

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the inter-meeting period, incoming data suggested that over the May–June period *M*-1 and *M*-2 on the average would grow at rates well within the specified ranges. Accordingly, the Manager continued to aim for a weekly-average funds rate of about 5⅜ per cent, and the rate remained close to that level during the period.

Short-term market rates changed little on balance over the inter-meeting period. Rates rose somewhat early in the period, but later they fell back partly in response to the steadiness of the Federal funds rate and to the indications of slow monetary growth after the April surge. In addition, demands for short-term credit by State and local governments as well as by businesses moderated, and the Treasury continued to redeem bills in its regular auctions. In late May most major banks raised their prime rate on business loans from 6½ to 6¾ per cent, but one of these banks later cut the rate back to 6½ per cent.

Bond yields declined 10 to 20 basis points over the inter-meeting period, in part because short-term rates did not rise as market participants had expected. In addition, the volume of public offerings of new corporate bonds declined in May and appeared likely to be much lower for the second quarter as a whole than for the first quarter. Moreover, the Federal budget registered a surplus during the second quarter, permitting not only a decrease in the volume of Treasury bills outstanding but also a reduction in offerings of new bonds. Offerings of new State and local government bonds rose to a record volume in May and appeared likely to be much larger for the second quarter than for the first. However, demands for tax-exempt bonds remained strong.

The volume of mortgage lending remained large in May, at commercial banks as well as at savings and loan associations. Moreover, issues of GNMA-guaranteed, mortgage-backed securities and net mortgage acquisitions by FNMA were considerably above the average for the first 4 months of the year. Average interest rates on new commitments for conventional home mortgages continued to edge higher in May, and in the secondary mortgage market yields in FNMA commitments auctions also rose slightly further.

At its April meeting the Committee had agreed that from the first quarter of 1977 to the first quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4½ to 6½ per cent; *M*-2, 7

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to 9½ per cent; and *M*-3, 8½ to 11 per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

In the discussion of the economic situation and outlook, the suggestion was made that it was reasonable to expect growth in real GNP for a number of quarters ahead to be fairly rapid, although less rapid than in the current quarter. Members differed somewhat in the emphasis placed on the favorable versus the unfavorable elements in the outlook for prices and costs.

It was observed that the expansion in personal consumption expenditures was likely to slow—and the rate of personal saving to increase—as consumer purchases of new automobiles leveled off or declined following their large gains in recent quarters. It was also observed, however, that strength in other sectors should be sufficient to sustain over-all expansion at a reasonably good rate. Specifically, it was suggested that the outlook for State and local government purchases of goods and services had strengthened because of higher tax revenues and enlarged transfers of funds from the Federal Government resulting from recent legislation; that expansion in business fixed investment in the second half of the year was likely to be stronger than portrayed by the latest Commerce Department survey; and that, in association with the expansion in fixed investment, business inventory investment would continue to increase.

Several members reported that businessmen were disturbed by an atmosphere of uncertainty about Government policies and regulations—in particular, those affecting taxes, energy, and environmental pollution. Moreover, businessmen were reported to be deeply concerned about inflation. In contrast with earlier times, inflation was now viewed as a cause of deterioration in profits, in part because of sharp increases in wage rates and in prices of raw materials and in part because of the taxation of profits that to some degree were unreal. Such considerations were seen as retarding the expansion in business fixed investment—which so far had been slower than might have been expected on the basis of earlier business expansions. Some members observed that business confidence nevertheless has been

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improving and that the behavior of new orders for nondefense capital goods and of other indicators pointed to continuing expansion in outlays for plant and equipment.

It was also suggested that confidence has been enhanced by System policies—specifically, by the promptness with which open market operations during the period between the April and May meetings responded to the April surge in monetary growth. The magnitude of recent declines in yields on long-term bonds was cited as partial evidence for this view.

In the discussion of the outlook for prices, it was observed that the second-quarter acceleration in the over-all measures was attributable in large part to substantial increases in prices of farm products, which had been influenced more by the severe winter weather and the early-spring drought than the initial estimates indicated they would be. It was noted that in the past few months supply prospects had improved considerably for both grains and meats. It was noted also that prices of a number of basic industrial materials had declined over the past 2 months.

With respect to wages and costs, the recent behavior of the index of average hourly earnings for private nonfarm production workers was described as an indication that the rise in labor costs per unit of output had not been accelerating, and it was noted that this was a favorable development for the present stage of the business expansion. On the other hand, there had been some pick-up during the past year in the rate of increase in the broader measure of compensation per manhour in the private business sector. It was suggested, moreover, that the accelerated increase in the consumer price index during the first 4 months of 1977 may well be reflected in the pace of wage advances later on, that a rapid rate of inflation by itself tended to reduce industry's resistance to granting large wage increases, and that the rate of gain in productivity was likely to slow.

In considering policy for the period immediately ahead, the members of the Committee took account of the likelihood that growth in *M*-1 would remain relatively slow in June—continuing to respond to the April surge—but that growth from the first to the second quarter would nevertheless exceed the Committee's longer-run range for that aggregate. In July, according to staff analysis, expansion of *M*-1 was likely to be magnified by a purely technical factor—namely, distribution of social security checks earlier in the month than usual,

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thereby causing demand deposits to be larger than they otherwise would be over the 3-day weekend including July 4.

The members differed little in their preferences for the ranges to be specified for the annual rates of growth in the monetary aggregates over the June–July period. For *M*-1, sentiment initially was about equally divided between ranges of 2½ to 6½ per cent and 3 to 7 per cent; the midpoint of each range was somewhat below the midpoint of the Committee's longer-run range for growth in that aggregate. However, after some discussion of the extent to which growth in *M*-1 in the second quarter was likely to exceed its longer-run range, sentiment in favor of the lower of the two ranges prevailed. For *M*-2, most members favored a range of 6 to 10 per cent, but sentiment was also expressed for a range of 5½ to 9½ per cent.

Most members favored giving greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting because of uncertainty about *M*-1 growth rates in the near term. However, a number of the members expressed a preference for continuing to have operating decisions in the period ahead based primarily on the behavior of the monetary aggregates.

Almost all members favored directing operations—at least initially—toward maintaining the Federal funds rate at about its prevailing level of 5⅜ per cent. Most of them advocated retaining the inter-meeting range for the funds rate of 5¼ to 5¾ per cent that had been specified at the May meeting, but sentiment was also expressed for a range of 5 to 5¾ per cent. One of the members who expressed a preference for continuing to base operations primarily on the behavior of the aggregates favored a range of 5½ to 6¼ per cent for the funds rate.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintaining about the prevailing money market conditions, as represented by a weekly-average Federal funds rate of 5⅜ per cent. With respect to the annual rates of growth in *M*-1 and *M*-2 over the June–July period, the Committee specified ranges of 2½ to 6½ per cent and 6 to 10 per cent, respectively. The members agreed that if growth in the aggregates should appear to approach or move beyond the limits of the specified ranges, with approximately equal weight given to *M*-1 and *M*-2, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion

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within a range of 5¼ to 5¾ per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services has grown in the current quarter at about the rapid rate of the first quarter. In May industrial output and employment continued to expand at a substantial pace, and the unemployment rate edged down from 7.0 to 6.9 per cent. Total retail sales increased from the advanced March–April level. The rise in the wholesale price index for all commodities slowed substantially in May, as average prices of farm products and foods changed little after having increased sharply for three consecutive months; average prices of industrial commodities also rose less than in other recent months.
>
> The average value of the dollar against leading foreign currencies has changed little on balance over the past month. The U.S. foreign trade deficit was nearly as large in April as in March.
>
> *M*-1 increased only slightly in May, after rising at an exceptionally rapid rate in April. Reflecting mainly the behavior of *M*-1, growth in *M*-2 and *M*-3 also slowed sharply. Inflows to banks of time and savings deposits other than large-denomination CD's continued to slacken, but inflows to nonbank thrift institutions remained sizable. Business short-term borrowing moderated from the sharply increased pace of April, and corporate borrowing in the capital markets was reduced further. Short-term market interest rates have changed little on balance in recent weeks, while longer-term yields have declined.
>
> In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.
>
> At its meeting on April 19, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4½ to 6½ per cent, 7 to 9½ per cent, and 8½ to 11 per cent, respectively, from the first quarter of 1977 to the first quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.
>
> At this time, the Committee seeks to maintain about the prevailing

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money market conditions during the period immediately ahead, provided that monetary aggregates appear to be growing at approximately the rates currently expected, which are believed to be on a path reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, the Committee seeks to maintain the weekly-average Federal funds rate at about 5⅜ per cent, so long as *M*-1 and *M*-2 appear to be growing over the June–July period at annual rates within ranges of 2½ to 6½ per cent and 6 to 10 per cent, respectively. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period are approaching or moving beyond the limits of the indicated ranges, the operational objective for the weekly-average Federal funds rate shall be modified in an orderly fashion within a range of 5¼ to 5¾ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

> Votes for this action: Messrs. Burns, Volcker, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Vote against this action: Mr. Coldwell.

Mr. Coldwell dissented from this action because he favored a funds rate range of 5 to 5¾ per cent, in order to provide more leeway for a reduction should the rates of growth in *M*-1 and *M*-2 appear to be near or below the lower limits of their specified ranges for the June–July period. This preference reflected his views that the April bulge in *M*-1 had been caused largely by special factors, that the projections of the aggregates for the June–July period were highly uncertain, and that realization of the staff projection for growth in nominal GNP would involve very large increases in the velocity of money.

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MEETING HELD ON JULY 19, 1977

Domestic Policy Directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the second quarter had been close to the pace in the first quarter, indicated by estimates of the Commerce Department to have been at an annual rate of 6.9 per cent. The rise in average prices—as measured by the fixed-weighted price index for gross domestic business product—appeared to have been somewhat faster than the annual rate of 6.5 per cent estimated for the first quarter, owing in large part to substantial increases in prices of foods. Staff projections suggested that the rate of growth in real GNP would be less rapid in the second half of 1977 than in the first and that it would slow somewhat further into 1978. The projections also suggested that the rate of increase in prices would moderate from that in the first half but would remain high.

In the second quarter, according to the latest staff estimates for the expenditure components of real GNP, growth in personal consumption expenditures had slowed appreciably from the high rate in the first quarter. Moreover, expansion in business fixed investment had been substantially below the rapid pace in the first quarter, reflecting recovery from strikes. On the other hand, residential construction activity had expanded very sharply, in part because of recovery from the effects of severe winter weather in the first quarter; State and local government purchases of goods and services had turned up; and the rate of business inventory accumulation had increased considerably further.

Staff projections for the second half of the year were virtually the same as those made a month earlier. They suggested that growth in consumption expenditures would slow somewhat further and that the pace of expansion in residential construction would moderate. At the same time, however, it was expected that increases in Federal purchases of goods and services would be substantial; that growth in

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State and local government purchases would be sustained at a high rate; that expansion of business investment would remain relatively strong; and that the rate of inventory accumulation would rise further, although by much less than in the first half.

In June industrial production rose 0.7 per cent, following gains of 0.7 and 1.0 per cent in April and May, respectively. Much of the June advance was accounted for by increases in output of automotive products—following 2 months of declines—and in production of business equipment and durable goods materials. Output of nondurable consumer goods and of nondurable goods materials changed little. Over the period from March to June, when the over-all index rose 2½ per cent, output of business equipment expanded about 5 per cent and production of consumer goods about 1¼ per cent.

The rate of capacity utilization for the materials-producing industries remained near 83 per cent in June, compared with about 81½ per cent in March. For durable goods materials and nondurable goods materials, respectively, the rates were about 80½ and 87½ per cent in June, compared with 78 and 87 per cent in March.

Expansion in employment moderated in June. Payroll employment in nonfarm establishments rose by 135,000 persons, less than half the average monthly increase in the preceding 5 months. Employment in manufacturing—after vigorous expansion earlier in the year—declined slightly in June, reflecting reductions in a number of nondurable goods industries. The unemployment rate rose from 6.9 to 7.1 per cent, reflecting an increase in the number of persons seeking part-time jobs—mainly teenagers and adult women. The civilian labor force continued to grow at a rapid pace. Since December 1976, when the unemployment rate was 7.8 per cent, the civilian labor force had risen by about 1¾ million persons. Teenagers and adult women accounted for about three-fourths of that increase.

Personal income expanded considerably less in April and May than in the preceding 2 months when increases had been especially large owing to the rebound in wage and salary payments from the weather-reduced level in January and to large increases in transfer payments. Wage and salary payments rose about 1 per cent in both April and May, close to the average monthly increase for the first quarter. For June the employment statistics suggested a smaller increase in wage and salary payments.

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Retail sales in June remained at about the level reached in March; however, the total for the second quarter was about 2 per cent above the first-quarter level. In June sales declined at general merchandise stores for the second consecutive month and fell sharply at apparel stores, but they rose appreciably at furniture and appliance stores and continued to expand at food stores. Sales of new automobiles—at an advanced annual rate of 11.8 million units—were close to the level of April and May and about 5 per cent above the average for the first quarter.

The book value of inventories in manufacturing and trade rose sharply in May, and the rate of increase over the first 2 months of the second quarter was moderately higher than that for the first quarter. In manufacturing, the rate of increase over the April–May period was almost twice as fast as in the first quarter, and for nondurable goods industries alone it was more than three times as fast.

The number of private housing units started in June had not been made public by the time of this meeting. In April and May starts were at an annual rate of about 1.9 million units—about 10 per cent above the average for both the first quarter of 1977 and the fourth quarter of 1976. Sales of new homes declined in May for the third consecutive month and were 16 per cent below the advanced rate for the first quarter. However, sales of existing homes rose in May to a near-record rate that was 7 per cent above the first-quarter average.

New orders for nondefense capital goods were unchanged in May, after having expanded about 6 per cent on balance over the preceding 4 months. Shipments of such goods continued to change little in May, and unfilled orders rose further to a level nearly 4 per cent higher than at the end of 1976. Contract awards for commercial and industrial buildings—as measured in terms of floor space—fluctuated widely during the first 5 months of 1977, but the April–May average was about 3½ per cent higher than the average for the first quarter.

As had been reported before the June meeting of the Committee, the latest Commerce Department survey of business plans suggested that in the third and fourth quarters of 1977 increases in spending for plant and equipment would be small—perhaps no more than the rise in prices for such goods. According to the survey, businesses would spend 12.3 per cent more for plant and equipment in 1977 than they had in 1976.

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The index of average hourly earnings for private nonfarm production workers rose at an annual rate of 3.7 per cent in June. The rate of advance over the first 6 months of 1977 was 6.7 per cent, compared with an increase of 6.9 per cent during 1976. Over the first half of 1977, however, relatively greater growth of employment in higher-wage industries and an increase in hours of overtime had resulted in a faster rate of advance in actual average hourly earnings than in the index, which is adjusted to exclude the effects of fluctuations in overtime in manufacturing and also the effects of changes in the proportion of workers in high-wage and low-wage industries.

The wholesale price index declined in June, after having risen much less in May than in the preceding 3 months. Average prices for farm products fell sharply further in June, and those for processed foods also declined. As in May, average prices of industrial commodities rose appreciably less than in earlier months of 1977.

The consumer price index rose 0.6 per cent in May—a little less than in April and the same as in March. Retail prices of foods increased 0.7 per cent in May—about half as much as in April—while commodities other than foods and services rose 0.4 per cent and 0.7 per cent, respectively.

The average value of the dollar against leading foreign currencies declined by more than 1 per cent over the inter-meeting period, following more than a year of relative stability. Over the 4-week period, moreover, foreign central banks intervened in the exchange markets to purchase, on balance, a substantial amount of dollars. The downward pressure on the dollar intensified at the end of June when public statements by some government officials fostered market expectations that the currencies of countries with large surpluses in their current accounts would appreciate. Declines in the dollar, which occurred against almost all major currencies, were especially marked against the Japanese yen, the German mark, and the Swiss franc.

The U.S. foreign trade deficit diminished somewhat in May from the high average during the preceding 4 months. In May imports of petroleum declined, and exports of agricultural commodities increased sharply, reflecting chiefly a rise in exports of soybeans. Exports of nonagricultural commodities were virtually unchanged; since the third quarter of 1976 they had been stable, on balance, in

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association with only moderate expansion in economic activity in major industrial countries marked by sluggishness in capital investment.

At U.S. commercial banks, growth in total credit slowed somewhat further in June and was slightly below the average for the first 5 months of the year. The slowing in June reflected declines in net acquisitions of Treasury and other securities. Growth of real estate loans accelerated to a near-record pace, and growth of most other major categories of loans was substantial. However, nonbank financial institutions reduced their outstanding bank loans, as they raised a record volume of funds in the commercial paper market.

Business credit demands—which had fallen off in May—rebounded in June, apparently in part because of borrowing by corporations to finance a record amount of Federal income tax payments due at midmonth. Business loans at banks and the outstanding volume of commercial paper issued by nonfinancial corporations both expanded at relatively high rates. Over the first half of the year, growth in business loans (excluding bankers acceptances) and in outstanding commercial paper was substantially faster than over the fourth quarter of 1976.

The narrowly defined money stock (*M*-1), after having risen at an exceptionally rapid rate in April and having increased little in May, grew at a moderate pace in June. On a quarterly-average basis, *M*-1 grew at an annual rate of 8.5 per cent in the second quarter, compared with 4.2 per cent in the first quarter.

Growth in the more broadly defined measures of money (*M*-2 and *M*-3) also was moderate in June. Inflows to banks of the time and savings deposits included in *M*-2 picked up somewhat, after having slackened for a number of months, and inflows to nonbank thrift institutions remained sizable. On a quarterly-average basis, *M*-2 and *M*-3, respectively, grew at annual rates of 9.2 and 10.0 per cent in the second quarter, compared with 9.9 and 11.3 per cent in the first quarter.

At its June meeting the Committee had decided that operations in the period immediately ahead should be directed toward maintaining about the prevailing money market conditions, as represented by a weekly-average Federal funds rate of 5⅜ per cent, provided that *M*-1 and *M*-2 appeared to be growing over the June–July period at annual rates within ranges of 2½ to 6½ per cent and 6 to 10 per cent,

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respectively. Throughout the inter-meeting period, incoming data suggested that over the June–July period M-1 and M-2 would grow at rates within those ranges. Accordingly, the Manager of the System Open Market Account sought to maintain the Federal funds rate around 5⅜ per cent.

In association with the stability in the Federal funds rate, market interest rates in general changed little during the inter-meeting period despite some increase in over-all credit demands. Rates on Treasury bills edged up—although the Treasury continued to redeem bills in its regular auctions—as the market apparently began to adjust to the anticipated near-term cessation of large redemptions. Changes in rates on private short-term instruments and on longer-term issues were small.

Treasury public sales and redemptions of securities were about in balance during the inter-meeting interval. For the second quarter as a whole, the Treasury made net repayments of marketable securities of $5 billion, in contrast with net borrowings of $14 billion during the first quarter. It was anticipated that the Treasury would raise a substantial amount of new money in conjunction with its mid-August refunding of $3.3 billion of maturing securities held by the public; it was expected that the terms of the financing would be announced on July 27.

In the corporate bond market the volume of new securities offered to the public increased in June, reflecting a relatively large volume of new issues by public utilities and financial concerns. For the second quarter as a whole, however, offerings were below the volume for the previous quarter, and those by industrial corporations were at the lowest level in more than 3 years.

Offerings of State and local government bonds rose to a record in June, raising the second-quarter volume to an unprecedented $13.4 billion, following $10.7 billion in the first quarter. As in other recent months, demands for these securities were strong from property-casualty insurance companies, commercial banks, and individuals—both directly and through municipal bond investment companies.

The volume of mortgage lending remained large in June at commercial banks as well as at savings and loan associations. Estimates for the second quarter indicated an acceleration from the high rate for the first quarter. While issues of GNMA-guaranteed, mortgage-backed securities declined from the strong first-quarter

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pace, net acquisitions of mortgages by FNMA expanded substantially. Average interest rates on new commitments for conventional home mortgages continued to edge higher in late June and early July, and yields in the secondary mortgage market changed little on balance.

In their discussion of the economic situation, members of the Committee agreed with the general outlines of the staff projections, which were described as presenting a fairly optimistic picture of prospective developments. Despite the broad consensus on the outlook, several members suggested that expansion in some sectors of demand might prove to be less strong than expected by the staff and that growth in real GNP was more likely to fall short of than to exceed the projected rates.

With respect to the immediate situation, attention was called to the rate at which inventories had accumulated in some sectors. The view was expressed that a minor adjustment of inventories—similar to although smaller than the one in the latter part of 1976—had been under way for the past 2 months or so and had already affected production and employment in nondurable goods industries. It was observed that businesses appeared to adjust inventory imbalances more promptly now than they had in the past; that such minor adjustments tended to forestall the development of a need for major adjustment; and that the adjustment that appeared to be in process was healthy in that it would serve to make the business expansion more sustainable. A question was raised as to whether the staff projections for the very near term adequately reflected the adjustment in inventories that appeared to be under way.

Questions were also raised about the staff projections for sales of new automobiles and for residential construction. It was suggested that auto sales might be reduced from the advanced level of recent months by two influences: one, increases in prices, not only for domestic models but also for imports because of the substantial appreciations of the Japanese yen and the German mark against the dollar; and two, the high level of consumer debt. With respect to residential construction, two members felt that the expansion in that sector might slow sooner than projected; in support of this view, it was suggested that the rise in prices for new homes had diminished the ability of consumers to buy them.

Despite the questions about certain aspects of the staff pro-

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jections, a number of reasons were advanced for viewing the prospective course of economic activity with some confidence: The trend of retail sales was basically upward—even though sales had leveled off on a high plateau in recent months—and the minor inventory imbalance was being corrected; any falling off in sales of automobiles that might develop was likely to be accompanied—as often in the past—by more rapid growth in sales of consumer nondurable goods; the expansion in business capital expenditures was gaining momentum; and purchases of goods and services by State and local governments would be a source of increasing strength in over-all activity. It was suggested, moreover, that a gradual slowing of growth in real GNP toward its long-term trend was desirable as rates of resource utilization approached their practical limits.

Although the outlook for plant and equipment expenditures was viewed as favorable, concern was expressed that the lag in growth of productive facilities so far in this business expansion might result in the development of pressures against available capacity while the unemployment rate was still relatively high. At the same time, it was noted that economists in general believed that the unemployment rate consistent with the goal of full employment was appreciably higher now than it had been some years earlier. The observation was made that the unemployment rate had remained comparatively high despite the extraordinary growth in employment so far in this business expansion mainly because women—and to a lesser extent, teenagers—had entered the labor force in unusually large numbers. It was suggested that many women sought part-time jobs—in some cases because of the effects of inflation—and that even though businesses had been adapting to this change in the labor market, the increase in the number of part-time jobs available had been far from sufficient.

Some members commented on pending legislation to increase the minimum wage. The view was expressed that an increase in the minimum tended to raise the whole structure of wages and that it had adverse effects on employment, particularly of teenagers, and on prices.

Finally, some members of the Committee expressed concern about the possible effects of developments abroad on the U.S. economy. Specifically, they observed that in some major countries

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the outlook for economic activity did not appear to be particularly strong and that continued sluggishness abroad had adverse implications for the U.S. trade balance, already heavily in deficit.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its April meeting the Committee had specified the following ranges for growth over the period from the first quarter of 1977 to the first quarter of 1978: *M*-1, 4½ to 6½ per cent; *M*-2, 7 to 9½ per cent; and *M*-3, 8½ to 11 per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. The ranges being considered at this meeting were for the period from the second quarter of 1977 to the second quarter of 1978.

In the discussion of the ranges for growth in the aggregates over the year ahead, most members of the Committee expressed the belief that a small downward adjustment should be made. All but one of these members supported a proposal to reduce the lower limit of the range for *M*-1 by ½ of a percentage point while retaining the existing ranges for *M*-2 and *M*-3; one member favored small reductions in the ranges for *M*-2 and *M*-3 as well as the ½-point decrease in the lower limit of the range for *M*-1. Other Committee members advocated more of a downward adjustment in the ranges; specifically, they favored a reduction of ½ of a percentage point in both the upper and the lower limits of the range for *M*-1, and these members in general favored some decrease in the ranges for *M*-2 and *M*-3 as well.

In support of the proposal to make some downward adjustment, several Committee members suggested that it would be desirable to take another step in the gradual process of bringing the longer-run ranges for growth in the monetary aggregates down to rates compatible with general price stability. Moreover, it was observed that the annual rate of growth in *M*-1 from the first to the second quarter of 1977 had exceeded the range adopted by the Committee at its meeting in April; that despite the gradual reduction of projected ranges of growth for the aggregates during the past 2 years, no meaningful reduction had as yet occurred in actual rates of growth; that the outlook for growth in real GNP was relatively good; and that the rate of inflation had intensified somewhat during the first half of 1977.

One member of the Committee favored a reduction of ½ of a percentage point in the upper, as well as the lower, limit of the range

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for *M*-1 while retaining the existing ranges for *M*-2 and *M*-3, with the objective of realigning the ranges in view of the increasing importance of new means of payment as substitutes for demand deposits. Other members argued, on the other hand, that any downward adjustment in the range for *M*-1 should be limited to the lower limit. It was noted that while second-quarter growth for that aggregate had been relatively high, growth in the first quarter had been low in relation to the Committee's longer-run range. In view of prospective developments—including, specifically, increases in prices attributable to such exogenous forces as increases in energy costs and in the minimum wage—it was suggested that a reduction of ½ of a percentage point in the upper as well as in the lower limit of the range for *M*-1 might run the risk of undesirable pressures in financial markets, a principal effect of which would be to slow growth in real GNP more than projected.

Three members of the Committee advocated a reduction of ½ of a percentage point in both limits of the range for *M*-1 and also some reduction in the ranges for the broader monetary aggregates. Their reasons for this position are contained in the statements of dissent below.

At the conclusion of its discussion the Committee decided to reduce the lower limit of the range for *M*-1 by ½ of a percentage point and to retain the existing ranges for *M*-2 and *M*-3. The ranges thus were 4 to 6½ per cent for *M*-1, 7 to 9½ per cent for *M*-2, and 8½ to 11 per cent for *M*-3. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent.[1] It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It was also understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for the year ahead.

The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the second quarter of 1977 to

[1]At this meeting the Committee decided to replace the bank credit proxy with a broader measure of all commercial bank credit. In recent years the proxy—which is based solely on data for member banks—has become increasingly less representative of total bank credit, in part because of the growth in importance of nonmember banks and in part because the proxy does not include certain borrowings by banks from the nonbank public.

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the second quarter of 1978: M-1, 4 to 6½ per cent; M-2, 7 to 9½ per cent; and M-3, 8½ to 11 per cent.

> Votes for this action: Messrs. Burns, Volcker, Gardner, Guffey, Lilly, Mayo, Morris, Partee, and Wallich. Votes against this action: Messrs. Coldwell, Jackson, and Roos.

Mr. Coldwell dissented from this action because he thought that liquidity was high; that less rapid growth in real GNP was now necessary in order to sustain the expansion later on; and that action to reduce the rate of growth in the aggregates might lessen upward pressures on prices, improve the U.S. foreign trade position, and strengthen the dollar. Mr. Jackson dissented because he believed that it was important to reduce the upper limit of the range for M-1 so that the Committee would take action to avoid a higher rate of growth, and that it was a logical consequence of that position to favor reductions also in the ranges for the broader aggregates. Mr. Roos, who also dissented, held the view that the retention of the existing upper limit of the range for M-1 following the overshoot of growth in that aggregate from the first to the second quarter of 1977 might result in too rapid monetary growth over the five-quarter period ending in the second quarter of 1978 and therefore lead to a probable acceleration of the rate of inflation.

As to policy for the period immediately ahead, members of the Committee did not differ greatly in their preferences for ranges of growth for the monetary aggregates over the July–August period. Most of them favored ranges of 3½ to 7½ per cent and 6½ to 10½ per cent for the annual rates of growth in M-1 and M-2, respectively. One member suggested that the Committee specify somewhat wider ranges around the same midpoints of those ranges because of greater-than-usual uncertainty about projections of monetary growth for the period just ahead. Also, some sentiment was expressed for slightly higher, and some for slightly lower, ranges.

All members favored a return to basing decisions for open market operations in the period immediately ahead primarily on the behavior of the monetary aggregates. At its meeting in June the Committee had decided to give greater weight than usual to money market conditions in conducting operations in the period until this meeting.

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Almost all members favored directing operations initially toward the objective of maintaining the Federal funds rate at its current level of 5⅜ per cent, but a few members suggested that operations be directed toward achieving a slightly higher rate within a short time. With respect to the degree of leeway for operations during the inter-meeting period should the aggregates appear to be deviating significantly from the midpoints of the specified ranges, most members advocated retaining the range for the Federal funds rate of 5¼ to 5¾ per cent that had been specified at the two preceding meetings. A few members suggested that it would be appropriate to specify a wider range for the funds rate in association with the return to conducting operations on the basis of the behavior of the monetary aggregates; ranges of 5¼ to 6 per cent, 5 to 6 per cent, and 5 to 5¾ per cent were suggested.

At the conclusion of the discussion the Committee decided that growth in *M*-1 and *M*-2 over the July–August period at annual rates within ranges of 3½ to 7½ per cent and 6½ to 10½ per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of *M*-1 and *M*-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average Federal funds rate of about 5⅜ per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5¼ to 5¾ per cent.[2] As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services grew in the second quarter at about the rapid

[2]Subsequently, as described on p. 836, the Committee modified the range by increasing the upper limit to 6 per cent.

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rate of the first quarter. In June industrial output continued to expand at a substantial pace. The rise in employment moderated, and the unemployment rate edged up from 6.9 to 7.1 per cent. Total retail sales remained at about the level reached in March; for the second quarter as a whole, however, sales were moderately above the first-quarter level. The wholesale price index for all commodities declined in June, owing to sharp decreases among farm products and foods; as in May, average prices of industrial commodities rose appreciably less than in earlier months of 1977. The index of average hourly earnings rose over the first half of the year at about the same pace that it had on the average during 1976.

The average value of the dollar against leading foreign currencies has declined more than 1 per cent over the past month; the declines were especially marked against the Japanese, German, and Swiss currencies. In May the U.S. foreign trade deficit diminished somewhat from the high rate in the first 4 months of the year.

M-1, after rising at an exceptionally rapid rate in April, increased little in May and grew at a moderate pace in June. Growth in *M*-2 and *M*-3 also was moderate in June. Inflows to banks of time and savings deposits included in *M*-2 picked up somewhat, after having slackened for a number of months, and inflows to nonbank thrift institutions remained sizable. Business short-term borrowing expanded sharply in June. Market interest rates in general have changed little in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

Growth in *M*-1, *M*-2, and *M*-3 within ranges of 4 to 6½ per cent, 7 to 9½ per cent, and 8½ to 11 per cent, respectively, from the second quarter of 1977 to the second quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the July–August period to be within the ranges of 3½ to 7½ per cent for *M*-1 and 6½ to 10½ per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly-average Federal funds rate of about 5⅜ per cent. If, giving

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approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 5¼ to 5¾ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

> Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

Subsequent to the meeting, on August 4, nearly final estimates indicated that in July M-1 had grown at an annual rate of about 18½ per cent and M-2 at a rate of about 16½ per cent. For the July–August period staff projections suggested that the annual rates of growth for both aggregates would be well above the upper limits of the ranges specified by the Committee in the next-to-last paragraph of the domestic policy directive issued at the July meeting.

The Federal funds rate had averaged 5.80 per cent in the statement week ended August 3, up from 5.45 per cent in the week ended July 27 and 5.35 per cent in the preceding 3 weeks. The Manager of the System Open Market Account was currently aiming at a funds rate of 5¾ per cent, the upper limit of the inter-meeting range specified in the directive.

Against that background, Chairman Burns recommended on August 4 that the upper limit of the range for the Federal funds rate be increased to 6 per cent so that the Manager might have some additional leeway for operations, while continuing to take account of the current Treasury financing and financial market developments. He further recommended that this additional leeway be used very gradually, and only in the event that the aggregates continued to register values far beyond the Committee's objectives.

On August 5, 1977, the Committee modified the inter-meeting range for the Federal funds rate specified in the next-to-last paragraph of the domestic policy directive issued on July 19, 1977, by increasing the upper limit from 5¾ to 6 per cent.

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Votes for this action: Messrs. Burns, Jackson, Mayo, Morris, Partee, Roos, Wallich, Balles, and Timlen. Votes against this action: None. Absent and not voting: Messrs. Coldwell, Gardner, Guffey, Lilly, and Volcker. (Messrs. Balles and Timlen voted as alternates for Messrs. Guffey and Volcker, respectively.)

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MEETING HELD ON AUGUST 16, 1977

Domestic Policy Directive

The information reviewed at this meeting suggested that real output of goods and services—which had increased at an annual rate of 6.4 per cent in the second quarter, according to preliminary estimates of the Commerce Department—was growing less rapidly in the current quarter. At the same time the rise in average prices, as measured by the fixed-weighted price index for gross domestic business product, appeared to be slowing from that of the second quarter, estimated to have been at a 7.0 per cent annual rate. Staff projections suggested that growth in real GNP was likely to remain less rapid over the remainder of 1977, and to slow a little further in 1978. The projections also suggested that the rate of increase in prices would moderate from that in the first half, but would still remain high.

According to the staff projections, rising activity in a number of sectors would contribute to a continuation of the economic expansion over the year. Growth in consumer spending, which had slowed appreciably in the second quarter, was projected to pick up gradually. Relatively strong growth was anticipated in business capital outlays, and inventory investment seemed likely to continue as an expansive factor, although much less so than in the first half of 1977. Increases in Federal purchases of goods and services were expected to remain substantial. Spending by State and local governments was projected to continue rising briskly, in part because of the stimulus of expanded Federal public works and job-related grant programs. On the negative side, slow export growth and rising imports seemed likely to exert a drag on economic activity over much of the projection period. And the increase in residential construction activity was expected to level off as the period progressed.

In July industrial production rose by 0.5 per cent, a little less than in June and roughly half of the substantial increase in May. The rate of capacity utilization in manufacturing edged higher, to an esti-

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mated 83.7 per cent. The July rise in production reflected sizable increases in the output of consumer durable goods and business equipment. Production of nondurable consumer goods changed little, and steel output declined. Auto assemblies rose slightly, but it was expected that production schedules would be reduced more than usual in August by the beginning of the changeover to the new model year.

Nonfarm payroll employment expanded by more than a quarter of a million in July, half again as much as in June, with factory jobs rising by 70,000. According to the household survey data, however, total employment—after increasing 2¼ million between December and June—declined in July, due to a sharp reduction in agricultural jobs. The labor force also contracted in July, almost wholly as a result of reduced participation by teenagers, and the unemployment rate declined 0.2 of a percentage point, returning to the May level of 6.9 per cent.

Personal income had advanced briskly during the first half of 1977 as a result of the large gains in employment. The rise in wage and salary payments slowed in June, but for the second quarter as a whole the increase was the largest since the first quarter of 1976. In July wage and salary payments apparently rose at a moderate rate, and growth in personal income was bolstered by a cost-of-living increase for social security recipients.

Available reports suggested that corporate profits had improved during the second quarter. Although comprehensive data were not yet available, the information at hand implied a second-quarter level of corporate profits that was significantly above the relatively low levels recorded in the third and fourth quarters of 1976 and the first quarter of 1977. As a proportion of GNP, however, corporate profits still remained below their longer-run average and well below previous postwar peaks.

The dollar value of retail sales had increased 0.5 per cent in July, according to the advance report. However, data for June—which had initially indicated no change from May—had been revised to show a decline of 1.3 per cent. For the second quarter as a whole the value of retail sales was now estimated to have risen 1.6 per cent, down from the earlier estimate of 2.1 per cent. In July there were sizable advances in sales at stores in the GAF (general merchandise, apparel, furniture and appliance) grouping. But auto sales fell to an

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annual rate of 10.8 million units, from the near-record pace of 11.8 million units in June.

Businesses appeared to be making prompt adjustments to evidence of developing imbalances in inventories of nondurable goods. In June the book value of such inventories declined at both manufacturers and wholesalers—at the latter, for the second consecutive month—following large increases earlier in the year. Inventories of durable goods continued to rise at a relatively rapid rate at both manufacturers and wholesalers, but the growth was about in line with the advance in sales.

Private housing starts declined to an annual rate of about 1.8 million units in June, the latest month for which data were available. This was close to the average rate that had prevailed since late 1976. In the second quarter as a whole, single-family starts—at an annual rate of 1.4 million units—were the highest for any quarter on record. Mortgage lending activity had remained strong in recent months; the rate of growth in mortgage debt outstanding was estimated to have been at a record during the second quarter, and it appeared to have risen somewhat further in July.

New orders for nondefense capital goods increased by about 5 per cent in June. Contract awards for commercial and industrial buildings—as measured in terms of floor space—edged off from the high May level; for the second quarter as a whole, however, they were 4.5 per cent above their level in the first quarter.

The index of average hourly earnings for private nonfarm production workers rose in July at an annual rate of 6½ per cent—close to the average rise over the preceding 18 months. Major collective bargaining settlements in the first half of 1977 provided for first-year wage increases averaging 8.0 per cent, compared with an average of 8.4 per cent under contracts negotiated in 1976. On the other hand, compensation per hour in the private nonfarm business sector rose at an annual rate of about 9.5 per cent in the first half, a little faster than in 1976.

The wholesale price index for all commodities, which had declined in June, was about unchanged in July. Average prices for farm products and foods—after having risen sharply in the early months of 1977—declined for the second successive month. Average prices for industrial commodities continued to advance but at a more moderate pace than in the earlier months of the year.

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The consumer price index in June rose 0.6 per cent—about the same as in the preceding 3 months. While the advance for commodities other than foods slowed to 0.2 per cent, the increases for foods and for services edged up to 0.8 per cent.

By the time of this Committee meeting, the average value of the dollar against leading foreign currencies had recoverd more than 1 per cent from the low reached on July 25, but it was still below its late-June level. The strengthening of the dollar since late July reflected reaction in the foreign exchange markets to statements by U.S. officials indicating the importance that the United States attaches to maintaining the strength of the dollar, and also to the recent relative rise in interest rates on dollar-denominated assets. The dollar appreciated most sharply against the German mark and the Japanese yen. It depreciated against sterling, however, after authorities in the United Kingdom elected to discontinue their earlier policy of maintaining a target ceiling rate for sterling defined exclusively in terms of the U.S. dollar.

The U.S. trade deficit rose sharply in June as imports rebounded from the somewhat reduced level in May and exports declined. For the second quarter as a whole, the trade deficit as measured in the international accounts was at an annual rate of $31 billion.

At U.S. commercial banks, total credit expanded slightly faster in July than in June, but the pace in July remained below the average for the first half of the year. Holdings by banks of U.S. Treasury securities declined sharply in July, while their holdings of other securities increased moderately. Total loans rose more rapidly than in any other month since last October, reflecting strength in most major categories. However, business loans grew considerably less than in June, when corporations had borrowed to finance an unusually large volume of Federal income tax payments. Also, the outstanding volume of commercial paper issued by nonfinancial corporations declined slightly in July.

Growth in the narrowly defined money stock (*M*-1) accelerated to an annual rate of about 18 per cent in July. While much of the increase apparently was temporary, part seemed to reflect rising transactions demands for money. For the 7 months ending with July, *M*-1 grew at an annual rate of nearly 8 per cent.

Growth in the more broadly defined measures of money (*M*-2 and *M*-3) also accelerated sharply in July, to annual rates of about 17 and

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16 per cent, respectively. The high rates of expansion in these measures were due primarily to the large increases in *M*-1, but inflows of the time and savings deposits included in *M*-2 and *M*-3 also picked up from their reduced rates in June. For the 7 months ending with July, *M*-2 and *M*-3 grew at annual rates of 10 and 11 per cent, respectively.

At its July meeting the Committee had decided that growth in *M*-1 and *M*-2 in the July–August period within ranges of 3½ to 7½ per cent and 6½ to 10½ per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 5⅜ per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5¼ to 5¾ per cent.

Data that had become available in the days immediately following the July meeting suggested that over the July–August period both *M*-1 and *M*-2 would grow at rates in the upper parts of their specified ranges. These data were considered especially tentative, however, because unusual patterns in the figures received just after the power failure in New York City suggested that the failure might have introduced statistical distortions. The System Account Manager, therefore, continued to seek a Federal funds rate of about 5⅜ per cent. Later, however, when new data not only confirmed the initial signs of strength but also suggested that growth in the aggregates would be somewhat above the upper limits of the specified ranges, System operations were directed at achieving a higher Federal funds rate. During the statement week ending August 3, the funds rate averaged 5.80 per cent, approximately equal to the 5¾ per cent upper limit of the Committee's range.

Information that became available on August 4 suggested that the growth rates in the aggregates in the July–August period would be well above the ranges specified by the Committee, and on August 5 the Committee voted to increase the upper limit of the range for the funds rate to 6 per cent. It was understood that the Manager would use this additional leeway very gradually and only in the event that the aggregates continued to register values far in excess of the Committee's objectives. When such strength in the aggregates did

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persist, the Account Manager aimed at a Federal funds rate of about 6 per cent.

In markets for short- and medium-term securities, interest rates generally rose by 3/8 to 1/2 of a percentage point over the inter-meeting period. Yields on corporate and municipal bonds, however, showed little change over the period, and those on Treasury bonds posted only small advances.

During the 4 weeks of the inter-meeting period the U.S. Treasury raised about $4.0 billion of new money in securities markets, including $3.0 billion obtained in connection with its mid-August refinancing. Issues offered in the refinancing consisted of $3.0 billion of 3-year notes, $2.25 billion of 7-year notes, and $1.0 billion of (reopened) 29½-year bonds.

In July the volume of new publicly offered corporate bonds was slightly larger than in June and was above the monthly average for the second quarter. Offerings by industrial issuers—which had been exceptionally low in June—were at their highest level since December 1976, while new issues by utilities were below their advanced second-quarter pace. The volume of new State and local government bonds dropped more than seasonally during July, following a record supply of new issues both in June and for the second quarter as a whole. The heavy volume of new municipal offerings in recent months included a large number of advance refundings, as well as issues offered earlier than originally planned, apparently in the expectation that interest costs would rise later in the year.

Average prices of common stocks traded on the New York Stock Exchange declined during the inter-meeting period—in the case of one widely used index, to the lowest level since early 1976. Indexes of issues traded on the American Stock Exchange and over the counter also declined somewhat during the period, but they remained near their highest levels since 1973.

In markets for home mortgages, average interest rates on new commitments for conventional loans were relatively stable in the weeks just prior to this meeting, following small advances in late June and early July. Meanwhile, yields in the secondary market for home mortgages generally edged higher.

In the Committee's discussion of the economic situation, the members agreed that the expansion was likely to continue for some time. Several members suggested that the apparent moderation in

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economic growth from the rapid pace of the first half of the year was an essentially healthy adjustment; continued expansion at the earlier pace might well have led in time to a reacceleration of inflation and created price distortions that would have brought the expansion to an early end. It was observed that the economy was experiencing few imbalances at present and that needed adjustments in business inventories were being made promptly. The view was widespread among members that the upward trend of business capital investment would persist and very likely would strengthen.

While the members agreed that the economic expansion was likely to continue, they differed regarding its probable profile over the quarters ahead. Specifically, several members thought that the rate of economic growth was likely to be slower in the second half of 1977, and faster in the first half of 1978, than suggested by the staff projections. With respect to the second half of 1977, these members thought that spending on consumer goods and housing would rise less than indicated, and they found it difficult to identify offsetting sources of strength. For the longer run, however, they believed that economic growth would be fostered by sustained increases in business capital outlays and in spending by Federal and State and local governments. It was suggested that such a pattern might well be associated with a slower rate of price advance than that projected by the staff.

Other members of the Committee indicated that, while they expected more strength in the economy in the second half of 1977 than their colleagues did, they were not persuaded that the rate of growth would rise after the turn of the year. In this connection they identified several potential problems. One was the possibility that the recent upcreep in unit costs of production relative to selling prices might continue, with a consequent further narrowing of profit margins. It was noted that when this process had developed in the past, an economic downturn had typically occurred within 1 to 2 years. Other potential problems mentioned were the recent rapid increase in consumer credit and the evidence of speculation in some real estate markets. One member of the Committee, in commenting on the erosion of profit margins, observed that businesses did not appear to be pressing as actively as they might to hold labor costs down, fearing the impact of strikes and assuming that inflation would continue.

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In the discussion of the outlook for business investment, it was noted that outlays were falling short of what might have been expected on the basis of past cyclical expansions, even in industries where the need for increased plant and equipment spending was clearly evident. A number of members expressed the view that narrow profit margins were tending to constrain investment spending. One member offered the hypothesis that a more typical increase in such spending might continue to be delayed until profit margins were widened by increases in product prices as capacity limits were approached. Among other factors mentioned as inhibiting investment was the unusual degree of uncertainty prevailing in business circles, particularly with respect to public policy on such matters as inflation control, energy, and tax reform.

Several members of the Committee cited the recent declines in stock prices as evidence of uncertainties about the prospects for corporate profits. In the discussion Committee members identified other factors they believed might help to account for some of the weakness in stock prices. One was the restructuring of investment portfolios being undertaken by many institutional investors to increase emphasis on fixed-rate instruments. Another was efforts by stockholders to realize accumulated capital gains, as a precaution against the possible enactment of legislation limiting the special tax treatment of capital gains.

At its July meeting the Committee had agreed that from the second quarter of 1977 to the second quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4 to 6½ per cent; *M*-2, 7 to 9½ per cent; and *M*-3, 8½ to 11 per cent. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In considering policy for the period immediately ahead, members of the Committee noted that growth in the monetary aggregates was expected to slow markedly in August and September. Because of the sharp increases in July, however, expansion in the third quarter as a whole—particularly in *M*-1—would be relatively rapid. It was observed that considerably slower growth rates would be needed in

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subsequent quarters if monetary growth for the year ending with the second quarter of 1978 was to be kept within the ranges that the Committee had decided upon in July.

While the views of members on appropriate short-run policy did not differ greatly, a number of members placed particular stress on the need to resist further sizable increases in the monetary aggregates, noting that continued rapid growth would foster inflationary expectations and weakening of confidence within the business community. Other members put more emphasis on the sizable increase that had occurred since late April in the Federal funds rate and other short-term interest rates, and some expressed reluctance to seek further tightening in the money market at a time when growth in economic activity was showing signs of moderating. These members suggested that, in the absence of unusual behavior in the monetary aggregates, it would be desirable to maintain relatively stable conditions in the money market for the time being.

The members agreed that, in view of the July bulge in the monetary aggregates, no easing of money market conditions should be sought in the coming interval even if growth rates in the aggregates during the August–September period appeared to be quite low. For *M*-1, most members favored a growth range for the August–September period of 0 to 5 per cent or 0 to 6 per cent; a few preferred slightly higher ranges. For *M*-2, most members favored a range of 3 to 8 per cent.

All members of the Committee favored directing inter-meeting operations initially toward the objective of maintaining the Federal funds rate at about the prevailing level of 6 per cent. Views differed somewhat with respect to the degree of leeway for operations during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges, but most members preferred ranges for the funds rate of 5¾ to 6¼ per cent or 5¾ to 6½ per cent. Some members suggested that more weight than usual should be placed on money market conditions in the directive to be issued to the Federal Reserve Bank of New York, but a majority preferred to continue to stress the monetary aggregates.

At the conclusion of the discussion the Committee decided that growth in *M*-1 and *M*-2 over the August–September period at annual rates within ranges of 0 to 5 per cent and 3 to 8 per cent,

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respectively, would be appropriate. It was understood that in assessing the behavior of these aggregates the Manager should continue to give approximately equal weight to the behavior of *M*-1 and *M*-2.

It was the Committee's judgment that such growth rates were likely to be associated with a weekly-average Federal funds rate of about 6 per cent. The members agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5¾ to 6¼ per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services is growing less rapidly in the current quarter than in the second quarter. In July industrial output rose a little less than in June. The rise in payroll employment in nonfarm establishments was substantial. According to the household survey data, total nonagricultural employment was unchanged and the unemployment rate edged down to 6.9 per cent, the same as in May. The dollar value of total retail sales rose somewhat, after 2 months of decline. The wholesale price index for all commodities was about unchanged in July; average prices of farm products and foods declined sharply further, and average prices of industrial commodities continued to rise at a more moderate pace than in the early months of 1977. The index of average hourly earnings has continued to advance at about the same pace that it had on the average during 1976.
>
> The weighted average exchange rate for the dollar against leading foreign currencies has recovered more than 1 per cent from the low point reached in late July. In June the U.S. foreign trade deficit rose sharply, and the deficit was larger for the second quarter as a whole than for the first.
>
> The increase in *M*-1 was exceptionally large in July. Inflows to banks of the time and savings deposits included in the broader monetary aggregates strengthened, and growth in *M*-2 and *M*-3 also accelerated sharply. Business short-term borrowing moderated from

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the rapid pace in June. Interest rates on short- and intermediate-term market instruments have risen appreciably in recent weeks, while yields on longer-term bonds have changed little.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

At its meeting on July 19, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4 to 6½ per cent, 7 to 9½ per cent, and 8½ to 11 per cent, respectively, from the second quarter of 1977 to the second quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the August–September period to be within the ranges of 0 to 5 per cent for *M*-1 and 3 to 8 per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly-average Federal funds rate of about 6 per cent. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 5¾ to 6¼ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

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MEETING HELD ON SEPTEMBER 20, 1977

1. Domestic Policy Directive

The information reviewed at this meeting suggested that real output of goods and services—which had expanded at an annual rate of 6.2 per cent in the second quarter, according to revised estimates of the Commerce Department—had grown less rapidly in the current quarter. The rise in average prices—as measured by the fixed-weighted price index for gross domestic business product—appeared to have slowed from that of the second quarter, now estimated to have been at an annual rate of 7.5 per cent. Staff projections suggested that real GNP would grow moderately over the year ahead, although at a slightly lower rate than projected a month earlier. The projections also suggested that the rate of increase in prices, while below that in the first half of 1977, would remain high.

According to staff estimates, the third-quarter slowing of growth in real GNP was accounted for by a sharp cutback in the rate of business inventory accumulation, following a large increase in the second quarter, as businesses attempted to prevent an excessive build-up of stocks. It was estimated that growth in final sales of goods and services in real terms was about the same in the third quarter as in the second.

Staff projections of moderate growth in real GNP over the year ahead reflected expectations that growth in consumer spending would pick up gradually; that expansion in business capital outlays would be sustained; and that increases in State and local government purchases of goods and services would remain large, in part because of the stimulus of increased Federal public works and job-related programs. It was still anticipated that the expansion in residential construction activity would taper off as the period progressed and

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that slow export growth combined with a somewhat faster rise in imports would exert a drag on domestic economic activity over much of the year ahead.

In August industrial production declined by 0.5 per cent, about as much as it had risen in July. A substantial part of the decline was accounted for by curtailments in automobile assemblies and electric utility power generation, both of which had increased sharply in July, but decreases in output were widespread. Production of iron ore was reduced by a strike.

Capacity utilization in manufacturing also declined in August, for the most part reflecting decreases in the transportation equipment and nonelectrical machinery industries. Utilization in the materials-producing industries edged down to 82.7 per cent. This rate was appreciably lower than at the comparable stage of other recent business expansions, in part because of larger supplies from foreign sources.

In association with the decrease in industrial output, employment in manufacturing fell in August—returning to the level of May—and the length of the average workweek declined for the second successive month. Total nonfarm payroll employment increased moderately, however, as employment outside the manufacturing sector continued to grow. According to the household survey, total civilian employment also rose moderately, but the labor force expanded sharply and the unemployment rate increased 0.2 of a percentage point to 7.1 per cent—the same level as in June. From April through August the unemployment rate fluctuated between 6.9 and 7.1 per cent.

The rise in personal income accelerated in July, as a result of a cost-of-living increase in social security payments, and then slowed in August to about the same rate as in May and June. In August total wage and salary disbursements increased little. Disbursements expanded substantially in government, reflecting gains in State and local payrolls attributable to a rise in Federally sponsored public service jobs, but declined in manufacturing and gained little in other industries.

The dollar value of retail sales had increased 1.7 per cent in August, according to the advance report. The August level of sales was somewhat above the earlier peak reached in March and moderately above the average for the second quarter. Sales gains in August

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were widespread among types of outlets and were particularly strong at furniture and appliance stores, apparel stores, and gasoline stations. Sales of new automobiles, which had fallen in July, recovered almost to the high rate that had prevailed throughout the second quarter.

The adjustment in inventories proceeded in July, when the book value of nondurable goods stocks actually declined. The increase in the book value of total manufacturing and trade stocks was substantially below the monthly-average increases in the first two quarters of 1977.

Private housing starts rose appreciably in July to an annual rate of nearly 2.1 million units and then edged down in August to a rate slightly above 2.0 million. The average for the 2 months was 7 per cent above the average for the second quarter, in large part because of gains in starts of multifamily units.

The Department of Commerce survey of business plans taken in late July and August suggested that spending for plant and equipment would be 13.3 per cent greater in 1977 than in 1976; the survey taken in May had suggested a year-to-year gain of 12.3 per cent. The latest survey implied average increases of somewhat less than 3 per cent in the third and fourth quarters of the year, compared with 3½ per cent in the first two quarters.

New orders for nondefense capital goods, which had increased about 5 per cent in June, were indicated by the partial sample estimate to have fallen about 10 per cent in July. Much of the rise and subsequent decline was accounted for by orders for commercial aircraft, apparently for export. The level of new orders in July was well below the average for the second quarter and about equal to the average for the first quarter. Manufacturers' shipments of nondefense capital goods expanded in July, and unfilled orders for such goods leveled off after having risen during the preceding 6 months. Contract awards for commercial and industrial buildings—measured in terms of floor space—declined in July and were moderately below the average for the second quarter.

The index of average hourly earnings for private nonfarm production workers, which had increased substantially in July according to revised data, advanced little in August. Over the first 8 months of 1977 the index rose at an annual rate of 6.8 per cent; over the 12 months of 1976 the index had risen 6.9 per cent.

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The wholesale price index for all commodities, which had declined in June and changed little in July, was about unchanged again in August. Average prices of farm products and foods declined sharply for the third successive month and were back down to about the level of December 1976. Average prices of industrial commodities continued to rise at a more moderate pace than in the latter part of 1976 and the first 4 months of 1977.

The consumer price index rose 0.4 per cent in July, considerably less than in any month in the first half of 1977. Retail prices of foods changed little, after having increased about 7 per cent over the preceding 6 months. Average prices of nonfood commodities also changed little in July, in part because of reductions for gasoline and used cars, but prices of services continued to rise at an annual rate of about 10 per cent.

The weighted-average exchange rate for the dollar against leading foreign currencies recovered further over the inter-meeting period and returned to the level of late June. During the period the Swedish krona was devalued by 10 per cent and was withdrawn from the European "snake" arrangement; the Norwegian and Danish kroner were devalued by 5 per cent within that arrangement. Upward pressure on sterling intensified, and the Bank of England intervened in the market to maintain the exchange rate for the pound against the dollar.

The U.S. foreign trade deficit declined in July from the record level of June and was about equal to the average for the second quarter. Imports of petroleum and products fell, following an increase of about 20 per cent in June. Inflows of capital, both private and foreign official, were sizable in July.

At U.S. commercial banks, growth in total credit accelerated during August to a rate somewhat above the average for the first 7 months of 1977. Growth in total loans remained at the advanced pace of July, while bank holdings of U.S. Treasury securities declined much less than in July and holdings of other securities continued to increase moderately. Expansion of business loans picked up from the reduced rate in July. Outstanding commercial paper issued by nonfinancial businesses increased in August, but by somewhat less than it had declined in July.

Growth in the narrowly defined money stock (*M*-1) slowed to an annual rate of about 5½ per cent in August from the July rate of

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more than 18 per cent. Nevertheless, growth over the 2-month period, at an annual rate of almost 12 per cent, was more rapid than the advanced rate of the second quarter.

Growth in the more broadly defined measures of money, *M*-2 and *M*-3, also slowed during August—to annual rates of 6.4 and 11.2 per cent, respectively—mainly because of deceleration of growth in the demand deposit and currency components common to all three measures of money. Expansion of the bank time and savings deposits included in the broader aggregates also slowed substantially, but inflows of deposits to nonbank thrift institutions remained strong. Over the July–August period, *M*-2 and *M*-3 grew at annual rates of 11.6 and 13.7 per cent, respectively.

At its August meeting the Committee had decided that during the August–September period growth in *M*-1 and *M*-2 within ranges of 0 to 5 per cent and 3 to 8 per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 6 per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5¾ to 6¼ per cent.

Data that had become available in the weeks immediately following the August FOMC meeting suggested that over the August–September period *M*-1 was growing at a rate in the upper half and *M*-2 at a rate near the midpoint of their respective ranges. Accordingly, the System Account Manager continued to seek a Federal funds rate of around 6 per cent. Near the end of the inter-meeting period, growth in *M*-1 for the 2-month period appeared to be exceeding the upper limit of its range and growth in *M*-2 appeared to be in the upper half of its range. Therefore, the Manager sought a firming in the Federal funds rate to around 6⅛ per cent, and the rate averaged close to that level in the 5 days just prior to this meeting of the Committee.

During the initial weeks of the inter-meeting period, market interest rates declined somewhat from the levels that had prevailed in mid-August. But in early September, when it became evident that growth in the monetary aggregates had not receded so much in August as market participants had anticipated and that the Federal

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funds rate was remaining above 6 per cent, other market interest rates turned up. Over the inter-meeting period, short-term rates posted net advances ranging up to about ¼ of a percentage point. Long-term rates, however, changed little on balance. Early in the inter-meeting period major commercial banks raised their prime rate on business loans ¼ of a percentage point to 7 per cent, and in the second week of September most of them raised the rate to 7¼ per cent.

Stock prices declined further during the inter-meeting period. Just prior to the September meeting, several major indexes of stock prices reached their lowest levels since the end of 1975 and early 1976.

On August 29 the Board of Governors of the Federal Reserve System announced its approval of action by directors of five Federal Reserve Banks raising the discount rate from 5¼ to 5¾ per cent, effective August 30; on August 30 and September 1 increases at the remaining Reserve Banks were approved. In announcing the approval, the Board stated that its action was intended as a technical move for the purpose of bringing the discount rate into better alignment with other short-term interest rates and that the action was taken to reduce the incentive for member banks to borrow from the Federal Reserve. Daily-average borrowings had risen from $323 million in July to $1,084 million in August; in the week ending August 24, they had reached $1,665 million. In the week ending September 14, daily-average borrowings were down to $337 million.

During the inter-meeting period the U.S. Treasury raised $6.3 billion of new money, including $1.5 billion in conjunction with a regular rollover of $1.9 billion of maturing 2-year notes and $3.0 billion through a new offering in the regular cycle of 4-year notes. Also, the Treasury sold $1.8 billion of short-dated, cash-management bills, which it refinanced at maturity by adding to the regular weekly bill auctions. This marked the Treasury's first sizable use of the bill market for new money since late 1976.

Gross offerings of new State and local government bonds increased substantially in August. Part of the large volume consisted of offerings that had originally been scheduled for September and then were advanced to August. Advance refunding of outstanding municipal issues rose to a record level.

The volume of new publicly offered corporate bonds declined in

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August, in large part for seasonal reasons. As in July, the bulk of the new offerings were from lower-rated issuers, reflecting the continuing reduction of risk premiums for such securities. Downward pressure on risk premiums in the public market apparently reflected some continuing spillover of funds from the private placement market—where the supply of investable funds being provided by insurance companies and pension funds remained large.

Growth in mortgage credit also remained strong in August. Mortgage loans outstanding at commercial banks continued to rise at a rapid pace, and new issues of GNMA-guaranteed, mortgage-backed securities increased further. At savings and loan associations the record volume of mortgage commitments outstanding at the end of July suggested that mortgage holdings had risen substantially further. Nevertheless, the liquidity position of these associations remained comfortable, reflecting the strong growth in deposits and large inflows of funds from mortgage repayments.

In the Committee's discussion of the economic situation and outlook, the members agreed—as they had at the August meeting—that the expansion was likely to continue for some time, and most of them expected that real GNP would grow at about the moderate pace projected by the staff. However, some members expressed doubts about the vigor of the expansion. One member reiterated a view that he had expressed at the August meeting, to the effect that growth was likely to fall short of the rate projected for the balance of this year and then to exceed the projected rates in the first half of 1978.

It was suggested during the discussion that recent developments bore some resemblance to those in 1976. Last year, it was recalled, progressive diminution in the quarterly rates of growth in real GNP had fostered concern that the expansion might be coming to an end and had given rise to recommendations for a stimulative fiscal program. It was noted, however, that the 1976 slowing had been caused by an inventory adjustment; final sales of goods and services had been strong throughout the year. It was observed that a similar adjustment of inventories had begun in the third quarter of this year and that once again the expansion in real final sales had been maintained while growth in total real GNP had slowed.

In view of the continued strength in final takings, it was suggested that the recent cutbacks in production and in employment in some

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activities were likely to be temporary. It was also observed that the performance of the recent unemployment statistics might have been affected by inadequate seasonal adjustments.

In the discussion, members offered reasons for expecting greater or less strength in business activity over the next year or so than suggested by the staff projections. Thus, some doubts were expressed that growth in consumer spending would pick up as much as projected and, in particular, that over the year ahead sales of new automobiles would increase further from the currently advanced levels. These doubts were attributed in part to the surge in spending for durable goods and the substantial rise in consumer debt that had already occurred. It was also suggested that expansion in consumer spending might be dampened by the adverse effect that the decline in stock prices had had on wealth. On the other hand, it was noted that rising real estate values had tended to increase consumers' wealth, and that the liquidity of real estate holdings—while less than that of market securities—had been increasing as a result of the greater ease with which homeowners could refinance first mortgages and obtain second mortgages. The comment was made that many second mortgages were being undertaken for the purpose of refinancing outstanding instalment debt.

Some concern was expressed about the sluggishness of economic activity in other major industrial countries, particularly in Europe, and about its effect on net exports and thus on domestic economic activity. However, the view was also expressed that in some major countries the foundation for improvement in activity was being laid by a slowing of the rise in wages and prices, a reduction of growth in money supplies, and a strengthening of external positions.

Business fixed investment was described as a sector whose contribution to over-all economic growth might well be greater than projected, as businessmen responded to further growth in economic activity and increases in capacity utilization. Moreover, business confidence was said to have increased somewhat, although it was still being adversely affected by uncertainties concerning Government tax and energy policies. It was suggested that the contribution to over-all economic growth from Federal Government expenditures also could be greater than projected.

Concern was expressed about the outlook for both unemployment and prices. It was remarked that even if real GNP grew at a

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moderate pace over the next year, little progress would be made in reducing the unemployment rate—which was still significantly above the level that might be regarded as "full employment," even if that level were judged for structural reasons to be considerably higher than in the past. Moreover, one member observed, recent experience had shown that high unemployment did not greatly reduce the rate of inflation, and the staff projections did suggest persistence of both a rapid rate of inflation and a high rate of unemployment. To a few members, those prospects for unemployment and prices indicated that active public discussion of some form of an incomes policy would be appropriate. Others observed that an incomes policy both workable and likely to have fairly wide support had not yet been devised, and also that an effort to institute such a policy probably would have an adverse effect on business fixed investment. One member expressed the view that the longer-run outlook for unemployment and inflation called for a shift in the policy mix toward a firmer monetary policy—to limit growth of liquidity—and an easier fiscal policy.

At its July meeting the Committee had agreed that from the second quarter of 1977 to the second quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4 to 6½ per cent; *M*-2, 7 to 9½ per cent; and *M*-3, 8½ to 11 per cent. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In their discussion at this meeting of policy for the immediate future, Committee members differed in their views on the appropriate response to the recent rapid growth in the monetary aggregates. It was noted that growth in *M*-1 and *M*-2 had not slowed so much in August as had been expected and that it apparently was picking up somewhat in September—making it likely that the rates of monetary expansion in the third quarter would be high relative to the Committee's longer-run ranges. Some members thought that the Committee's primary objective in the period immediately ahead should be to resist continued rapid expansion in the aggregates, in light of the implications of such expansion for inflation and inflationary expecta-

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tions. On the other hand, some members advocated avoiding substantial increases in interest rates at present, in light of their doubts about the economic outlook. It was also noted that the recent high rate of growth in *M*-1 might represent a return to a more typical relationship between that rate and the growth rate in nominal GNP—following a period in which the demand for money had been held down by changes in financial practices—and accordingly that it might not warrant the kind of policy response that would be appropriate under other circumstances. Most members, however, were of the opinion that the Committee could not afford to ignore either the uncertainties in a generally favorable economic outlook or the recent high rates of monetary growth, and they favored finding some middle ground.

These differences in members' views were reflected in their preferences for operating specifications for the period immediately ahead. For the annual rate of growth in *M*-1 over the September–October period, most members favored a range with a lower limit of 2 or 3 per cent and an upper limit of 7 or 8 per cent. For *M*-2, most favored a range of 4 to 8 or 4 to 9 per cent. However, one member, who advocated maintaining relatively stable money market conditions, preferred ranges of 2 to 9 per cent for *M*-1 and 5½ to 9½ per cent for *M*-2. Another member favored a range of 0 to 5 per cent for *M*-1.

With respect to the Federal funds rate, a variety of views were expressed as to both the objective toward which operations should be directed initially and the degree of leeway that should be provided during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges. Most members favored directing operations initially toward a funds rate of 6⅛ per cent—the prevailing level—or 6¼ per cent, but some sentiment also was expressed for a higher initial objective. In view of the rapid monetary growth over recent months, the members in general believed that it would be desirable to avoid any significant decline in the weekly-average Federal funds rate from its current level, and almost all favored 6 per cent for the lower limit of the range. The view was expressed that a weekly-average Federal funds rate above 6½ per cent should not be sought before the Committee had had an opportunity for further consultation, and a majority favored 6½ per cent as the upper limit for the

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range. There was, however, considerable sentiment for an upper limit of 6¾ per cent.

At the conclusion of the discussion the Committee agreed that growth in *M*-1 and *M*-2 over the September–October period at annual rates within ranges of 2 to 7 and 4 to 8 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of *M*-1 and *M*-2.

The Committee decided that operations should be directed initially toward a weekly-average Federal funds rate of 6¼ per cent. The members agreed that if growth rates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 6 to 6½ per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services has grown less rapidly in the current quarter than in the second quarter. In August industrial output declined by about as much as it had risen in July. Employment increased moderately but the labor force rose more and the unemployment rate edged up to 7.1 per cent, the same as in June. The dollar value of total retail sales, which had turned up in July, rose appreciably in August. The wholesale price index for all commodities was about unchanged; average prices of farm products and foods declined sharply for the third successive month, and average prices of industrial commodities continued to rise at a more moderate pace than in the early months of 1977. So far this year the index of average hourly earnings has advanced at about the same pace as it had on the average during 1976.
>
> The weighted average exchange rate for the dollar against leading foreign currencies has recovered further in recent weeks, returning to the level of late June. In July the U.S. foreign trade deficit was at about the second-quarter rate, and there were sizable net inflows of foreign private and official capital.
>
> Growth in *M*-1 and *M*-2 slowed in August from the exceptionally

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rapid rates in July. Expansion of both demand deposits and time and savings deposits at banks slackened. Growth in *M*-3 also slowed, although inflows to nonbank thrift institutions remained strong. Business short-term borrowing increased somewhat from the reduced pace in July, but remained below the volume of preceding months. Short-term interest rates, which had risen appreciably in early August, most recently have advanced somewhat further. Yields on longer-term market securities, however, have changed little on balance in recent months. Federal Reserve discount rates were increased from 5¼ to 5¾ per cent in late August and early September, and member bank borrowings receded from the high levels of the latter part of August.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

At its meeting on July 19, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4 to 6½ per cent, 7 to 9½ per cent, and 8½ to 11 per cent, respectively, from the second quarter of 1977 to the second quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in *M*-1 and *M*-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the September–October period to be within the ranges of 2 to 7 per cent for *M*-1 and 4 to 8 per cent for *M*-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly-average Federal funds rate of about 6¼ per cent. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 6 to 6½ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Mayo, and Par-

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tee. Votes against this action: Messrs. Lilly, Morris, Roos, and Wallich.

Messrs. Lilly and Wallich dissented from this action because it allowed for somewhat more firming in money market conditions than they thought was appropriate at present in view of their judgment that the economic situation was not very strong. They also felt that the rapid monetary growth over recent months might represent an increase in the public's demand for money in relation to growth in GNP of a kind that should be accommodated. Mr. Lilly believed, in addition, that further tightening in money market conditions would not be effective in dealing with the underlying structural inflation.

Messrs. Morris and Roos dissented on the ground that the policy adopted by the Committee represented an inadequate response to the rapid rates of monetary growth over recent months, which in their view were not compatible with a healthy economy over the longer run. Mr. Roos felt that, if the Committee did not take action now that would assure a reduction in the rate of growth in *M*-1, the rate of inflation would accelerate and more drastic action would need to be taken later on.

2. Authorization for Domestic Open Market Operations

On September 30, 1977, Committee members voted to increase from $2 billion to $3 billion the limit on Federal Reserve Bank holdings of special short-term certificates of indebtedness purchased directly from the Treasury, specified in paragraph 2 of the authorization for domestic open market operations, effective immediately.

Votes for this action: Messrs. Burns, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Partee, Roos, Wallich, Eastburn, and Timlen. Votes against this action: None. (Messrs. Eastburn and Timlen voted as alternates for Messrs. Morris and Volcker, respectively.)

This action was taken on the recommendation of Chairman Burns. The Chairman had advised the Committee that the current temporary debt ceiling of $700 billion would expire at midnight on September 30, 1977; that unless congressional action to extend the

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temporary ceiling were completed before that time, the ceiling would revert to its permanent level of $400 billion; and that under the temporary ceiling, the Treasury had leeway to borrow an additional amount between $2 billion and $3 billion and had requested that the System stand ready to purchase that day directly from the Treasury such amounts of special short-term certificates of indebtedness as the Treasury might be able to issue under the temporary ceiling.

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MEETING HELD ON OCTOBER 17–18, 1977

1. Domestic Policy Directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the third quarter had slowed from the pace in the second quarter, estimated by the Commerce Department to have been at an annual rate of 6.2 per cent. The rise in average prices—as measured by the fixed-weighted price index for gross domestic business product—appeared to have moderated appreciably from that of the second quarter, estimated to have been at an annual rate of 7.5 per cent. Staff projections suggested that growth in real GNP would pick up in the fourth quarter and would continue at a moderate, although slightly diminishing, pace in 1978. It was also expected that the rate of increase in prices, while less than that in the first half of 1977, would remain high.

According to staff estimates, the third-quarter slowing of growth in real GNP was attributable mainly to a reduction in the rate of business inventory accumulation, following a large increase in the second quarter, as businesses attempted to prevent an excessive build-up of stocks. It was estimated that growth in final sales of goods and services in real terms had been about the same in the third quarter as in the second.

Staff projections of growth in real GNP over the year ahead reflected expectations that expansion in business capital outlays would be sustained; that increases in State and local government purchases of goods and services would remain large, in part because of the stimulus of increased Federal public works and job-related programs; and that growth in consumer spending would be moderate. It was still anticipated that the expansion in residential construction activity would taper off as the period progressed and that exports of goods and services would continue to exceed imports by a sizable, but not an increasing, amount.

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In September industrial production expanded 0.4 per cent, returning to the level reached in July. About one-third of the September rise was attributable to gains in copper and coal mining following the end of strikes, but small increases in output were widespread. Production of steel declined, and automobile assemblies were about unchanged at a relatively high rate. From the second quarter to the third, total industrial production advanced 1.2 per cent, about half as much as from the first quarter to the second.

Capacity utilization in manufacturing in September remained at the August level of 82.9 per cent. In the materials-producing industries, utilization changed little, and at 82.8 per cent for both September and the third quarter as a whole, it remained appreciably lower than at the comparable stage of other recent business expansions.

Total nonfarm payroll employment expanded substantially in September, reflecting in large part continuation of strong growth in the service-producing sector—specifically, in services, retail trade, and State and local government. Payroll employment in manufacturing increased too, recovering most of the decrease of August, but the length of the average workweek of production workers declined for the third consecutive month—reaching 40.0 hours, compared with 40.5 in June. Total employment, as measured by the survey of households, also increased substantially in September. The civilian labor force rose somewhat less than total employment, as a sizable increase in the number of women in the labor force was offset in part by decreases in the number of adult men and of teenagers, and the unemployment rate edged down 0.2 of a percentage point to 6.9 per cent. From April through September the unemployment rate had fluctuated between 6.9 and 7.1 per cent.

The size of the gain in employment in September suggested an increase in the pace of expansion in wage and salary disbursements. In August such disbursements had increased little.

The dollar value of retail sales had declined 1.2 per cent in September, according to the advance report, after having increased 2.3 per cent over the preceding 2 months. From the second quarter to the third the value of sales had risen 0.3 per cent, considerably less than the rise from the first quarter to the second and, most likely, less than the increase in average prices of the goods and services sold. Unit sales of new autos—domestic and foreign

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models—declined more than 10 per cent, but the weakness may have been caused by the lateness of the changeover to 1978 models for some domestic makes and by reduced inventories of both foreign cars and 1977 domestic models.

Expansion in the book value of business inventories accelerated in August, after having slowed sharply further in July, but it was still slightly less rapid than the monthly-average rise in the first half of 1977. The build-up of stocks at retail stores was somewhat faster than in July and considerably more rapid than the average increase during the preceding 6 months, reflecting exceptionally high rates of accumulation both at durable goods stores other than automobile dealerships and at nondurable goods stores. In manufacturing, on the other hand, accumulation slowed further in August; in both durable goods and nondurable goods industries, the rate of accumulation was less than that over the first 6 months of the year.

As had been reported before the September meeting of the Committee, private housing starts were at an annual rate of slightly more than 2.0 million units in August, almost as much as in July. The average for the 2 months was 7 per cent above the average for the second quarter, reflecting in large part gains in starts of multifamily units.

The latest Department of Commerce survey of business plans, taken in late July and August and published in early September, suggested that spending for plant and equipment would be 13.3 per cent greater in 1977 than in 1976. The survey implied somewhat less expansion in spending in the second half of the year than in the first half.

Manufacturers' new orders for nondefense capital goods picked up somewhat in August after having declined sharply in July; the average for the 2 months was well below that for the second quarter and about equal to that for the first quarter. However, the machinery component of such orders—generally a better indicator of underlying trends in demand for business equipment—was at an appreciably higher rate in July–August than in the second quarter. Over-all shipments of nondefense capital goods continued to expand in August, and unfilled orders for such goods edged down. Contract awards for commercial and industrial buildings—measured in terms of floor space—rose sharply in August, and the July–August average was about 8 per cent above the average for the second quarter.

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The index of average hourly earnings for private nonfarm production workers advanced at a moderate pace in September. Over the first 9 months of 1977 the index had risen at an annual rate of about 7 per cent, the same as the increase over the 12 months of 1976.

The wholesale price index for all commodities, which had declined in June and then had shown little change in July and August, rose moderately in September. Average prices of farm products and foods changed little following 3 months of large decreases, and prices of industrial commodities rose more than in the immediately preceding months. Among industrial commodities, sizable increases were recorded for lumber and wood products, certain fuels, some types of machinery, and roofing and insulation materials.

The consumer price index in August, as in July, rose considerably less than in any month of the first half of 1977. Retail prices of foods changed little over the July–August period, after having risen about 6½ per cent over the preceding 6 months. The increase in prices of nonfood commodities was relatively small in September for the third consecutive month, and the rise in prices of services was significantly less than the average increase in the preceding 7 months.

In foreign exchange markets, pressure on the dollar emerged at the end of September—following 2 months of recovery from the depreciation that had occurred in early summer—in reaction mainly to statements by U.S. Government officials concerning the large deficits in both foreign trade and the current accounts that were in prospect for 1977 and were projected for 1978. From late September to mid-October the trade-weighted average value of the dollar depreciated about 1½ per cent, reflecting declines against all major currencies except the Canadian dollar; the largest declines were against the Japanese yen and the Swiss franc. Over the period, moreover, foreign central banks intervened in the exchange markets to purchase a substantial amount of dollars.

The U.S. foreign trade deficit widened in August. The monthly-average deficit for July and August was somewhat greater than that for the second quarter.

At U.S. commercial banks, growth in total credit was small in September following substantial expansion in the preceding 2 months. In September bank holdings of U.S. Treasury securities declined considerably further. Total loans expanded, but by less than in July and August. Real estate loans continued to grow at a

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rapid pace, but business loans increased less than in any month earlier in the year.

The small increase in business loans at banks in September was accompanied by a decrease of about the same amount in the outstanding volume of commercial paper issued by nonfinancial corporations. For the third quarter as a whole, business credit expansion through these two sources slowed to an annual rate of 6 per cent—the lowest since the summer of 1976.

The narrowly defined money stock (*M*-1) grew at an annual rate of 7¾ per cent in September, up from the August pace of 5½ per cent. Data for early October suggested further acceleration. *M*-1 grew at an annual rate of 9¼ per cent from the second quarter to the third, and by about 7¼ per cent from the third quarter of 1976 to the third quarter of 1977.

Growth in the more broadly defined measures of money, *M*-2 and *M*-3, also stepped up in September—to annual rates of 8 and 12 per cent, respectively, from rates of about 6½ and 11½ per cent in August. These more rapid rates resulted almost entirely from the acceleration of expansion in the demand deposit and currency components common to all three measures of money. Expansion in the time and savings deposit component of *M*-2 changed little in September from the reduced rate of August; and inflows of deposits at nonbank thrift institutions, included in *M*-3, remained near the strong pace of August. From the third quarter of 1976 to the third quarter of 1977, *M*-2 and *M*-3 grew about 11 and 12½ per cent, respectively.

At its September meeting the Committee had decided that during the September–October period growth in *M*-1 and *M*-2 within ranges of 2 to 7 per cent and 4 to 8 per cent, respectively, would be appropriate. The Committee had established 6 to 6½ per cent as the range for variation in the weekly-average Federal funds rate for the period until the next meeting. The 6¼ per cent midpoint of the range was slightly above the rate of 6⅛ per cent prevailing in the days just before that meeting. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of their ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within its indicated range.

In accordance with the Committee's decision, the Manager of the

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System Open Market Account began immediately after the September meeting to seek bank reserve conditions consistent with a Federal funds rate of around 6¼ per cent. Data that were becoming available at the same time suggested that over the September–October period M-1 and M-2 would grow at rates at or above the upper limits of the ranges specified by the Committee, and the estimates of these growth rates were raised further on the basis of the data that became available in subsequent weeks. Therefore, the Manager sought a gradual firming in the Federal funds rate to 6½ per cent, the upper limit of its specified range. In the three business days prior to this meeting of the Committee, the funds rate averaged 6½ per cent.

Interest rates in securities markets also rose during the inter-meeting period. Increases ranged from 30 to 65 basis points in markets for short-term securities and up to 20 basis points in markets for long-term instruments. Major banks raised the rate on loans to prime business borrowers from 7¼ to 7½ per cent.

As market rates of interest rose, member bank borrowings at Federal Reserve Banks expanded. In the 5 days preceding the Committee meeting, borrowings averaged nearly $1.6 billion, up from a daily average of $337 million in the statement week ending September 14.

Stock prices drifted down further over the inter-meeting period, and several major indexes of stock prices reached their lowest levels since the end of 1975. The reduced prices of common stocks, in combination with a record number of dividend increases announced so far this year, raised the average yield of dividends to an unusually high level by historical standards.

The U.S. Treasury raised $3.3 billion of new money during the inter-meeting period. For the third quarter as a whole, its cash borrowing totaled $17 billion—excluding $2.5 billion of temporary borrowing from the Federal Reserve System at the end of the quarter. Of the $17 billion, $2.8 billion was provided through sales of special nonmarketable Treasury securities to State and local governments that were making temporary investments of the proceeds from advance refundings.

Gross offerings of new bonds by State and local governments remained substantial in September, reflecting a continued large volume of advance refundings. Primarily because of such refundings, State and local government offerings of long-term securities in

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the first 9 months of 1977 exceeded the record volume of sales in all of 1976.

Gross public offerings of corporate bonds remained strong both in September and in the third quarter as a whole. Total external financing by nonfinancial corporations in the third quarter appeared to have been substantially greater than the gap between capital outlays and internally generated funds. In those circumstances, such a large volume of financing suggested that some firms were encouraged by the levels of prevailing yields to borrow in advance of their current needs. The proceeds of such borrowings may have been used to enlarge holdings of liquid assets as well as to reduce short-term debt.

Growth in mortgage credit in September apparently remained near the strong pace registered earlier in the third quarter. Expansion in mortgage loans at commercial banks slightly exceeded the sizable July–August average, and new issues of GNMA-guaranteed, mortgage-backed securities were down only moderately from the August record volume. At savings and loan associations, outstanding mortgage loan commitments had risen appreciably in August to a new record level. At the same time, inflows of funds to these institutions during September were apparently sufficient to permit them to acquire a sizable volume of spot loans in addition to financing takedowns of outstanding mortgage commitments.

In the Committee's discussion of the economic situation, the members agreed that the expansion in activity was likely to continue for some time to come. They differed, however, in their assessments of the prospective vigor of the expansion. Most indicated no disagreement with the staff projections suggesting that growth in real GNP would pick up in the fourth quarter and would continue at a moderate—if slightly diminishing—pace in 1978, although the view was expressed that uncertainties about the current situation and outlook had increased in recent months. One of the members suggested that the private economy had demonstrated great vitality since the start of the current business upswing, as evidenced by growth of nearly 7 million persons in total employment. He believed that the expansion could well pick up speed again if the tax proposals being developed by the administration were practical and included, in particular, measures designed to foster a higher rate of business capital expenditures. Another member who regarded the

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staff projections as reasonable nevertheless thought that any deviation was more likely to be in the direction of shortfalls. A third member felt that the economy had not displayed any significant weaknesses and that its performance was likely to be as favorable as, or more favorable than, that projected by the staff.

On the other hand, several members felt that the performance of the economy was likely to be less favorable than projected and, consequently, that there might be little further progress in reducing the rate of unemployment from its high level. One of these members observed that the projections for a number of sectors of activity appeared to be on the high side and that shortfalls were likely to occur in at least some cases. Another of these members suggested, however, that a rate of growth in real GNP of less than 5 per cent—which was being widely forecast on the assumption of the existing fiscal policy—was likely to lead to some new measures of fiscal stimulus, although uncertainty existed about the amount of time required to legislate new measures and about their probable effectiveness. Another member expressed the view that, compared with the staff projections, growth was likely to be weaker in the fourth quarter of 1977, to be stronger in the first half of 1978, and to be weaker again in the second half of 1978.

Members differed somewhat in their appraisals of the outlook for major categories of expenditures. With respect to business fixed investment, little disagreement was expressed with the staff projection that expansion would be sustained over the year ahead. It was observed that new orders for machinery had been strong; that a revival in large-scale industrial and commercial building projects had begun earlier this year; and that new businesses were being formed at an increasing rate. However, the view was also expressed that business confidence had deteriorated somewhat—owing to the rather indifferent performance of profits, to the decline in stock prices, and to widespread uncertainty concerning a number of Government policies—and it was noted that some private surveys of plans for 1978 did not suggest any great strength in business capital spending. Concerning inventories, it was observed that businesses were likely to continue pursuing conservative policies, that the recent increase in stocks at retail stores had occurred as sales had leveled off, and that any appreciable increase in inventory investment in the period ahead might reflect involuntary accumulation and

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thus be indicative of weakness rather than strength in the over-all situation.

Several members expressed skepticism concerning the staff projection of some further expansion in housing starts from recent levels and of somewhat higher starts in 1978 as a whole than in 1977. In that connection, it was suggested that starts might be limited by supplies of insulating and other building materials as much as by any easing in demands. On the other hand, the view was expressed that certain factors affecting starts of multifamily units had become more favorable and that increases in such starts might sustain the total, although it was recognized that on the average less construction activity was involved in multifamily than in single-family units. With respect to financing, it was observed that the availability of funds for mortgages remained good. Moreover, it was suggested that thrift institutions apparently had become less exposed than in the past to diversions in savings flows in response to higher market rates of interest, mainly reflecting a lengthening in the maturity structure of their liabilities.

A few members viewed the staff projection of moderate growth in real consumer spending as optimistic. One of these expressed doubt that purchases of new automobiles would increase further from the advanced rate of the past year or so. Another observed that expansion in disposable income was likely to fall short of that required to validate the projection, especially if, as widely expected, the savings rate recovered from the reduced levels of recent quarters.

Some members expressed doubt about the expansion in exports projected for the year ahead, which was large enough in real terms to offset the projected rise in imports; thus they viewed the foreign trade sector as a source of weakness in prospects for growth in total real GNP. Concern was also expressed that at some point continuation of a large current-account deficit could have adverse psychological effects in exchange markets, although it was recognized that the deficit could be financed without repercussions—especially if relative interest rates remained favorable and price performance in the United States did not deteriorate. One member suggested that even if interest rate relationships were not especially favorable, capital might still flow in because of improving profits of U.S. enterprises.

It was suggested that the performance of prices could be some-

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what better than that portrayed by the staff projection. Specifically, it was thought that further improvement in supplies of foodstuffs might result in continued downward pressure on prices, and that worldwide demands for industrial raw materials were unlikely to be strong enough to drive their prices up to any significant degree. It was also noted, however, that the underlying rate of inflation remained high and that the rate of increase in unit labor costs in the private business sector of the economy was unlikely to be reduced in the coming year. One member indicated concern about the structural inflation that appeared to have a life of its own; he referred specifically to the increase in the salary structure for Federal employees that had taken effect in early October, to recent increases in wage rates in the private sector, to pending legislation raising the minimum wage, and to pressures for import quotas. The judgment was expressed that the administration apparently was not being effective in pursuing its anti-inflation policy.

Finally in the discussion of the economic situation, it was reported that declines in prices of agricultural commodities had led to declines in prices of farmland in a few States for the first time in many years. It was noted, moreover, that banks were finding it necessary to restructure an increasing number of loans to finance agricultural operations because of the farmers' inability to repay them on time.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its July meeting the Committee had specified the following ranges for growth over the period from the second quarter of 1977 to the second quarter of 1978: *M*-1, 4 to 6½ per cent; *M*-2, 7 to 9½ per cent; and *M*-3, 8½ to 11 per cent. The associated range for growth in commercial bank credit was 7 to 10 per cent. The ranges being considered at this meeting were for the period from the third quarter of 1977 to the third quarter of 1978.

In the discussion of the appropriate ranges for growth in the monetary aggregates over the year ahead, it was suggested that the Committee make clear its continuing determination to bring the ranges down gradually to levels compatible with general price stability, while at the same time assuring that growth in the aggregates would be sufficient to facilitate an orderly expansion of economic activity. In such a framework it was further suggested that the Committee indicate that its basic goal was to contribute to the

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satisfactory performance of the economy and that it would not sacrifice or compromise that goal in the interest of seeking to attain pre-determined rates of monetary growth.

In the discussion, attention was drawn to the behavior of the monetary aggregates and to certain developments in financial markets. Specifically, it was noted that over the year from the third quarter of 1976 to the third quarter of 1977 growth in *M*-1 had exceeded by a sizable margin the upper limit of the range that the Committee had set at its meeting in early November 1976, whereas on other recent occasions when the Committee had reconsidered its longer-run ranges it could look back to periods of a year when growth in *M*-1 had fallen within, or below the lower limit of, its range. Growth in *M*-2 and *M*-3 over the year to the third quarter of 1977 also had exceeded the upper limits of the ranges adopted in early November 1976, and growth in all three aggregates over the period had exceeded their longer-run ranges for the first time since the Committee had begun to adopt such ranges. However, it was also noted that, although growth in *M*-1 had been at a faster rate in the first 9 months of 1977 than during 1976, growth in *M*-2 and *M*-3 had been slower; and that *M*-1 had begun to grow rapidly only over the two most recent quarters.

With respect to financial market developments, it was noted that short-term interest rates in general had risen about 200 basis points since the beginning of the year—with a substantial part of that rise having occurred in the third quarter. However, it was pointed out, long-term rates had not changed much on balance since the beginning of the year, although they had increased somewhat in recent weeks. Also, the decline in stock prices was interpreted as signaling that investors were uneasy about the profitability of corporations and about the performance of the economy.

Uncertainty was expressed about the underlying causes of the expansion of the demand for money (narrowly defined) in the second and third quarters and about the implications of that expansion for policy. It was suggested that various changes in financial technology that had been resulting in substitution of income-earning deposits for demand deposits had become less powerful and, consequently, that increasing demands for transactions balances in the latest two quarters had had a greater effect on growth in *M*-1. One member suggested that the demand for money had also been raised recently

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by increased uncertainty of various kinds—about conditions in the job market, about prices of securities, about foreign exchange rates, and about other elements in the economic situation—and that this had contributed to the apparent decline in the income velocity of *M*-1 in the third quarter. In his view, however, the decline in velocity more fundamentally reflected the sluggishness of economic expansion in the third quarter, and a pick-up in the pace of expansion once again might be accompanied by a sharp rise in velocity.

Because of the uncertainty about the underlying causes of the recent expansion in the demand for *M*-1 and about the prospects for its velocity, some members indicated that they now had less confidence in the behavior of the monetary aggregates as guides to monetary policy than they might have had earlier. It was felt, moreover, that those uncertainties made it particularly important to emphasize that the Committee's basic goal was to contribute to the satisfactory performance of the economy rather than to pursue pre-determined rates of monetary growth.

In commenting on the ranges for growth in the monetary aggregates over the period from the third quarter of 1977 to the third quarter of 1978, most members concurred in the view that the objective of continuing the gradual process of bringing the longer-run ranges for growth in the monetary aggregates down to rates compatible with general price stability would best be served at this time by retaining the existing range of 4 to 6½ per cent for *M*-1 and making some reduction in the ranges for *M*-2 and *M*-3. Proposals to achieve the latter included reducing the upper limits of the ranges by ½ of a percentage point, reducing the lower as well as the upper limits by that amount, and reducing both limits by 1 percentage point.

In support of the proposal to make some downward adjustment in the ranges for *M*-2 and *M*-3, several members observed that the rise in short-term interest rates that had already occurred would tend to reduce flows of funds into time and savings deposits (exclusive of money market CD's), so in the period ahead growth in *M*-2 and *M*-3 was likely to slow in relation to growth in *M*-1. However, it was expected that flows into the thrift accounts would still be substantial and would be consonant with the maintenance of a high rate of residential construction activity.

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Several reasons were advanced for retaining the existing range for *M*-1. It was suggested that any change in that range at this time would imply a degree of knowledge that, in view of the changes that were taking place in the demand for money, was not present. The observation was also made that until it became clear that the recent slowing in economic growth would not proceed further, the Committee should avoid making any change in the range for *M*-1 that might be construed as a measure of tightening. One member expressed the view that if changes in financial technology were in fact having less effect on the demand for money than they had for some time, the existing range for *M*-1 now would represent a somewhat more restrictive policy than it had before. And it was suggested that any reduction in the upper limit of the range for *M*-1 following the excessive rates of growth over the past two quarters might be interpreted as implying an aggressive policy for the short run or as implying policy objectives that were not attainable.

Some sentiment was expressed for reducing the upper limit of the range for *M*-1 by ½ of a percentage point. It was suggested that, in view of the magnitude of recent "overshoots" in growth of *M*-1, such a reduction would underscore the System's determination to work gradually toward a rate of growth consistent with general price stability and thus might have a positive effect on economic activity by tending to encourage business and consumer spending.

Two members advocated some widening of the longer-run range for *M*-1 because of uncertainty about changes in the demand for money and, thus, about the income velocity of *M*-1; it was noted that at times in the past the Committee had adopted ranges as wide as 3 percentage points. One of these members expressed the view that even if the rise in velocity picked up again in the period ahead, it was unlikely to be as rapid as it had been earlier, and he recommended raising the upper limit of the range for *M*-1 by ½ of a percentage point. At the same time, he recommended a reduction of a full percentage point in the lower limit of the range. The other member advocated an increase of ½ of a percentage point in the upper limit of the range for *M*-1 and no change in the lower limit; he also advocated a widening of the ranges for *M*-2 and *M*-3.

At the conclusion of its discussion the Committee decided to retain the existing range for *M*-1 and to reduce both the upper and lower limits of the ranges for *M*-2 and *M*-3 by ½ of a percentage

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point. Thus the new ranges, which applied to the period from the third quarter of 1977 to the third quarter of 1978, were 4 to 6½ per cent for *M*-1, 6½ to 9 per cent for *M*-2, and 8 to 10½ per cent for *M*-3. The associated range for growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It was also understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for the year ahead.

The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the third quarter of 1977 to the third quarter of 1978: *M*-1, 4 to 6½ per cent; *M*-2, 6½ to 9 per cent; and *M*-3, 8 to 10½ per cent.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, and Roos. Vote against this action: Mr. Wallich.

Mr. Wallich dissented from this action because—believing that abnormal gains in the income velocity of *M*-1 had come to an end, at least temporarily—he preferred to raise the upper limit of the range for *M*-1 to 7 per cent. At the same time, he would have widened the range by reducing the lower limit to 3 per cent.

As to policy for the period immediately ahead, members of the Committee were in relatively close agreement with respect to their preferences for ranges of growth for the monetary aggregates over the October–November period. Most of them favored ranges of 3 to 8 per cent and 5½ to 9½ per cent for the annual rates of growth in *M*-1 and *M*-2, respectively. A few members indicated that slightly lower growth ranges would also be acceptable.

Somewhat greater differences of view were expressed concerning the Federal funds rate. A number of members favored directing operations initially toward maintaining the current rate of around 6½ per cent, but some preferred to raise the rate to around 6⅝ per cent and one felt that a prompt move to 6¾ per cent was needed. Differing views were also indicated with regard to the amount of leeway that should be provided in conducting operations during the inter-meeting period as new information became available on the

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performance of the monetary aggregates. The members were agreed that little or no decline in the Federal funds rate should be contemplated under foreseeable circumstances, but views were divided with respect to the upper limit that should be set for the rate; several members recommended a ceiling of 6¾ per cent while others preferred a ceiling of 7 per cent. Some members in favor of the lower ceiling indicated that they would be prepared to accept a higher rate if the performance of the economy and the monetary aggregates during the inter-meeting period differed significantly from their expectations.

A majority of the members were in favor of giving greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting. In that connection some cited the uncertain implications of the growth of the monetary aggregates in recent months. However, a number of members expressed a preference for continuing to have operating decisions in the period ahead based primarily on the behavior of the monetary aggregates; in their view such operations should be adjusted promptly if the aggregates appeared to be deviating significantly from the midpoints of the specified ranges.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintaining prevailing money market conditions, as represented by a weekly-average Federal funds rate of about 6½ per cent. However, the members agreed that if growth in the aggregates should appear to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6¼ to 6¾ per cent. With respect to the annual rates of growth in *M*-1 and *M*-2 over the October–November period, the Committee specified ranges of 3 to 8 per cent and 5½ to 9½ per cent, respectively. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of *M*-1 and *M*-2.

As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

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The following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that growth in real output of goods and services slowed in the third quarter, mainly because of a reduction in the rate of inventory accumulation. In September industrial production expanded, returning to about the level reached in July, and employment increased substantially. The unemployment rate edged down to 6.9 per cent, but remained near the level prevailing since April. The dollar value of total retail sales declined after having risen appreciably in July and August. The wholesale price index for all commodities, which had declined on balance since May, advanced in September; average prices of farm products and foods changed little following 3 months of sharp decreases, and average prices of industrial commodities rose more than in the immediately preceding months. So far this year the index of average hourly earnings has advanced at about the same pace as it had on the average during 1976.

Pressure on the dollar in foreign exchange markets emerged at the end of September, and the dollar has declined against most major foreign currencies and particularly against the Japanese yen. In August the U.S. foreign trade deficit widened; the July–August average was somewhat above the second-quarter rate.

M-1 and *M*-2 expanded somewhat more in September than in August, and increased substantially further in early October. Inflows to banks of time and savings deposits increased little in September from the reduced rate in August, while inflows to nonbank thrift institutions remained strong. Short-term interest rates have risen further in recent weeks, and yields on longer-term market securities have increased.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

Growth of *M*-1, *M*-2, and *M*-3 within ranges of 4 to 6½ per cent, 6½ to 9 per cent, and 8 to 10½ per cent, respectively, from the third quarter of 1977 to the third quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

At this time, the Committee seeks to maintain about the prevailing money market conditions during the period immediately ahead, provided that monetary aggregates appear to be growing at approximately the rates currently expected, which are believed to be on a path reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, the Committee seeks to maintain the weekly-average Federal funds rate at about

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6½ per cent, so long as M-1 and M-2 appear to be growing over the October–November period at annual rates within ranges of 3 to 8 per cent and 5½ to 9½ per cent, respectively. If, giving approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period are approaching or moving beyond the limits of the indicated ranges, the operational objective for the weekly-average Federal funds rate shall be modified in an orderly fashion within a range of 6¼ to 6¾ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Partee, Roos, and Wallich. Vote against this action: Mr. Morris.

Mr. Morris dissented from this action because he was convinced that the Committee should take more aggressive action to curb excessive growth in the monetary aggregates, which in his opinion would not be conducive to a healthy, long-term expansion in the economy. He also believed that short-term interest rates could rise somewhat further without significantly damaging short-term prospects for economic activity.

2. Authorization for Domestic Open Market Operations

Committee members voted to reduce from $3 billion to $2 billion the limit on Federal Reserve Bank holdings of special short-term certificates of indebtedness purchased directly from the Treasury, specified in paragraph 2 of the authorization for domestic open market operations, effective immediately.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

This action was taken on the recommendation of Chairman Burns. On September 30, 1977, when the temporary debt ceiling was due to

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expire at midnight, Committee members had voted to raise the limit on System holdings of directly purchased certificates of indebtedness from $2 billion to $3 billion, and the Treasury had issued a $2.5 billion certificate to the Federal Reserve Bank of New York. The Treasury had retired the certificate on October 4, following approval of legislation increasing the debt ceiling, and the need for the higher limit had passed.

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MEETING HELD ON NOVEMBER 15, 1977

Domestic Policy Directive

The information reviewed at this meeting suggested that growth in real output of goods and services—which had slowed to an annual rate of 3.8 per cent in the third quarter, according to preliminary estimates of the Commerce Department—was picking up in the current quarter. At the same time the rise in average prices, as measured by the fixed-weighted price index for gross domestic business product, appeared to be stepping up somewhat from the annual rate of 5.2 per cent estimated for the third quarter. Staff projections suggested that growth in real GNP would continue at a moderate, although gradually diminishing, pace throughout 1978. It was also expected that the rate of increase in prices would remain high.

The staff estimate of a pick-up in growth of real GNP in the current quarter was attributable to expectations of accelerated expansion in final sales of goods and services, reflecting indications of renewed strength in consumer spending for both durable and nondurable goods, in business fixed investment, and in residential construction. It was anticipated that business inventory accumulation would remain near the rate of the second and third quarters.

The staff projections of growth in real GNP during the year ahead reflected expectations that the expansion in business capital outlays would be sustained; that growth in consumer spending would remain moderate; that increases in State and local government purchases of goods and services would continue to be sizable; that the expansion in residential construction activity would taper off as the period progressed; and that the rise in Federal purchases of goods and services would be smaller than over the past year. The projections implied a gradual further decline in the unemployment rate over the year ahead.

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In October industrial production expanded 0.3 per cent, almost the same as in September, owing in part to an increase in automobile assemblies and to a large rise in coal output after the striking miners had returned to work. Capacity utilization in manufacturing was estimated to have remained at about 83 per cent; in both the materials-producing and the advanced processing industries, utilization rates were close to their levels in the second and third quarters. For the former group of industries, the rate was about 10 percentage points below the high reached in the preceding period of business expansion.

Total nonfarm payroll employment expanded in October, although by considerably less than in September. Growth in employment in the service-producing industries slowed; in manufacturing both employment and the length of the average workweek of production workers changed little. Total employment, as measured by the survey of households, also increased less than in September, and the unemployment rate edged up from 6.9 to 7.0 per cent. From April through October the unemployment rate had fluctuated between 6.9 and 7.1 per cent.

The pace of expansion in wage and salary disbursements and in total personal income picked up in September, the latest month for which data were available. In the third quarter as a whole, the gain in total personal income in current dollars was less than that in the first two quarters of 1977, but in real terms it was about equal to the average gain in the first two quarters.

The dollar value of retail sales had risen 1.8 per cent in October, according to the advance report. Moreover, sales estimates for August and September were revised upward substantially—resulting in an increase of 1.5 per cent from the second to the third quarter, rather than the 0.3 per cent that had been reported earlier.

Unit sales of new autos—domestic and foreign models—rose about 5 per cent in October, after having declined more than 10 per cent in September. At an annual rate of 10.9 million units, the level of sales in October was the same as in the third quarter but somewhat less than in the second quarter.

Private housing starts were at an annual rate of slightly more than 2 million units in September, virtually unchanged from August. For the third quarter as a whole, starts were almost 8 per cent more than for the second quarter and at the highest level since

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1973. Nearly three-fourths of the gain in the third quarter was accounted for by starts of multifamily units.

The latest Department of Commerce survey of business plans, taken in late July and August and published in early September, suggested that spending for plant and equipment would be 13.3 per cent greater in 1977 than in 1976 and that the expansion in spending would be somewhat less in the second half of the year than in the first half. Private surveys suggested a somewhat smaller increase in capital outlays in 1978 than in 1977.

Manufacturers' new orders for nondefense capital goods advanced sharply in September, bringing the total for the third quarter up to the second-quarter level. The machinery component of such orders—generally a better indicator of underlying trends in demand for business equipment—expanded about 5 per cent in the third quarter. At the same time contract awards for commercial and industrial buildings—measured in terms of floor space—rose about 10 per cent to a level 30 per cent higher than in the third quarter of 1976.

The index of average hourly earnings for private nonfarm production workers advanced at a fast pace in October. The rate of increase over the first 10 months of the year was about 8 per cent, compared with a rise of about 7 per cent over the 12 months of 1976.

The wholesale price index for all commodities, which had turned up in September after 3 months of little change, rose sharply in October. Average prices of farm products and foods advanced appreciably, after having declined over the preceding 4 months. The rise in average prices of industrial commodities in October was a little less than in September but about equal to the rate of increase over the past year.

In September the consumer price index rose at an annual rate of about 4 per cent, the same as over the preceding 2 months but considerably less than during the first half of 1977. From June to September retail prices of foods increased only about 0.4 per cent, in contrast with a rise of nearly 7 per cent over the first 6 months of the year. The rise in average prices of commodities other than foods and of services also slowed during the third quarter.

The trade-weighted value of the dollar—which had declined about 1½ per cent from late September to mid-October—

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depreciated about 1 per cent further over the period to mid-November, reflecting mainly appreciation of the Japanese yen, of the Swiss franc, and of the U.K. pound. Over the period, moreover, foreign central banks purchased a substantial amount of dollars, even though on October 31 the U.K. authorities allowed the pound to float upward. The downward pressure on the dollar was associated with continuing concern about the deficit in the U.S. current account, especially as compared with the surpluses in the current accounts of several other industrial countries.

The U.S. foreign trade deficit declined somewhat in September, reflecting a sharp increase in exports that was attributable in large part to temporary factors—specifically, anticipation of the strike by longshoremen that began on October 1 and a rebound in shipments of coal from a strike-depressed level in August. For the third quarter as a whole, the deficit was about the same as for the second quarter.

At U.S. commercial banks, growth in total credit accelerated in October from the relatively slow pace recorded in September. The pick-up reflected a vigorous expansion in bank lending that was offset only in part by a further reduction in holdings of Treasury securities.

Growth in business loans at banks was especially strong in October, following little change in September. To some extent the monthly changes appeared to reflect a shift in the seasonal pattern that had not yet been captured in adjustment factors; the average increase over the 2 months represented a continuation of relatively strong growth. The outstanding volume of commercial paper issued by nonfinancial corporations declined in October by the same amount that it had in September. Nevertheless, business credit expansion through these two sources was brisk over the 2-month period.

Growth in the narrowly defined money stock (*M*-1) accelerated in October to an annual rate of 12 per cent. However, data for early November suggested a sharp slowing of growth.

Growth in *M*-2 also picked up during October and then slowed again in early November. In October expansion in the total of interest-bearing deposits included in *M*-2 was maintained at about its September pace, although the key components of this total showed divergent changes. Inflows of savings deposits to banks

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slowed appreciably as yields on competitive market securities rose further above the ceiling rate on savings deposits, and the rate of expansion in small-denomination time deposits changed little. However, the rate of expansion accelerated for nonnegotiable, large-denomination time deposits, which are not subject to interest rate ceilings. In association with the increase in loan demand, banks also expanded the outstanding volume of negotiable, large-denomination CD's (not included in *M*-2) by the largest amount for any month in nearly 3 years.

Growth in *M*-3 changed little in October. Inflows of funds to nonbank thrift institutions slowed somewhat from the strong pace of the preceding 2 months, offsetting the effect on *M*-3 of the acceleration of the expansion in *M*-1.

At its October meeting the Committee had decided that operations in the period immediately ahead should be directed toward maintaining about the prevailing money market conditions, as represented by a weekly-average Federal funds rate of 6½ per cent, provided that *M*-1 and *M*-2 appeared to be growing over the October–November period at annual rates within ranges of 3 to 8 and 5½ to 9½ per cent, respectively. However, the members also had agreed that if growth in the aggregates appeared to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6¼ to 6¾ per cent.

Immediately following the meeting, incoming data had suggested that over the October–November period *M*-1 and *M*-2 would grow at rates within their specified ranges. Accordingly, the Manager of the System Open Market Account sought to maintain the Federal funds rate at around 6½ per cent. In late October, however, additional data suggested that *M*-1 and *M*-2 were growing at rates approaching or moving beyond the upper limits of their ranges. Therefore, the Manager sought a slight firming in the funds rate. Still later, available data again suggested that growth in both aggregates would be within the ranges; hence the Manager's objective for the funds rate was returned to 6½ per cent. During the inter-meeting period the funds rate generally fluctuated between 6½ and 6⅝ per cent, and it was at the lower rate in the last few business days before this meeting of the Committee.

Fluctuations in other market interest rates were larger than those

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in the funds rate, owing chiefly to changes in the perceptions of market professionals concerning the probable course of monetary policy. But on balance over the period, changes in interest rates were quite small; short- and medium-term rates generally declined a little, and changes in bond yields were mixed. In late October most large commercial banks raised the rate on loans to prime business borrowers from 7½ to 7¾ per cent. A few major banks, located chiefly on the west coast, held their prime rate at 7½ per cent.

On October 25 the Board of Governors announced its approval of actions by directors of all 12 Federal Reserve Banks raising the discount rate from 5¾ to 6 per cent, effective October 26. In announcing the approval, the Board stated that the action was taken in recognition of increases that had occurred in other short-term interest rates and that it would bring the discount rate into closer alignment with short-term rates generally. The Board also stated that the increase would reduce the incentive for member banks to borrow from the Federal Reserve. Member bank borrowing had increased to a daily average of more than $1.8 billion during the week ending October 19, compared with an average of $337 million 5 weeks earlier. In the week ending November 9, daily-average borrowings were down to $887 million.

Major indexes of stock prices declined to new lows for 1977 during the initial weeks of the inter-meeting period, but then rallied in early November. At the time of the November meeting the indexes were about 5 per cent above their 1977 lows.

In November, in connection with its quarterly refinancing, the U.S. Treasury refunded $2.4 billion of maturing debt held by the public; sold $4.1 billion of additional securities to the general public for cash; and sold $700 million of new securities directly to foreign central banks for cash. Securities issued to the public in this operation included $3.3 billion of 3-year notes, sold at an average yield of 7.24 per cent; $2.0 billion of 10-year notes, sold at an average yield of 7.69 per cent; and $1.3 billion of 30-year bonds, sold at an average yield of 7.94 per cent. At the time that plans for the November refinancing were announced, the Treasury reported that its cash-borrowing needs in the fourth quarter were expected to total $18¾ billion.

Gross public bond offerings by nonfinancial corporations de-

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clined in October. However, the total volume of new corporate bond issues was sustained by unusually large offerings by financial firms, including several large issues of mortgage-backed bonds.

In October the volume of mortgage lending apparently remained close to its unprecedented third-quarter pace. The increase in mortgage loans at commercial banks was almost as large as the record monthly-average gain in the third quarter; and net acquisitions of mortgage loans at savings and loan associations were probably about maintained, even though inflows of deposits to these institutions slowed somewhat. Outstanding mortgage commitments of the associations had risen to a record level at the end of September, and in October these institutions increased their reliance on borrowings from the Federal home loan banks and on the sale of mortgage-backed bonds. Between mid-October and mid-November the average interest rate on new commitments for conventional home mortgages at savings and loan associations changed little.

In the Committee's discussion of the economic situation, the members agreed that the staff projections—suggesting that growth in real GNP would continue at a moderate, although gradually diminishing, pace throughout 1978—were reasonable. There were, however, some shadings of view about prospects for the economy.

Two members suggested that the outlook was potentially stronger than that implied by the staff's projections. One of these members remarked that some of the uncertainties that had plagued this business expansion were being cleared up. In his judgment a reasonably good fourth quarter, which he was inclined to expect, could have a favorable influence on business and consumer attitudes; and that development, in turn, could affect business activity in 1978. The other member observed that there was a real possibility that 1978 would prove to be a very good year, particularly if administration statements were of a kind that tended to strengthen business confidence. In a related comment, another member observed that business decisions were being influenced by uncertainty generated not only by Federal tax and energy policies but also by expectations of further inflation.

Two members expressed the view that while the staff projections were not unreasonable, any deviations from them were more likely to be in the direction of shortfalls than of overshoots—particularly

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in the latter part of the projection period. One of these members remarked that economic policy-makers, including the Federal Reserve, would need to act if any marked slowing in the rate of economic growth appeared likely to develop. However, in his judgment it was too early to reach such a conclusion. In this connection, he noted that there seemed to have been a general tendency among economic forecasters in recent years to underestimate growth rates by progressively larger amounts for more distant periods. The other member who thought the staff's projections were on the high side of the range of possibilities observed that there was ample time for new developments to lead to improved prospects for the second half of 1978. At the moment, however, he did not find such developments to be clearly in prospect.

It was noted during the discussion that, according to projections of the Federal budget on a "high employment" basis, fiscal policy would move from a highly stimulative stance in the second half of 1977 to approximate neutrality by the end of 1978, unless some new fiscal initiatives were undertaken. It was also noted that sustained growth in spending by State and local governments was likely to contribute to the strength of the expansion, but that the foreign trade sector would probably be a source of weakness.

It was suggested that prospects for business capital spending were a key element in the economic outlook. One member observed that the underlying need for additions to capacity might soon have an increasing impact on spending for plant and equipment—a greater impact than implied by the recent private surveys of business spending plans—especially if proposals for reductions in taxes should prove to be reasonable and if business confidence should improve. Another member remarked that enough time had elapsed since the culmination of the recession in early 1975 for businessmen to conclude that profit opportunities had been neglected and for them to become more willing to take risks on longer-term commitments. This member added, however, that he expected uncertainties to persist throughout 1978, in part because of a bulge in the rate of inflation early in the year that in his opinion would be produced mainly by recent and prospective Federal legislation.

Other comments about the outlook included the observation by

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one member that the rate of economic growth projected by the staff for late 1978, although somewhat below the rates projected for earlier in the year, was still quite satisfactory. Another member remarked that he expected the growth rate to be lower in the first quarter of 1978 and higher in the second quarter than the staff's projections suggested. In his judgment it was too early to arrive at any firm view about prospects for the second half of next year.

At its October meeting the Committee had agreed that from the third quarter of 1977 to the third quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4 to 6½ per cent; *M*-2, 6½ to 9 per cent; and *M*-3, 8 to 10½ per cent. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In the discussion of policy for the period immediately ahead, members noted that growth in the monetary aggregates appeared to be slowing sharply in November. It was observed that for a number of reasons growth rates for December were particularly difficult to project, but even if they also proved to be low, two consecutive months of slow growth would be acceptable in view of the rapid monetary expansion of recent months. The comment was made that the sharp slowing in early November suggested that the aggregates might grow at reasonably satisfactory rates over the November–December period, assuming continuation of a Federal funds rate at about its current level. Many members indicated that they would like to maintain stable conditions in the money market for a time and that they were willing to accept a rate of growth in *M*-1 over the November–December period within a somewhat wider range than usual, encompassing relatively low growth.

Most members expressed a preference for continuing to give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting of the Committee. However, a number of members were in favor of basing operating decisions primarily on the behavior of the monetary aggregates.

The members did not differ greatly in their preferences for

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operating specifications for the period immediately ahead. Most members favored a range of 1 to 6 or 1 to 7 per cent for the annual rate of growth in *M*-1 over the November–December period and a range of 5 to 9 per cent, or a slightly lower one, for growth in *M*-2. With respect to *M*-1, some sentiment was also expressed for a range of 2 to 7 per cent. And one member suggested a range of 2½ to 7½ per cent because he was concerned that the velocity of *M*-1 would not tend to increase so much in the period ahead as he thought was implied by the lower range.

With respect to the Federal funds rate, almost all members favored an operating range of 6¼ to 6¾ per cent for the period until the next meeting. However, one member who preferred to base decisions for operations primarily on the behavior of the monetary aggregates suggested a wider range, one of 6 to 7 per cent.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintenance of prevailing money market conditions, as represented by the current level of the Federal funds rate. However, the members agreed that if growth in the aggregates should appear to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6¼ to 6¾ per cent. With respect to the annual rates of growth in *M*-1 and *M*-2 over the November–December period, the Committee specified ranges of 1 to 7 per cent and 5 to 9 per cent, respectively. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of *M*-1 and *M*-2.

As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that growth in real output of goods and services is picking up in the current quarter from the reduced pace in the third quarter. The dollar value of total retail sales, which had been unchanged in September, rose substan-

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tially in October. Industrial production and employment increased somewhat. The unemployment rate, at 7.0 per cent, remained in the narrow range prevailing since April. The wholesale price index for all commodities rose sharply in October, as average prices of farm products and foods increased after having declined appreciably over the preceding 4 months. Prices of industrial commodities rose at about the average rate of the preceding 12 months. The index of average hourly earnings increased sharply in September and has advanced at a somewhat faster pace so far this year than it had on the average during 1976.

The trade-weighted value of the dollar against major foreign currencies has declined further since mid-October. In September the U.S. foreign trade deficit was reduced somewhat, in part as a result of temporary factors.

M-1 and *M*-2 increased substantially in October, but growth slowed sharply in early November. In October inflows to banks of the total of savings deposits and small-denomination time deposits fell off, but banks expanded the outstanding volume of large-denomination CD's substantially as credit demands strengthened. Inflows to nonbank thrift institutions slowed somewhat in October from the strong pace of the preceding 2 months. Following a substantial rise in member bank borrowings, Federal Reserve discount rates were increased from 5¾ to 6 per cent in late October. Market interest rates have fluctuated moderately since mid-October and most recently have tended to decline.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

At its meeting on October 18, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4 to 6½ per cent, 6½ to 9 per cent, and 8 to 10½ per cent, respectively, from the third quarter of 1977 to the third quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

At this time, the Committee seeks to maintain about the prevailing money market conditions during the period immediately ahead, provided that monetary aggregates appear to be growing at approximately the rates currently expected, which are believed to be on a path reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, the Committee seeks to maintain the weekly-average Federal funds rate at about the current level, so long as *M*-1 and *M*-2 appear to be growing over the November–December period at annual rates within ranges of 1 to 7 per cent and 5 to 9 per cent, respectively. If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth

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rates over the 2-month period are approaching or moving beyond the limits of the indicated ranges, the operational objective for the weekly-average Federal funds rate shall be modified in an orderly fashion within a range of 6¼ to 6¾ per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

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MEETING HELD ON DECEMBER 19–20, 1977

1. Domestic Policy Directive

The information reviewed at this meeting suggested that real output of goods and services was growing in the current quarter at about the third-quarter pace, which the Commerce Department had revised upward appreciably to an annual rate of 4.7 per cent. At the same time the rise in average prices, as measured by the fixed-weighted price index for gross domestic business product, appeared to be stepping up somewhat from an annual rate of 5.1 per cent estimated for the third quarter. Staff projections for the year ahead, which were based on assumptions that did not include reductions in Federal income taxes, differed little from those prepared just before the November meeting of the Committee; they suggested that real GNP would continue to grow at a moderate, although gradually diminishing, pace throughout 1978. It was also expected that the rate of increase in prices would remain high and that the unemployment rate would decline gradually.

The staff estimate of continued growth of real GNP in the current quarter at about the third-quarter pace was attributable to expectations of substantially greater expansion in final sales of goods and services in combination with a decline in the rate of business inventory accumulation. With respect to final sales, there were indications of considerable strength in consumer spending for both durable and nondurable goods and in residential construction. It was anticipated, moreover, that growth in business fixed investment would pick up from the reduced rate in the third quarter.

The staff projections for the year ahead reflected expectations that, in real terms, the expansion in business capital outlays would be relatively strong; the growth in consumer spending would remain moderate; the increases in State and local government purchases of goods and services would continue to be sizable; the expansion in residential construction activity would taper off as the period

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progressed; and the rise in Federal purchases of goods and services would be smaller than over the past year.

In November industrial production expanded 0.5 per cent, compared with 0.3 per cent in October and 0.4 per cent in September. Increases in output were widespread in November, but automobile assemblies were reduced. Capacity utilization in manufacturing was estimated to have remained at about 83 per cent; in both the materials-producing and the advanced processing industries, utilization rates were close to their levels in the second and third quarters. For the materials-producing industries, the rate was about 10 percentage points below the high reached in the previous period of business expansion.

Nonfarm payroll employment rose substantially in November. In particular, gains were large in services and finance, trade, and State and local government. Employment in manufacturing advanced moderately, and the average workweek edged up further to 40.5 hours, the same as in June. The increase in total employment, as measured by the survey of households, was particularly large. The rise in the civilian labor force also was substantial, however, and the unemployment rate, at 6.9 per cent, remained in the narrow range prevailing since April.

The pace of expansion in personal income had increased sharply to an annual rate of more than 16 per cent in October and then slowed to a rate of about 11 per cent in November, according to statistics released since the Committee's meeting in mid-November. In October growth in wage and salary payments had been augmented by raises in pay for Federal civilian and military personnel. Farm income—bolstered by increased price supports for grains and sugar—advanced in both October and November, after having declined for a half year.

The dollar value of retail sales had risen 1.5 per cent in November according to the advance report. Moreover, the estimate of sales for October had been revised upward substantially and was 2.7 per cent above the September level. As a consequence, the average for the first 2 months of the fourth quarter was up almost 4 per cent from the monthly average for the third quarter. Increases in total sales from one quarter to the next had not been that large since the fourth quarter of 1976.

Although the total value of retail sales advanced in November,

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Federal Reserve Bank of St. Louis

unit sales of new domestic and foreign autos declined about 5 per cent. Unit sales appeared to have been trending downward since spring. In October and November the average rate was nearly 10 per cent below that in the second quarter.

Private housing starts rose substantially in October to an annual rate of more than 2.2 million units—the highest monthly rate since the current upswing began in early 1975—and then edged down in November to a rate of about 2.1 million units. The average for the 2 months was 5 per cent higher than that for the third quarter.

The latest Department of Commerce survey of business spending plans, taken in late October and November, suggested that spending for plant and equipment would expand at an annual rate of 5.8 per cent in the fourth quarter of 1977 and at rates of 11.4 and 10.2 per cent in the first and second quarters of 1978, respectively. The survey also indicated that such spending would be 13.7 per cent greater in 1977 as a whole than in 1976; the preceding survey of the Department of Commerce had indicated a year-to-year gain of 13.3 per cent.

Manufacturers' new orders for nondefense capital goods, which had advanced sharply in September, increased somewhat further in October to a level 8½ per cent above the monthly average for the third quarter. Contract awards for commercial and industrial buildings—measured in terms of floor space—in October were close to the average for the third quarter, which was up about 10 per cent from the average for the preceding quarter and 30 per cent from that for the third quarter of 1976.

The index of average hourly earnings for private nonfarm production workers increased relatively little in November following a sharp rise in October. The rate of increase over the first 11 months of 1977 was about 7½ per cent, compared with a rise of about 7 per cent over the 12 months of 1976.

The wholesale price index for all commodities rose sharply in November for the second successive month. Average prices of farm products and foods, which had advanced 1.3 per cent in October, increased 2.3 per cent further to a level 4.8 per cent higher than in November 1976. For industrial commodities, the rise slowed to 0.4 per cent from 0.6 per cent in October and 0.8 per cent in September. Over the 12 months ending in November, the increase in the industrial commodity average was 6.5 per cent.

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Federal Reserve Bank of St. Louis

The consumer price index rose 0.3 per cent in October, marking the fourth consecutive month of moderate increases. From June to October retail prices of foods advanced only about 0.5 per cent, in contrast with a rise of nearly 7 per cent over the first 6 months of the year. The rise in average prices of commodities other than foods continued in October at about the reduced pace of the third quarter, and the advance in prices of services slowed somewhat.

The dollar had been under considerable selling pressure in foreign exchange markets throughout the inter-meeting period, and its trade-weighted value had declined more than 3 per cent further even though central banks purchased a substantial amount of dollars. All major currencies rose against the dollar over the period, and appreciations amounted to 9 per cent for the Swiss franc, 6 per cent for the German mark, and 2 per cent for the Japanese yen. The persistent pressure on the dollar reflected uncertainty about U.S. economic policies, especially with respect to energy, as well as continuing concern in the markets about the deficit in U.S. foreign trade and about the weakness in economic activity in other industrial countries relative to that in the United States.

The U.S. foreign trade deficit increased sharply in October. However, the widening of the deficit was attributable to the 2-month dock strike that was terminated at the end of November. Because of statistical procedures, the strike depressed recorded exports more than recorded imports.

At U.S. commercial banks, expansion of total credit in November was close to the fast pace in October. Bank loans continued to grow at a rapid rate, and the strength was broadly distributed among major loan categories. As in October, banks reduced their holdings of Treasury securities somewhat more than they added to their holdings of other securities.

Commercial banks in the aggregate financed the November increase in loans entirely through managed liabilities. Negotiable CD's at weekly reporting member banks increased $4.5 billion over the month, and other large time deposits not subject to rate ceilings expanded $5.0 billion. The total increase of $9.5 billion for the month was a record for large-denomination time deposits.

The narrowly defined money stock (*M*-1) contracted slightly in November, following a large increase in October. For October and November combined, growth in *M*-1 was at an annual rate of 5 per

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Federal Reserve Bank of St. Louis

cent, and for the 11 months ending with November, it was at an annual rate of about 7¼ per cent.

Growth in *M*-2 slowed to an annual rate of 4½ per cent in November. The increase in the interest-bearing component was concentrated in the large-denomination time deposits that are not subject to interest rate ceilings. The total of savings deposits and small-denomination time deposits, which are subject to rate ceilings, declined slightly. Throughout November rate ceilings on all but the longest maturities of bank time accounts were significantly below the yields available on competing market securities. Over the first 11 months of 1977, *M*-2 grew at an annual rate of about 9¼ per cent.

At nonbank thrift institutions, inflows of funds slowed further in November. Growth in *M*-3 was reduced to an annual rate of about 7¼ per cent, from 12½ per cent in October. Over the first 11 months of the year *M*-3 grew at an annual rate of about 11¼ per cent.

At its November meeting the Committee had decided that operations in the period immediatey ahead should be directed toward maintaining about the prevailing money market conditions, provided that monetary aggregates appeared to be growing at approximately the rates then expected. Specifically, the Committee sought to maintain the weekly-average Federal funds rate at about its current level—which was 6½ per cent—so long as *M*-1 and *M*-2 appeared to be growing over the November–December period at annual rates within ranges of 1 to 7 per cent and 5 to 9 per cent, respectively. However, the members also had agreed that if growth in the aggregates appeared to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6¼ to 6¾ per cent.

Throughout the period between the November and December meetings, incoming data suggested that growth in *M*-1 and *M*-2 would be well within the ranges that had been specified by the Committee. Accordingly, the Manager of the System Open Market Account sought to maintain reserve conditions consistent with a Federal funds rate of 6½ per cent.

In association with the stability in the Federal funds rate, short-term market interest rates changed little during the inter-meeting period, although a minor realignment in relationships occurred. Rates on Treasury bills declined, reflecting in large part substantial

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foreign purchases of such securities, while yields on private short-term instruments edged up. Rates on longer-term securities rose somewhat during the period.

The U.S. Treasury raised $10.2 billion of new money during the inter-meeting period, including $1.3 billion in its regular weekly bill auctions, $3.0 billion through 139-day, cash-management bills, and $5.9 billion through 1-year bills and 2- and 4-year notes. Moreover, the Treasury planned to auction $3 billion of 2-year notes on the Wednesday after this meeting and $1.5 billion of 15-year bonds in the following week.

Gross public offerings of corporate bonds in November were close to the October volume, and private placements of bonds were estimated to have remained large. Total gross issues of corporate securities increased as stock offerings—primarily by public utility firms—reached the highest level in nearly 2 years.

Gross offerings of new bonds by State and local governments declined somewhat more than seasonally in November. Advance refundings accounted for about one-fifth of the November total—the same proportion that had prevailed during the first 10 months of the year—although the volume was apparently reduced by a Treasury announcement on November 5 of an intention to issue new regulations restricting certain types of advance refunding issues. Demands for municipal securities continued to be strong from commercial banks, from property-casualty insurance companies, and from individuals through municipal bond investment companies.

The volume of mortgage lending in November apparently remained near the record pace of other recent months. The increase in mortgage loans at commercial banks was larger than in October and near the high monthly-average gain in the third quarter. Outstanding mortgage commitments at savings and loan associations rose to a new record in October. In November these institutions apparently maintained a high level of mortgage lending activity, and they continued to float additional issues of mortgage-backed bonds and to increase their borrowings from the Federal home loan banks. By month-end, outstanding advances from those banks had reached their highest level since early 1975. The average interest rate on new commitments for conventional home mortgages at savings and loan associations changed little in late November and early December.

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In the Committee's discussion of the economic situation, the members were in agreement that the expansion in activity was likely to continue throughout the year ahead. A number of members expressed the view that growth in real GNP during 1978 would be as strong as or stronger than that suggested by the staff projections. Other members foresaw substantial strength for the period immediately ahead—in response to the recent pick-up in final sales and consequent adjustment of inventory positions—but less strength later in 1978. It was noted, however, that the administration was planning to propose a substantial reduction in taxes on individual and business incomes in the new year, and that such reductions—depending upon their nature and timing—could have a significant effect on the course of activity.

Although the prospective reductions in taxes were seen as supportive of the rate of expansion in over-all activity, there was some concern about their implications for the mix of policies affecting aggregate demand and, consequently, for business fixed investment over the longer term. It was observed that long-term interest rates were relatively low, after allowing for the prevailing rate of increase in prices; but it was also observed that enlarged deficits in the Federal budget might be accompanied by increases in interest rates as the year progressed. It was suggested, moreover, that the rate of inflation could prove to be higher than expected and could, therefore, hamper the progress of the expansion.

As at other recent meetings, members expressed different assessments of the outlook for business capital spending. A few felt that expansion in such spending would be at least as strong as suggested by the staff projections—which, in turn, were stronger than implied by the surveys of expenditures for the early part of 1978. One of these members suggested that, in a variety of ways, the recent decline in the value of the dollar against other major currencies had increased the attractiveness of investment in industrial facilities in the United States. On the other hand, some members felt that the staff projections of capital outlays were on the optimistic side. In the opinion of one of these, manufacturers had been able to achieve new efficiencies in their production facilities, which added significantly to capacity without requiring large expenditures for additional structures.

With respect to the housing market, it was suggested that a

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number of forces were at work that might make activity in 1978 fall short of the rates projected by the staff. On the other hand, the thought was expressed that demands might continue to be buoyed by consumer perceptions of homeownership as an effective hedge against inflation.

One member suggested that the expansion in residential construction activity had been sustained at a fast pace, despite the high and rising prices for housing, by such temporary influences as the rapid increase in homeowners' equity and a backlog of demands accumulated earlier during a period of reduced construction activity, whose force might now be spent; consequently, demands for housing in the period ahead might be more closely related to such fundamental factors as family formation and growth in disposable income. It was suggested also that construction activity in some areas might be impeded by elements of the Government's energy program and by moratoria on new hook-ups for utilities, although building activity in the inner cities might be stimulated.

A few members expressed doubts that the demand for automobiles would measure up to the staff projections, which suggested that sales would be sustained in 1978 at about the fast pace of 1977. The observation was made that sizable cutbacks in assemblies, should they be made necessary by slippage in sales, might not be effected until the spring. It was also suggested, however, that some decline in the rate of sales was a reasonable expectation and, in view of the excessive expansion in consumer credit recently, a welcome development.

In commenting on unemployment, one member questioned whether the over-all rate might not be about as low as could be expected, given the rapid growth in the labor force. He suggested that the high rate of unemployment was a structural problem that could not be solved with monetary policy instruments; in his view, growth in real GNP at any rate above the longer-run average would be satisfactory. Another member observed that a particularly troublesome aspect of the situation was that the large increase in employment during the current business expansion had not lowered the unemployment rate for blacks, especially for black teenagers. It was observed that the increase in the minimum wage that would become effective at the beginning of the new year would contribute to that problem, and it was suggested that in the coming year serious

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attention might again be given to proposals for a youth differential in the minimum wage.

In the Committee's discussion, serious concern was expressed about the recent weakness of the dollar in foreign exchange markets. While it was noted that depreciation of the dollar might in time contribute to improvement in the U.S. trade balance, it was pointed out that it contributed to the rate of inflation in this country and weakened business confidence both here and abroad. Excessive appreciation of foreign currencies, it was suggested, could have adverse effects on over-all economic activity abroad and, consequently, on the U.S. trade balance. The observation was made that the position of the dollar would be strengthened by adoption in this country of an effective energy program, of a tax policy conducive to business investment here, and of a more effective attack on inflation, as well as by pursuit abroad of faster rates of economic growth.

At its October meeting the Committee had agreed that from the third quarter of 1977 to the third quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: *M*-1, 4 to 6½ per cent; *M*-2, 6½ to 9 per cent; and *M*-3, 8 to 10½ per cent. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In the Committee's discussion of policy for the period immediately ahead, the members took note of the slowdown in the growth of the monetary aggregates in recent weeks and of the uncertainties in financial markets usually associated with the year-end. Against that background and in light of the performance of the economy, it was observed that increases in short-term interest rates were probably not warranted at this time. On the other hand, it was suggested, the weakness of the dollar in foreign exchange markets argued against declines in such rates. Accordingly, most members were in favor of the maintenance of prevailing conditions in the money market for the time being and of continuing to give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting of the

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Committee. However, some members indicated a preference for basing operating decisions in the period ahead primarily on the behavior of the monetary aggregates.

The members did not differ greatly in their preferences for ranges of growth for the monetary aggregates over the December–January period. Most of them favored ranges of 2½ to 8½ per cent and 6 to 10 per cent for the annual rates of growth in *M*-1 and *M*-2, respectively. However, there was some sentiment for a slightly lower and some for a slightly higher range for *M*-1. And one member who preferred to base operations on the behavior of the monetary aggregates believed that System operations should be directed toward a firming in money market conditions if it appeared that over the 2-month period *M*-1 would grow at a rate in excess of 6½ per cent.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintenance of prevailing money market conditions, as represented by the current level of the Federal funds rate. However, the members agreed that if growth in the aggregates should appear to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6¼ to 6¾ per cent. With respect to the annual rates of growth in *M*-1 and *M*-2 over the December–January period, the Committee specified ranges of 2½ to 8½ per cent and 6 to 10 per cent, respectively. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of *M*-1 and *M*-2.

The Committee decided to include in the next to last paragraph of its directive to the Federal Reserve Bank of New York the following sentence: "In the conduct of day-to-day operations, account shall be taken of emerging financial market conditions, including the unsettled conditions in foreign exchange markets." This instruction was added to provide the Manager with somewhat greater flexibility, in part because of the Committee's view that pressures on the dollar in foreign exchange markets might appropriately influence the nature and timing of domestic open market operations from day to day.

As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instruc-

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tions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services is growing in the current quarter at about the pace in the third quarter. The dollar value of total retail sales, which had increased sharply in October, rose considerably further in November. Industrial production continued to expand, and employment increased substantially. However, the unemployment rate, at 6.9 per cent, remained in the narrow range prevailing since April. The wholesale price index for all commodities rose sharply in November for the second successive month, reflecting another large increase in average prices of farm products and foods. However, the rise in average prices of industrial commodities was less rapid than in the preceding 2 months. The index of average hourly earnings has advanced at a somewhat faster pace so far this year than it had on the average during 1976.
>
> The dollar has been under considerable pressure in foreign exchange markets in recent weeks, and its trade-weighted value against major foreign currencies has declined more than 3 per cent further since mid-November. In October the U.S. foreign trade deficit widened sharply, primarily as a result of the dock strike at many U.S. ports.
>
> *M*-1—which had expanded substantially in October—declined slightly in November, and *M*-2 increased relatively little. The total of savings deposits and small-denomination time deposits at commercial banks declined somewhat, but growth in large-denomination time deposits accelerated sharply further as credit demands remained strong. Inflows to nonbank thrift institutions slowed further in November. Market interest rates have changed relatively little since mid-November.
>
> In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.
>
> At its meeting on October 18, 1977, the Committee agreed that growth of *M*-1, *M*-2, and *M*-3 within ranges of 4 to 6½ per cent, 6½ to 9 per cent, and 8 to 10½ per cent, respectively, from the third

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quarter of 1977 to the third quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

At this time, the Committee seeks to maintain about the prevailing money market conditions during the period immediately ahead, provided that monetary aggregates appear to be growing at approximately the rates currently expected, which are believed to be on a path reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, the Committee seeks to maintain the weekly-average Federal funds rate at about the current level, so long as *M*-1 and *M*-2 appear to be growing over the December–January period at annual rates within ranges of 2½ to 8½ per cent and 6 to 10 per cent, respectively.

If, giving approximately equal weight to *M*-1 and *M*-2, it appears that growth rates over the 2-month period are approaching or moving beyond the limits of the indicated ranges, the operational objective for the weekly-average Federal funds rate shall be modified in an orderly fashion within a range of 6¼ to 6¾ per cent. In the conduct of day-to-day operations, account shall be taken of emerging financial market conditions, including the unsettled conditions in foreign exchange markets.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, and Wallich. Vote against this action: Mr. Roos.

Mr. Roos dissented from this action because he believed that the upper limit of the December–January range for growth in *M*-1 specified by the Committee allowed for the possibility of too rapid growth in that aggregate, particularly in view of the rate at which it had grown so far this year. In his opinion, growth in *M*-1 over the December–January period at a rate in excess of 6½ per cent would require an excessively restrictive policy later, if the Committee's long-range growth path were to be achieved.

Subsequent to the meeting, on January 9, 1978, the Committee voted to raise the range for the Federal funds rate to 6½ to 7 per

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cent and to instruct the Manager to raise the rate to 6¾ per cent over the next few days. This action was taken upon recommendation of Chairman Burns.

During the preceding 2 weeks the Federal funds rate had averaged a little over 6⅝ per cent, or above the midpoint of the range of 6¼ to 6¾ per cent established at the December meeting. Year-end money market pressures had affected the rate, but most recently the Manager had not discouraged some rise above the midpoint of the range in view of unsettled conditions in foreign exchange markets. Available data had suggested that over the December–January period *M*-1 and *M*-2 would grow at rates within the ranges specified at the December meeting.

On January 6, just before the Chairman recommended this action, the Board of Governors had approved action by directors of two Federal Reserve Banks raising the discount rate from 6 to 6½ per cent. In announcing the increase in the discount rate, the Board had issued the following press release:

"The recent disorder in foreign exchange markets constitutes a threat to orderly expansion of the domestic and international economy. In view of this, the Board of Governors of the Federal Reserve System today approved an increase in the discount rate from 6 per cent to 6½ per cent.

"The Board expressed the hope that the need for the increase will prove temporary. The Board further indicated that the condition of the domestic economy is sound and that credit supplies to sustain economic expansion will remain ample.

"In making the change, the Board acted on requests from directors of the Federal Reserve Banks of New York and Chicago, increasing the discount rates of those Banks to 6½ per cent, effective Monday, January 9. The discount rate is the interest rate that is charged member banks when they borrow from their district Federal Reserve Banks."

On January 9, 1978, the Committee modified the domestic policy directive adopted at its meeting of December 19–20, 1977, by raising the range for the Federal funds rate to 6½ to 7 per cent and by instructing the Manager to raise the rate to 6¾ per cent over the next few days.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Mayo, Roos, and Wal-

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Federal Reserve Bank of St. Louis

lich. Votes against this action: Messrs. Lilly, Morris, and Partee. Absent and not voting: Mr. Jackson.

Messrs. Lilly, Morris, and Partee voted against this action because they did not believe that the performance of the domestic economy justified an increase in interest rates at this time. Mr. Morris believed, in addition, that the proper response to present conditions in the foreign exchange markets was more aggressive intervention, not a higher level of domestic interest rates.

2. Authorization for Foreign Currency Operations

Paragraph 1D of the Committee's authorization for foreign currency operations authorizes the System Open Market Account to maintain an over-all open position in all foreign currencies not exceeding $1.0 billion, unless a larger position is expressly authorized by the Committee. On January 6, 1978, the Committee authorized an increase in the limit to $1.5 billion. The Foreign Currency Subcommittee (consisting of Messrs. Burns, Gardner, Volcker, and Wallich) recommended the increase of $500 million in the limit in view of the recent scale of operations and the continuing unsettled condition of the foreign exchange markets. It was announced on January 4, 1978, that the Exchange Stabilization Fund of the U.S. Treasury would henceforth be utilized actively together with the $20 billion swap network operated by the Federal Reserve System to check speculation and to help re-establish order in the foreign exchange markets.

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Federal Reserve Operations in Foreign Currencies

The Federal Reserve intervened in the New York foreign exchange market occasionally during the first three quarters of 1977, and more actively during the last quarter, to counter disorderly market conditions. The System also operated in the market to acquire foreign currency balances, some of which were used to repay past swap indebtedness. Gross sales by the System of foreign currencies in the exchange market during the year totaled $1,100 million equivalent, and gross purchases totaled $530 million equivalent. In addition to these market transactions, the System also purchased $743 million equivalent of Swiss francs directly from the Swiss National Bank (see note to table on the following page).

Downward pressure on the dollar built up gradually during the year as the U.S. trade and current-account deficits began to widen and as market participants came to expect that these deficits would remain large in 1978. Foreign central banks purchased large amounts of dollars during the year, especially in the fourth quarter when there was a 6 per cent drop in the dollar's trade-weighted average value against 10 major currencies.

During the first three quarters of the year, trading in the New York foreign exchange market was orderly for the most part, with only occasional periods of disorder. During the final quarter, however, markets were frequently disorderly—as evidenced by wide bid–ask spreads with large and abrupt movements of exchange rates.

The Federal Reserve's intervention in exchange markets in 1977 was conducted almost entirely in German marks. The System's gross sales of marks totaled $1,096 million equivalent, $835 million of which was financed by swap drawings on the German Federal Bank with the remainder coming from System balances. The System's gross purchases of marks totaled $410 million equivalent, most of which were bought during the first three quarters for the purpose of accumulating mark balances and to repay a $15 million equivalent swap

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Federal Reserve Bank of St. Louis

drawing on the German Federal Bank that had been outstanding at the beginning of the year and a $35 million equivalent swap drawing made in July.

During the year the Federal Reserve repaid $544 million equivalent on its special Swiss franc swap facility created with the Swiss National Bank in October 1976 to facilitate repayment of swap debts in Swiss francs that had been outstanding since August 1971. The System purchased the required Swiss francs directly from the Swiss National Bank against dollars and other foreign currencies (see note to table) and in the market. These repayments reduced the outstanding Swiss franc swap obligations of the Federal Reserve to $507 million equivalent on December 31, 1977.

The System's outstanding swap debt to the German Federal Bank at the end of 1977 was $800 million equivalent. Consequently, the System's total outstanding swap debt at the end of the year was $1,307 million equivalent, up $241 million equivalent from the amount outstanding at the beginning of the year.

In February 1977 the Bank of Mexico repaid, at maturity, two swap drawings totaling $150 million equivalent that had been made

Federal Reserve purchases and sales (−) of foreign currencies, 1977

Millions of dollars equivalent

Currency	Q1	Q2	Q3	Q4	Year
French francs	18.6	15.1	24.7	22.7	81.1
	−1.1	...	...	...	−1.1
German marks	138.8	114.8	128.0	28.7	410.3
	−46.1	−89.9	−106.2	−853.9	−1,096.1
Netherlands guilders	...	8.5	...	...	8.5
	...	−3.3	...	...	−3.3
Swiss francs	28.9	...	1.7	...	30.6
	...	...	...	...	...
Total	186.3	138.4	154.4	51.4	530.5
	−47.2	−93.2	−106.2	−853.9	−1,100.5

NOTE.—Purchases and sales made directly with foreign central banks are excluded. During 1977 the Federal Reserve purchased $743.2 million equivalent of Swiss francs directly from the Swiss National Bank, using $542.6 million, $114.9 million equivalent of German marks, $85.3 million equivalent of French francs, and $0.4 million equivalent of Netherlands guilders.

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on the Federal Reserve in November 1976. There were no swap drawings on the Federal Reserve by foreign central banks during 1977.

During the year the System had realized losses of $146 million on its foreign exchange transactions. Profits of $5 million associated with transactions entered into during the current year were offset by losses of $151 million related to the repayment of Swiss franc swap debt outstanding since 1971.

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Consumer Affairs

INTRODUCTION

In the field of consumer affairs the Federal Reserve during 1977 strove to increase the flow of benefits to the public from the consumer credit protection laws. The Board of Governors—as the primary source of consumer credit regulation and interpretation—expanded its enforcement and educational programs over the year. At the same time, and as a further means of helping consumers obtain the benefits intended by the Congress, the Board gave major emphasis to simplification of the Truth in Lending Act and the Board's related Regulation Z.

As part of its effort to increase compliance with consumer credit protection laws the Board undertook a wide range of actions in 1977. Because lack of understanding of the requirements of these laws appeared to be a major obstacle to full compliance, the Board instituted a formal advisory program to assist member banks in understanding and complying with this large, complex, and mainly new body of law and regulation.

Enforcement and compliance actions (discussed more fully later in this section) included:

..Adoption of a Systemwide enforcement program (published March 30, 1977) establishing special procedures for determining—through both regular and special examinations—whether banks are meeting the requirements of consumer credit protection laws applicable to banks.

..Development, for the use of examiners, of special consumer credit protection manuals, checklists, instructions, and special examination reports.

..Special examination—at least once yearly at first—of each State member bank, for compliance with consumer credit protection laws applicable to banks.

..Participation in the development, with other Federal regulators of banks, credit unions, and thrift institutions, of uniform guidelines to be applied when violations of Truth in Lending are discovered.

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In October five Federal regulatory agencies (the Board of Governors, the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank Board (FHLBB), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC)), jointly proposed uniform enforcement guidelines. The guidelines, on which the agencies invited public comment, were intended to "promote improved and uniform enforcement of the Truth in Lending Act through corrective action, including reimbursement, for borrowers who have been overcharged or otherwise harmed by violations of the Act." Final action was pending at the year-end.

As part of this effort to encourage a uniform approach to the enforcement by banks of consumer credit protection laws, the Board, the FDIC, and the Office of the Comptroller conducted two joint consumer regulation schools for examiners in 1977 and planned at least one additional session in 1978.

Early in 1977 the Board's Division of Consumer Affairs reorganized its staff in order to handle its expanding responsibilities more effectively. A Compliance Section was established to be responsible for the education of a special corps of consumer credit protection examiners, for development of specialized examination materials and techniques, and for the review of consumer credit protection examination reports.

The Board considers education as a key means of improving general compliance with consumer legislation as it applies to banks. To this end, the enforcement program announced March 30, 1977, included, as one of its main objectives, help for all member banks that want assistance in learning the requirements of these laws and how to comply with them. Under this part of the program, personnel of the Board and of the Reserve Banks made some 700 visits of a day or more to individual banks, to provide instruction in how to comply with consumer credit protection laws and regulations. In all, approximately 900 banks—national as well as State member—received assistance, including reviews of forms used in credit transactions, procedures in extending credit, and a general understanding of their responsibilities under consumer laws applying to bank credit. The response of member banks to this program was extremely favorable, and the Board plans to continue this service.

In another effort to achieve general compliance with consumer

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legislation affecting banks, the Board in 1977 published a number of model forms, which, when properly used, will meet the requirements of the legislation and of the Board's related regulations.

To meet its responsibilities under the Federal Trade Commission Improvement Act, the Board identified several areas of potential difficulty and supplied examiners with a questionnaire to be used during special consumer bank examinations in checking for unfair and deceptive acts or practices by banks. The FDIC and the Comptroller of the Currency also planned to use the questionnaire in the first quarter of 1978 to ascertain the prevalence and significance of such practices among banks under their supervision. It is expected that the information obtained from the questionnaire will help the Board to assist banks in complying with the statute.

To obtain the information needed to review and evaluate its over-all enforcement effort by the end of 1978, the Board developed a computerized program to identify common types of violations, geographical concentrations of violations, and other violation patterns. The Board's enforcement and educational activities are expected to result in enhanced compliance with the consumer credit protection laws.

As a step toward simplification of the first of the consumer credit protection laws—Truth in Lending—the Board prepared a draft bill that was submitted to the Senate Committee on Banking, Housing and Urban Affairs in July. The draft bill, which was prepared at the request of the committee, would simplify the act's requirements for disclosures concerning closed-end credit and would simplify and improve disclosures for open-end credit transactions. The proposed bill would reduce the detail required to be disclosed; summarize important information concerning the terms of transactions, such as whether collateral was given; improve the readability of required information by separating contract terms from other required information and by using everyday language to describe key terms (such as defining "Finance charge" as "The dollar cost of the credit"). The bill also proposed the development of model forms to improve compliance and proposed a series of simplifications of Truth in Lending concepts.

The Board also initiated action on nine simplifying amendments or interpretations of Regulation Z (Truth in Lending) in 1977. Six

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were adopted, and final action on three proposals was pending at the year-end. (These items are discussed in detail later in this section.)

During 1977 the Survey Research Center of the University of Michigan completed—under joint sponsorship of the Board, the FDIC, and the Office of the Comptroller—a survey of consumer opinion and consumer awareness of such key matters as the cost of credit, annual percentage rates, finance charges, and the like. At the year-end a full analysis of the survey results was in preparation. A preliminary and partial analysis appears later in this report. It indicates sharply increased consumer awareness of credit costs since Truth in Lending became law in 1969 but shows that awareness varies with education, race, income status, and the type of credit concerned. It is expected that the survey results will help the Congress and the Board in identifying needs for changes in the consumer credit protection laws and regulations.

Three consumer education pamphlets—of which more than 5 million copies were printed—were distributed by the Board in 1977. They explain the provisions of the Equal Credit Opportunity Act, and of the Board's related Regulation B, against discrimination in credit transactions on the basis of sex and age, and the use of incidental credit by doctors, lawyers, and small retailers. In addition, the Board's Division of Consumer Affairs prepared a speech outline and visual aids for use in explanatory discussions of Equal Credit Opportunity. This material was used extensively by staff from the Reserve Banks who spoke to groups that wanted to know more about Equal Credit Opportunity.

TRUTH IN LENDING

This ninth Annual Report on Truth in Lending (dated January 3, 1978), highlighting the efforts to simplify the disclosure requirements and the encouraging findings of the Consumer Awareness Survey, is submitted to the Congress by the Board of Governors of the Federal Reserve System ("Board"). The report also includes an assessment of the extent to which compliance with the requirements of the act is being achieved and a summary of the Board's administration of its functions under the act. It does not include any recommendations for amendments to the act since the Board submitted comprehensive recommendations during the 1977 Truth in Lending

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Federal Reserve Bank of St. Louis

hearings of the Senate Committee on Banking, Housing and Urban Affairs.

Simplification of Truth in Lending

A great deal of attention has been devoted during the past year to the need for simplification of the requirements of both the Truth in Lending Act and Regulation Z. After an in-depth study, the Board proposed for comment various amendments to simplify and to clarify the current requirements of the regulation. Many of the problems and complexities, however, arise from the statute itself and cannot be resolved through regulatory change. Therefore, the Board in July submitted to the Senate Committee on Banking, Housing and Urban Affairs a draft bill to simplify the closed-end credit disclosures and, subsequently, at the request of the committee, prepared additional recommendations to simplify and to improve disclosures for open-end credit transactions.

The Board's proposal took several different approaches to simplifying requirements under Truth in Lending. First, it reduced the detail of the disclosures and emphasized the important cost disclosures. For example, the components of the finance charge and of the amount financed would not be itemized. Second, the Board recommendation summarized the important information about terms, such as whether the obligation was secured. Third, the recommendation improved the method of delivering the information to consumers by requiring it to be segregated from contract terms and from other information required to be disclosed by State or Federal laws. Everyday language would be used to describe the cost information, for example, "FINANCE CHARGE (This is the dollar cost of the credit)," and the Board would publish model forms and clauses that, if properly completed, would insulate creditors from civil liability under the act. Finally, the proposal contained a series of amendments to simplify some of the concepts and to clear up various technical ambiguities that have arisen since the late 1960's.

The Board's proposal complemented several other Truth in Lending bills that limited private civil actions to the failure to disclose important credit terms, increased agency enforcement powers, and made other improvements. Many of the Board's recommendations are contained in the committee print under consideration by the Senate Committee on Banking, Housing and Urban Affairs.

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New information on effectiveness

During the past year, one major survey and a lesser investigation have been undertaken in an effort to learn more about credit use and consumer needs, as well as to provide helpful information about consumer awareness and the use of existing consumer credit legislation.

Consumer awareness survey. A survey of consumer opinion was conducted in the summer of 1977 by the Survey Research Center of the University of Michigan under the joint sponsorship of the Board, the Federal Deposit Insurance Corporation (FDIC), and the Comptroller of the Currency. Preliminary analysis of the results of this survey,[1] when compared with two earlier surveys conducted for the Board by Chilton Research[2] in 1969 and 1970, indicates that Truth in Lending has contributed significantly to increased consumer awareness of credit costs, including annual percentage rates charged on various types of consumer credit. The 1977 survey, which was based on interviews with a nationwide sample of consumers, provided information on awareness of annual percentage rates as well as many aspects of the use of consumer credit. A full analysis of the findings is currently being prepared, and the results will be made available when the work is completed.

The 1969 and 1970 studies indicated that awareness of rates increased sharply in the first 15 months after Truth in Lending went into effect, but the 1977 study shows that there have been significant further increases in consumer awareness over the last 8 years, as Table 1 shows.[3] As of the summer of 1977, the proportions of consumer credit users who were aware of the annual percentage rates charged had reached 54.5 per cent for closed-end credit, 64.7 per cent for retail revolving credit, and 71.3 per cent for bank credit cards.

Closed-end credit. There was considerable variation in both the level of awareness and the extent of improvement among the users

[1] This preliminary analysis is based on the initial computer runs of the data, which are subject to revision as more complete data are developed.

[2] A private research company in Philadelphia, Pennsylvania, which was under contract to the Board.

[3] Awareness of annual percentage rates charged on consumer credit was determined by comparing the survey responses with a large sample of rates calculated from credit contracts collected by the Federal Trade Commission.

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Federal Reserve Bank of St. Louis

1. Instalment credit: Awareness of annual percentage rates, by type

Type	Level of awareness (per cent)			Change in awareness (percentage points)		
	1969	1970	1977	1969-70	1970-77	1969-77
Closed-end credit	14.5	38.3	54.5	23.8	16.2	40.0
New automobiles	17.5	43.3	70.0	25.8	26.7	52.5
Used automobiles	7.2	17.3	38.3	10.1	21.0	31.1
Appliances and furniture [1]	11.7	35.0	44.6	23.3	9.6	32.9
Home improvement	15.3	43.3	66.7	28.0	23.4	51.4
Personal loans	20.2	49.2	54.6	29.0	5.4	34.4
Retail revolving credit	35.2	55.5	64.7	20.5	9.2	29.5
Bank credit cards	26.6	63.4	71.3	36.8	7.9	44.7

[1] Figures for 1977 are for durable goods and recreational goods.

SOURCE.—Robert P. Shay and Milton W. Schober, *Consumer Awareness of Annual Percentage Rates of Charge in Consumer Instalment Credit: Before and After Truth in Lending Became Effective* (Washington: Technical Studies of the National Commission on Consumer Finance, Volume I, Number 1, Government Printing Office, 1973), Tables 1 and 2; 1977 Survey of Consumer Credit.

of different types of closed-end credit. Users of credit for the purchase of new automobiles and home improvements, for example, had the highest rates of awareness: 70.0 per cent and 66.7 per cent, respectively. The same groups also showed the largest improvement in awareness over the entire period since 1969, as Table 1 shows. The lowest level of awareness and the smallest improvement were shown by users of credit for the purchase of used automobiles. Only 38.3 per cent of the users in this group were aware of the annual percentage rates charged.

Both the level of awareness of rates in 1977 and the extent of improvement in awareness since mid-1969 were greater for closed-end credit users with higher incomes and for those with more education, as shown in Table 2. There has, however, been significant improvement in awareness among credit users with lower incomes and with less formal education. Age appears to have relatively little relationship to either the level of awareness or the extent of improvement.

Black credit users had a lower level of awareness of the annual percentage rates charged on closed-end credit than did the other racial groups in each of the three surveys, as shown in Table 2. Nevertheless, there has been a fourfold improvement in the awareness of black users, from 9.4 per cent in 1969 to 38.2 per cent in 1977. Most of this increase in awareness has occurred since 1970,

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in contrast to the other racial groups, which showed about two-thirds of their increase in awareness during the first 15 months after Truth in Lending went into effect.

Awareness of annual percentage rates charged on closed-end credit was substantially higher among customers of financial institu-

2. Closed-end credit: Awareness of annual percentage rates, by education, age, income, and race/ethnic group

Group	Level of awareness (per cent)			Change in awareness (percentage points)		
	1969	1970	1977	1969–70	1970–77	1969–77
By education:						
Some high school or less	8.6	25.8	40.6	17.2	14.8	32.0
High school	17.5	38.4	53.1	20.9	14.7	35.6
Some college or more	18.4	50.8	64.7	32.4	13.7	46.3
By age:						
Under 35	15.1	40.0	54.6	24.9	14.6	39.5
35–49	15.2	40.9	59.0	25.7	18.1	43.8
50 or more	12.8	35.7	48.6	22.9	12.9	35.8
By income:[1]						
Less than $7,500	6.5	23.9	32.0	17.4	8.1	25.5
$7,500–$12,499	14.7	29.3	48.7	14.6	19.4	34.0
$12,500–$17,499	15.6	36.6	57.1	21.0	20.5	41.5
$17,500 or more	17.7	48.3	63.8	30.6	15.5	46.1
By race:						
Caucasian (non-Hispanic)	15.1	42.5	56.5	27.4	14.0	41.4
Black (non-Hispanic)	9.4	16.2	38.2	6.8	22.0	28.8
Hispanic, American Indian, Asian	18.4	44.4	56.6	26.0	12.2	38.2

[1] Income categories for 1969 and 1970 were adjusted to 1977 dollars, using the consumer price index. Slight adjustment of categories was made in 1977 to accommodate the scales used by the interviewers.

SOURCE.—Shay and Schober, *op. cit.*, Tables 3 and 4; 1977 Survey of Consumer Credit.

3. Closed-end credit: Awareness of annual percentage rates, by source of credit

Source	Level of awareness (per cent)			Change in awareness (percentage points)		
	1969	1970	1977	1969–70	1970–77	1969–77
Banks	12.8	42.0	52.2	29.2	10.2	39.4
Credit unions	27.8	36.1	65.8	8.3	29.7	38.0
Finance companies	16.7	38.7	57.8	22.0	19.1	41.1
Retail dealers	9.4	32.8	42.0	23.4	9.2	32.6

SOURCE.—Shay and Schober, *op. cit.*, Table 5; 1977 Survey of Consumer Credit.

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tions than among those who obtained their credit from retail dealers, as shown in Table 3.

Open-end credit. The levels of awareness of annual percentage rates charged on retail revolving credit and bank credit cards and the changes in these levels are shown for various educational, income, and age groups in Table 4. The level of awareness increased with education and income in all three surveys as it did for closed-end credit; however, the degree of improvement for revolving credit

4. Two segments of open-end credit: Awareness of annual percentage rates, by education, income, and age group

Group	Level of awareness (per cent)			Change in awareness (percentage points)		
	1969	1970	1977	1969–70	1970–77	1969–77
	Retail revolving credit					
By education:						
Some high school or less	20.0	29.7	44.6	9.7	14.9	24.6
High school	31.6	54.5	61.1	22.9	6.6	29.5
Some college or more	48.1	68.7	76.2	20.6	7.5	28.1
By income:[1]						
Less than $7,500	19.1	27.1	41.9	8.0	14.8	22.8
$7,500–$12,499	28.1	43.3	55.1	15.2	11.8	27.0
$12,500–$17,499	37.4	57.1	59.0	19.7	1.9	21.6
$17,500 or more	42.8	64.7	77.3	21.9	12.6	34.5
By age:						
Under 35	40.3	64.8	69.0	24.5	4.2	28.7
35–49	39.3	61.6	72.8	22.3	11.2	33.5
50 or more	26.7	42.3	56.1	15.6	13.8	29.4
	Bank credit cards					
By education:						
Some high school or less	16.4	39.8	51.6	23.4	11.8	35.2
High school	19.4	51.0	65.6	31.6	14.6	46.2
Some college or more	38.8	77.4	80.3	38.6	2.9	41.5
By income:[1]						
Less than $7,500	11.4	60.8	58.5	49.4	[2] (2.3)	47.1
$7,500–$12,499	22.9	53.7	61.4	30.8	7.7	38.5
$12,500–$17,499	29.2	56.7	66.9	27.5	10.2	37.7
$17,500 or more	33.0	68.4	77.7	35.4	9.3	44.7
By age:						
Under 35	34.7	68.3	76.1	33.6	7.8	41.4
35–49	27.1	62.7	74.8	35.6	12.1	47.7
50 or more	21.1	59.1	65.3	38.0	6.2	44.2

[1] Income categories for 1969 and 1970 were adjusted to 1977 dollars, using the consumer price index. Slight adjustment of categories was made in 1977 to accommodate the scales used by the interviewers.

[2] For the period 1970–77 there was a decrease in awareness of annual percentage rates of 2.3 per cent among consumers with incomes of less than $7,500.

SOURCE.—Shay and Schober, *op. cit.*, Table 7; 1977 Survey of Consumer Credit.

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over the entire period from 1969 to 1977 varied little among the educational groups, and only the highest income groups showed a significantly larger increase than the other income groups. Among the age groups, those 50 years of age and older showed a lower level of awareness than did the lower age groups, but there was little difference in the percentage-point increase in awareness from 1969 to 1977.

The levels of awareness of rates charged on bank credit cards in 1977 also increased with both education and income. The extent of improvement over the entire period was significantly lower for those with limited formal education. Differences in awareness among age groups for bank credit cards were similar to those for retail revolving credit.

Inquiry on rights under the Fair Credit Billing Act. In November 1977 the Board decided to undertake an inquiry to obtain information, among other things, as to the extent to which consumers are exercising certain rights under the Fair Credit Billing Act and the cost to creditors of compliance with the act. The Board hopes that the information received from this inquiry will help in assessing the effectiveness of the act.

Compliance

There has been a significant increase in the efforts made by the Federal Reserve System and other Federal enforcement agencies during the past year to promote compliance with the act and the regulation. These efforts have included specialized examinations of financial institutions, development and distribution of comprehensive examination manuals and checklists, and intensive training of examiners and supervisory personnel. Federal Reserve System examiners, for example, have conducted special examinations of approximately 400 State member banks to determine compliance with consumer credit regulations, including Truth in Lending.

Because lack of understanding of the requirements seems to be a major obstacle to compliance, the Board has instituted a formal advisory program to assist member banks in understanding and complying with the act's requirements. This assistance is offered in the form of both group meetings and individual visits to banks at which Reserve Bank personnel review forms and procedures, review meth-

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ods of computing annual percentage rates, and discuss other problem areas. Approximately 770 visits, generally lasting from ½ day to 1½ days, were made in 1977. The response of banks to this advisory service has been extremely favorable.

Five of the Federal agencies that enforce the act with respect to financial institutions (the Board, the Comptroller of the Currency, the FDIC, the Federal Home Loan Bank Board, and the National Credit Union Administration) have joined in proposing uniform guidelines for enforcing the act's requirements. These guidelines are intended to promote improved and uniform enforcement among Federally regulated banks, thrift institutions, and credit unions through corrective action, including reimbursement of borrowers who have been overcharged or otherwise harmed by violations of the act. The proposal identifies several of the common violations. It is hoped that adoption and publication of uniform guidelines will focus creditors' attention on the need to comply with the regulation.

The Federal Trade Commission (FTC) undertook a pilot enforcement program concerning the advertising requirements of Regulation Z and has instituted five civil penalty cases in connection therewith. Based on the success of the program in improving compliance, the FTC intends to extend this program to other types of violations.

Several of the enforcement agencies have significantly expanded their programs to educate examiners about the requirements of the act and the regulation. The Board, for example, continued its program by conducting three 2-week schools during 1977 to train 96 of its examiners as well as several representatives from other agencies and State banking authorities.

The Board, the FDIC, and the Comptroller began conducting joint consumer regulation schools in 1977 in addition to their own training programs. Two sessions of the joint school, involving 64 participants from the three agencies, have been held, and another, more extensive school is planned for early 1978. These schools, which were instituted in response to a recommendation by the General Accounting Office that the agencies combine their training efforts, are conducted and taught jointly by the staffs of the agencies.

The agencies responsible for enforcing the Truth in Lending Act have made varying assessments of the level of compliance being achieved by creditors subject to their jurisdiction. Most of the exempt States and several of the Federal agencies report a high level

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of compliance and note that most violations that have been discovered are technical in nature and result from misunderstanding, inadvertence, or clerical error. The Federal bank regulatory agencies, however, all noted a significant increase in the number of banks found to be in error. For example, the FDIC noted an increase from 25.6 per cent in 1976 to 36.2 per cent in 1977, and it has issued seven cease-and-desist orders involving Truth in Lending violations. The Comptroller estimates that 88 per cent of all national banks have not achieved full compliance (although most violations are technical). The Board estimates that 72 per cent of State member banks have failed to comply fully. (Again, many are technical errors.)

The increase in the number of banks discovered to be in violation may be attributed to a greatly enhanced examination effort by the bank regulatory agencies during the past year rather than to a decline in creditor compliance. The Board also anticipates improved compliance due to increased educational and examination efforts by the agencies, since much of the lack of compliance appears to result from misunderstanding of the requirements of the act. Greater emphasis on education and examinations should eliminate much of this misunderstanding.

The FTC believes that, based on its limited review of disclosure forms, substantial compliance remains high, but it notes several areas that continue to be problems, such as the voluntariness of credit life insurance, the use of open-end credit disclosures in other than open-end credit transactions, and the failure to provide timely disclosures and notices.

Consumer Advisory Council

The Consumer Advisory Council, established in the fall of 1976 to advise and consult with the Board on consumer-related matters, met four times during 1977. It considered various consumer issues, including the Board's proposals to simplify Regulation Z, the various bills being considered by the Congress to simplify and reform the Truth in Lending Act, the jointly proposed uniform enforcement guidelines, and amendments and interpretations of Regulation Z. The Council has expressed special concern about the complexity of the current disclosures and the need to simplify the requirements.

Those members of the Council appointed to 1-year terms in 1976 were reappointed to 3-year terms; there were three resigna-

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Consumer Advisory Council

Dates indicate expiration of term

Leonor K. Sullivan
Chairman
St. Louis, Missouri
12-31-78

William D. Warren
Vice Chairman
Los Angeles, California
12-31-80

Roland E. Brandel
San Francisco, California
12-31-80

Agnes H. Bryant
Detroit, Michigan
12-31-78

John G. Bull
Fort Lauderdale, Florida
12-31-79

Robert V. Bullock
Frankfort, Kentucky
12-31-80

Linda M. Cohen
Washington, D.C.
12-31-78

Robert R. Dockson
Los Angeles, California
12-31-80

Anne G. Draper
Washington, D.C.
12-31-78

Carl Felsenfeld
New York, New York
12-31-79

Marcia A. Hakala
Omaha, Nebraska
12-31-80

Joseph F. Holt III
Oxnard, California
12-31-78

Edna DeCoursey Johnson
Baltimore, Maryland
12-31-79

Robert J. Klein
New York, New York
12-31-80

Percy W. Loy
Portland, Oregon
12-31-79

R. C. Morgan
El Paso, Texas
12-31-80

Reece A. Overcash, Jr.
Dallas, Texas
12-31-78

Raymond J. Saulnier
New York, New York
12-31-79

E. G. Schuhart
Dalhart, Texas
12-31-80

James E. Sutton
Dallas, Texas
12-31-78

Anne Gary Taylor
Alexandria, Virginia
12-31-79

Richard D. Wagner
Simsbury, Connecticut
12-31-80

Richard L. Wheatley, Jr.
Stillwater, Oklahoma
12-31-78

tions from the Council during the year. A list of the members currently serving on the Council, indicating the term of each, appears above.

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Administrative functions

Amendments and interpretations of Regulation Z

Consumer leasing. The Consumer Leasing Act of 1976 and the implementing regulations issued by the Board in October 1976 became effective on March 23, 1977. To facilitate compliance with the regulation, in February 1977 the Board issued sample disclosure forms and instructions for use as interpretations of Regulation Z. The forms cover three types of leasing: open-end and closed-end vehicle leasing and furniture leasing. The forms are disclosure statements, not lease contracts, and are designed to provide consumers with full information regarding the terms of their leases of personal property, as required by the Consumer Leasing Act. Lessors are not required to use the sample forms, but lessors making proper use of them will be considered to be in compliance with the act and the regulation.

Simplification of Regulation Z. In May 1977 the Board proposed for comment four simplifying revisions of Regulation Z. The proposals are intended to promote creditor compliance with the regulation as well as to eliminate what may be unnecessary information from the Truth in Lending disclosure statement and thereby focus consumers' attention on the more meaningful and useful cost disclosures.

The proposals would:

> Eliminate itemization of the components of the finance charge (for example, interest, loan fees, and required credit life insurance premiums);
>
> Eliminate itemization of the components of the downpayment, as, for example, "cash downpayment" and "trade-in";
>
> Eliminate the need to itemize license, certificate of title, and registration fees in order to exclude such fees from the finance charge; and
>
> Eliminate identification of the method used to calculate the rebate of unearned finance charges if a credit obligation is prepaid, and require instead a statement of whether or not a rebate will be made in such circumstances.

Numerous written comments on these proposals were received, and final action is presently being considered.

Cash discounts. In July 1977 the Board amended Regulation Z to implement the provisions of Public Law 94–222. These amend-

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ments to the act and the regulation augment earlier provisions providing, with certain limitations, that a discount of up to 5 per cent may be offered to induce payment for a transaction by cash, check, or other means not involving the use of a credit card, without considering the discount to be a finance charge. These amendments prohibit imposing a surcharge on credit-card customers for 3 years. They also provide that the discount shall not be considered a cost of credit for purposes of State usury and credit disclosure laws.

Variable rates. In April 1977 the Board amended Regulation Z, effective October 10, 1977, to require advance disclosure when variable interest rate provisions are present in credit transactions. In all such transactions, the amendment requires disclosure of the fact that the annual percentage rate is subject to increase, the conditions under which the rate may increase, and the manner in which an increase would be effected (for example, through an increase in the payment amount or in the number of payments). In certain transactions, primarily those involving mortgages of the customer's home, the amendment also requires numerical examples showing the effect an immediate increase of one-quarter of a per cent in the rate would have on the payment amount or on the number of payments.

Spanish language disclosures. In April 1977 the Board amended Regulation Z to permit Truth in Lending disclosures to be provided in Spanish rather than English in the Commonwealth of Puerto Rico. This action was based on the fact that Spanish is the traditional and predominant language used in Puerto Rico, and it was intended to permit creditors to provide more meaningful disclosures to customers in a more effective manner. The amendment permits, but does not require, use of the Spanish language; furthermore, it requires that disclosures in the English language be provided upon the customer's request.

Descriptive billing of nonsale transactions. In September 1977 the Board proposed for comment an amendment to change the provisions of Regulation Z concerning the date to be used to describe a cash-advance check and other nonsale credit transactions. The proposal would permit a creditor to disclose the date on which it debits the transaction to the account rather than the date on which the transaction takes place or the date written on the check or other credit instrument.

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If the date of debiting is used, however, the proposal provides that a customer inquiry about the transaction, submitted in accordance with the Fair Credit Billing Act, must be handled in the manner prescribed by that act. Further, the transaction must be treated as an erroneously billed item, which means that the customer cannot be charged finance charges caused by the delay in paying the amount until the question is resolved.

The Board made the proposal to facilitate compliance by creditors who have experienced operational difficulty in ascertaining the transaction date or the date that appears on the check or other credit document. Final action is expected to be taken on the proposal in the near future.

Transaction-by-transaction billing. In August 1977 the Board issued an interpretation of Regulation Z simplifying procedures for two-party credit-card issuers that bill customers in full on a transaction-by-transaction basis and impose no finance charges. These issuers differ from most other credit-card issuers in that they send a bill for each transaction rather than a cumulative statement at regular intervals. Furthermore, no finance charges are imposed and payment is expected upon receipt of each bill. In light of these differences, the Board determined that only certain provisions of Regulation Z should apply to such credit-card issuers; the interpretation specifies which provisions of the regulation are applicable, and it relieves them of the need to maintain cumulative accounts and send periodic billing statements to their customers.

Dealer participation. In March 1977 the Board adopted an interpretation of Regulation Z stating that the amount of a dealer's participation in the finance charge on a credit purchase need not be disclosed as a separate component of the finance charge. (Dealer participations primarily relate to credit sales of automobiles or other consumer durables.) At the same time, the Board withdrew an amendment to the regulation, proposed for comment in January 1977, that would have required separate disclosure of the existence (but not the amount) of such a dealer participation. Both of these actions were based on the Board's belief that consumers would not be significantly helped in shopping for credit by disclosure of the fact that part of the finance charge might represent a dealer participation, while addition of another required disclosure would further complicate Truth in Lending disclosure statements.

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Rescission in open-end credit. In December 1977 the Board published for comment a proposed amendment to Regulation Z concerning the right to rescind open-end credit transactions in which a security interest is taken in the consumer's principal residence. The proposals provide that consumers must be informed of their right to cancel such credit plans and must be given a 3-day "cooling-off period" in which to exercise that right in three instances, that is, when the open-end credit plan is first opened, when the credit limit is increased, and when a security interest in a home is added to an existing credit plan.

The Board expects to take final action on the proposal early in 1978 after comments have been received.

Staff interpretations of Regulation Z. The staff of the Board has continued to provide interpretations of Regulation Z in response to inquiries. During 1977 more than 100 official staff interpretations were issued, explaining and applying the requirements of the regulation to specific situations. In accordance with Section 130(f) of the Truth in Lending Act, as amended in 1976, creditors who act in good faith in conformity with such official staff interpretations may not be held liable for violation of the act. In addition, the staff has issued approximately 300 unofficial staff interpretations of the regulation during the year.

State exemptions. No new exemptions from the requirements of the Truth in Lending Act were granted to States in 1977. In November 1977 the Board considered the request of the Massachusetts Commissioner of Banks to expand that State's present exemption to include national banks, Federal savings and loan associations, and Federal credit unions. The Board concluded that it could not act upon the application because there was no indication that arrangements had been made with the appropriate Federal authorities (Comptroller of the Currency, Federal Home Loan Bank Board, and National Credit Union Administration) to ensure effective enforcement of Massachusetts' law.

Education. Educational efforts by the various agencies responsible for Truth in Lending have continued during the past year. These efforts have included speeches, workshops, and seminars presented to both creditor and consumer groups, publication and dissemination of newsletters, pamphlets, and educational materials such as con-

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sumer credit guides, and consultation with professional educators. In addition, both consumers and creditors have become more aware of Truth in Lending and have come to understand it better through the handling of individual consumer complaints and inquiries and through the examination process. The FTC reports that its staff is currently conducting a review of both public and private sector consumer educational materials in an effort to determine whether further activity in this area by the Commission would be advisable.

EQUAL CREDIT OPPORTUNITY

The Board of Governors of the Federal Reserve System is pleased to submit to the Congress (on January 26, 1978) this second Annual Report on the Equal Credit Opportunity Act (ECOA). This Report describes the highlights of the year, including extensive amendments to the act, outlines the Federal Reserve System's enforcement activities, and provides the Board's assessment of the extent of compliance on the part of State member banks. The Report also discusses the compliance and enforcement efforts of other agencies assigned administrative responsibilities under Section 704 of the act and their assessment of compliance on the part of creditors that they supervise.

The Report does not contain recommendations for statutory amendments. Such recommendations, if any, will be made in the Board's ANNUAL REPORT to the Congress.

The amendments to the ECOA and the regulations implementing the amended act became effective in March 1977. In an effort to mitigate many of the compliance problems that creditors had experienced under the original Regulation B, the Board published several model application forms. As to the substantive requirements of Regulation B, the chief problem for banks seems to be understanding and complying with Regulation B's limits on requests for the signature of an applicant's spouse. The Board's advisory visit program was developed to explain this provision and other provisions of the regulation to member banks.

The Board issued four interpretations of Regulation B, and the Board's staff issued seven official staff interpretations to clarify technical ambiguities in the regulation.

Few lawsuits, to the Board's knowledge, were filed under the act either by private parties or by the Department of Justice.

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Enforcement and assessment of compliance

As described below, the Board and the other Federal agencies substantially increased their enforcement efforts in 1977.

Federal Reserve System

1. *Examination.* Examination of banks is the primary means by which the Federal Reserve System enforces the act. To improve enforcement of Regulation B, the Board developed new examiner manuals, checklists, instructions, and report forms. The Board also initiated a program of special compliance examinations aimed specifically at consumer credit regulations, including Regulation B. Since the implementation of this program, approximately 400 member banks have undergone the special compliance examination. By April 1, 1978, one year after the revised Regulation B became effective, nearly all member banks will have been examined for compliance with the regulation. A copy of the examination report is reviewed by the Board's Division of Consumer Affairs to determine the individual bank's compliance and to evaluate and improve the examination program.

To ensure that its examiners are thoroughly versed in Regulation B, the Board conducted three 2-week training institutes in 1977. Ninety-six System examiners and several representatives of other Federal and State agencies attended these schools. Four more schools are planned for 1978. In response to a General Accounting Office recommendation, joint consumer regulation schools were initiated by the Board, the Federal Deposit Insurance Corporation (FDIC), and the Comptroller of the Currency to supplement their respective training programs. Two sessions, attended by 64 participants from the three agencies, were held. Another joint school is scheduled for early 1978.

The Board's figures indicate that while 73 per cent of the banks that have received special consumer examinations were not in full compliance with Regulation B, the overwhelming majority of violations relate to the use of outdated credit applications and forms. Most other violations involve the unlawful request for the signature of a nonapplicant spouse, the notification requirements of Regulation B, and the failure to request information for monitoring purposes.

During the course of consumer examinations, Reserve Bank examiners explain the nature of any violations discovered and outline

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the prospective corrective action necessary for compliance. All State member banks are either in compliance at the conclusion of the examination or have agreed to establish policies and procedures designed to prevent recurrence of violations. Continuing emphasis on the special consumer examination program, in conjunction with the Board's advisory visit program, should aid achievement of full compliance for all State member banks.

2. *Advisory visit program.* The Board's examination experience indicates that a lack of familiarity with Regulation B's requirements is the single most significant obstacle to full compliance with the regulation. This is particularly true of smaller banks, which often do not possess either the personnel or resources to study the regulation and develop procedures for compliance. In response to this need and in an effort to improve compliance, the Board initiated a voluntary advisory visit program, consisting of both group meetings and individual visits, for all interested member banks. In half-day or full-day meetings with bank management, Federal Reserve Bank personnel review the bank's forms, procedures, and policies, as well as discuss any problems or questions that the management and operating staff may have concerning compliance. Approximately 770 such visits were made during 1977; the total number of banks that received assistance was higher, approximately 900, since certain meetings were attended by several banks. This program has been well received by member banks.

3. *Model forms.* Prior to the revision of Regulation B, many creditors experienced difficulty in adapting their credit application forms to the regulation's restrictions on permissible questions. To alleviate this problem, the Board developed five model forms for the following types of credit: open-end, unsecured consumer credit transactions; closed-end, secured transactions; closed-end transactions, whether unsecured or secured; credit in community property States; and residential real estate mortgage transactions. The model forms appear in an appendix to the regulation. While their use is optional, proper usage by a creditor assures compliance with the requirements of Regulation B relating to application forms. These model forms not only should promote compliance but should reduce the cost of compliance.

4. *Consumer complaints.* Another method by which the Federal Reserve System enforces compliance with the act is the investiga-

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tion of consumer complaints. In the course of an investigation, an attempt is made to resolve the problem of the individual complainant. The Board has developed a Systemwide computerized complaint control procedure to monitor the handling of complaints and to aid in their resolution.

From January 1, 1977, through October 31, 1977, the Federal Reserve System received 731 complaints involving the act or Regulation B, of which approximately 40 per cent were related to State member banks and 60 per cent to other creditors. The latter group was handled either by referring them to the appropriate agency or by supplying information or an explanation to the complainant.

With respect to the 293 complaints regarding State member banks, 132 investigations have been completed, 69 are still under investigation, and 92 were handled by furnishing information or an explanation. The 132 completed investigations yielded the following results: the bank was determined to be legally correct in 83 cases; was found to be legally correct but nevertheless reached an accommodation with the complainant in 28 cases; was found to have made an error, which has since been corrected, in 13 cases; was involved in a possible violation, which has since been resolved, in 6 cases; and was involved in a possible violation, which is still unresolved, in 2 cases.

The most common complaint (574 out of a total of 731) was unfair denial, termination, or change in terms of credit. Not all of these 574, however, claimed discrimination on one of the bases prohibited in the act. For example, 159 complainants believed that the reason for the adverse action was their credit history. Level of income was cited by 68 as the perceived reason for the denial. On the other hand, 42 complainants felt that marital status was the reason for the creditor's adverse action, 41 cited discrimination because of sex, and 16 because of race, color, or national origin.

In an effort to evaluate consumer satisfaction with the Federal Reserve's handling of complaints, the Board has sent a followup questionnaire to those persons whose complaints were received subsequent to April 1, 1977. The questionnaire is sent to complainants shortly after the investigation is completed. The questionnaire deals with the acceptability of the resolution, the clarity of the explanation, the amount of time in which the complaint was handled, the courteousness of System staff, and whether or not the consumer would

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contact the Federal Reserve in the event of a future problem. The Board is reviewing returns from the followup letter and the entire procedure to determine if any changes should be made to improve this service to the public.

5. *Other compliance activities.* The Board is currently conducting a survey of selected major creditors that extend open-end credit to determine the extent to which consumers are exercising their rights to a credit history reported separately from that of a spouse and to a notification of specific reasons for the denial of credit. The results should assist the Board in evaluating the effectiveness of these requirements as well as in determining the cost of compliance.

The Board and the other financial institution regulatory agencies are working on a uniform set of guidelines for enforcement of Regulation B, specifying corrective action that will be taken by the appropriate agency when certain violations are discovered. The guidelines are intended to promote better and more uniform enforcement among all Federally regulated financial institutions.

Other agencies

1. *Comptroller of the Currency.* The Comptroller of the Currency, who is responsible for enforcing the act for national banks, instituted in October 1976 a program of consumer affairs examinations. To date, 2,859 national banks have undergone such examinations. The examinations are conducted by specially trained examiners who have completed a 2-week consumer school. Six such schools have been conducted.

Enforcement of Regulation B also occurs through the resolution of consumer complaints. From January 1, 1977, through November 30, 1977, the Comptroller received 451 complaints, the majority of which alleged discrimination on the basis of sex or marital status. When a violation is discovered through investigation, the bank not only must take corrective action in the applicant's case but is also required to establish policies and procedures to prevent future violations.

The Comptroller's examinations reveal that 97 per cent of all national banks were in violation of the act to some extent. However, 86 per cent of the violations appear to be technical in nature, that is, attributable to the use of obsolete credit applications and other forms. Most (86 per cent) of the substantive violations involve the

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unlawful request for the signature of a nonapplicant spouse and the denial of separate credit to married applicants. All national banks have taken or have promised to take prospective corrective action when the examination has disclosed violations. The Comptroller believes that substantial compliance is achieved by national banks after a consumer examination has occurred and the directed corrective action taken.

2. *Federal Deposit Insurance Corporation (FDIC).* The FDIC, which enforces the act for insured nonmember banks, initiated in May 1977 a program of separate compliance examinations, conducted by specially trained examiners, to determine compliance with consumer protection laws and regulations. Under this program, the FDIC expects to examine each insured nonmember bank at least once every 15 months.

From October 1, 1976, through September 30, 1977, 26.6 per cent of the compliance examination reports indicated apparent violations, which related primarily to the notification requirements of Regulation B and to the provisions concerning applications, particularly the conditions governing permissible terminology on application forms and permissible requests for information.

During the same period, the FDIC received 291 consumer complaints alleging ECOA violations. Sex or marital status discrimination comprised the largest category, followed by consumer disagreement with the bank's reasons for taking adverse action. A thorough inquiry is conducted to determine the merits of all discrimination complaints. Should violations be found, the FDIC takes appropriate action to bring the bank into compliance.

From October 1, 1976, through September 30, 1977, the FDIC's Board approved six cease-and-desist orders involving equal credit opportunity.

In assessing the extent of compliance with the ECOA, the FDIC reports that the majority of violations discovered thus far relate to form and procedure rather than substantive discrimination.

3. *Federal Home Loan Bank Board (FHLBB).* The FHLBB, which enforces the act for Federally chartered savings and loan associations, conducts regular examinations to determine compliance with Regulation B. During late 1976 and early 1977, the FHLBB conducted 2½-day training sessions in consumer law for all of its examiners.

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In July 1977 the FHLBB instituted a new consumer complaint procedure. During the first 11 weeks of operation, 48 discrimination complaints were received. Redlining was the most common type of complaint, followed by discrimination on the bases of race and national origin, sex, or marital status. As of December 5, 1977, discrimination complaints received numbered approximately 200. Each complaint is investigated to determine whether a violation has occurred, and the complainant is notified of the result of the investigation.

The FHLBB believes that most savings and loan associations wish to comply but that confusion on procedural matters as well as extremely literal interpretations on the part of association staff often defeat the act's purpose. Thus, most noncompliance derives from "technical violations" and compliance is promptly obtained.

4. *National Credit Union Administration (NCUA).* The NCUA enforces the act for Federally chartered credit unions. Enforcement activities, like those of the other financial regulatory agencies, include examiner training, specialized examination procedures, and, if a violation is discovered, appropriate followup with credit union officials. Approximately 90 per cent of the 12,800 Federal credit unions were examined by the year-end.

The NCUA conducts a field investigation of all written consumer complaints and, when necessary, institutes corrective action. The agency has received 30 complaints or requests for information, with the largest group pertaining to discrimination on the basis of race or national origin. The next most common complaint alleged discrimination due to factors not prohibited by existing law, followed by discrimination alleged to be based on marital status. Eight complaints are still under investigation, but of the remainder, only two were substantiated by objective review of the facts. In both of these cases, corrective action was undertaken promptly and in several other instances, subsequent loan applications by complainants were approved as a result of improved understanding between the parties.

NCUA's preliminary results indicate that 83 per cent of the credit unions examined were in compliance at the conclusion of the examination and the remainder had agreed to take prompt corrective actions.

5. *Federal Trade Commission (FTC).* The FTC enforces the act for all creditors not subject to the jurisdiction of any of the other

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enforcement agencies. Potential violators of the act are identified through several sources of information, including consumer complaints, consumer and civil rights organizations, and other enforcement agencies. When there is evidence that a violation may have occurred, an informal inquiry is made, followed by a full investigation when warranted. During 1977 the FTC staff initiated a number of investigations, which are expected to result in formal action in the near future.

During the first 10 months of 1977, the FTC received 6,500 complaints and inquiries concerning equal credit opportunity. The agency states that many complaints allege discrimination on the basis of sex or marital status while a significant number of complaints claim discrimination based on race and age.

The FTC believes that creditors are making a good faith effort to comply with the act and are achieving a substantial degree of compliance. However, some evidence indicates that smaller creditors may be less familiar with the requirements of the act and with Regulation B than major national creditors. The FTC hopes that this problem will be alleviated by increased creditor and consumer educational efforts and by the deterrent effect of litigation and administrative enforcement actions.

6. *Civil Aeronautics Board (CAB).* The CAB, which enforces the act for domestic and foreign air carriers, continues to monitor industry practices through the resolution of consumer complaints, none of which, to date, have been considered valid. Enforcement measures include contacting the carrier or supplying information to the consumer. On the basis of complaints received, the CAB believes that compliance within the industry is relatively good.

7. *Interstate Commerce Commission (ICC).* The ICC enforces the act for regulated common carriers. In its view, common carriers are forbidden to discriminate in the granting of credit by Section 3(1) of the Interstate Commerce Act and by several ICC credit regulations. Thus, the ICC believes that the ECOA does not have a significant impact on the surface transportation industry.

8. *U.S. Department of Agriculture (USDA).* The USDA includes agencies with responsibilities under the act. The Packers and Stockyards Administration enforces the act for creditors under its jurisdiction. Since the livestock industry characteristically operates on a cash basis, the agency's monitoring is handled on a complaints re-

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ceived basis, and in the event of a violation, remedial action will be initiated. As no complaints have been received to date, the Packers and Stockyards Administration assumes there is substantial compliance within the industry.

The Farmers Home Administration, itself a creditor, is under the enforcement authority of the FTC. During 1977, 140 complaints against this organization concerning the denial of loans were received by the USDA's Office of Equal Opportunity.

9. *Small Business Administration (SBA).* The SBA enforces the act for small business investment companies and, through a letter of understanding with the FTC, with regard to other recipients of SBA assistance and with regard to SBA program offices. During fiscal year 1977, seven SBA program offices were reviewed and 15,954 recipient businesses were monitored for compliance, with 844 being subjected to on-site reviews.

Six complaints were received alleging sex discrimination when applying for loans from SBA program offices, but investigations revealed that the complaints were unsubstantiated. No consumer complaints alleging discrimination were received from customers or clients of recipients of SBA assistance.

Due to the general nature of SBA recipients (small businesses) and the lack of consumer complaints received, the SBA believes creditors subject to its authority to be in adequate compliance.

10. *Securities and Exchange Commission (SEC).* The SEC enforces the act for securities brokers and dealers. The SEC reports having received no complaints during 1977 that alleged discrimination in securities credit transactions and states that creditors subject to its jurisdiction appear to be complying with the act and with Regulation B.

11. *Farm Credit Administration (FCA).* The FCA enforces the act for Federal land banks, Federal land bank associations, Federal intermediate credit banks, and production credit associations. FCA enforcement activities include regular examinations, conducted every 12 to 18 months. Such examinations in the current year have not disclosed significant problems in the area of discrimination.

In 1977 approximately a dozen complaints were received by the agency and reviewed for appropriate followup. In none of the nine complaints resolved thus far was evidence disclosed of intent to discriminate, and no known complaints have resulted in litigation.

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The FCA concludes that the record of compliance by farm credit institutions appears to be good.

Consumer Advisory Council

The Consumer Advisory Council, established in late 1976 to advise and consult with the Board on matters relating to consumer credit, held four meetings in 1977. The Council considered such topics as consumer education and the survey of consumers (both mentioned on page 357).

Those members of the Council appointed to 1-year terms in 1976 were reappointed to 3-year terms in 1977, and three members resigned during the year. A list of current Council members appears on page 341.

Administrative functions

Interpretations and amendments of Regulation B

1. *Board intepretations.* On April 28, 1977, the Board adopted two interpretations of revised Regulation B, both concerning the possible inconsistency of California law with the act and the regulation. One interpretation, designated 202.1101, states that a law requiring delivery of a notice explaining the obligations of a co-signer only when the signers of a consumer credit contract are not married to each other is not inconsistent with Regulation B. The other interpretation, designated 202.1102, states that a law requiring translation of certain consumer credit documents into Spanish but not into other languages is not inconsistent with Regulation B.

On July 8, 1977, the Board adopted an interpretation of Regulation B, designated 202.1103, determining that State laws making contracts enforceable against married persons at a younger age than against unmarried persons are not inconsistent with the act.

On August 4, 1977, the Board issued an interpretation, designated 202.801, dealing with special-purpose credit programs under Section 202.8 of the regulation. The interpretation states that a credit program is to be considered "expressly authorized by Federal or State law," as required for programs seeking to qualify under Section 202.8(a)(1), if it is authorized either by the terms of a Federal or State statute, or by a regulation lawfully promulgated by the agency administering the program. The interpretation further states that

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participating creditors will not violate Regulation B by complying with regulations that implement the program. Finally, the Board stated that determinations on another of the criteria for qualification under Section 202.8(a)(1), namely, whether particular programs benefit an "economically disadvantaged class of persons," should be made by the agency administering the program, not by the Board.

2. *Official staff interpretations.* Regulation B was amended during 1976 to implement the provisions of the 1976 amendments to the act, which authorized the Board to empower staff members to issue interpretations of Regulation B or the act. Creditors can rely on such interpretations to the same extent as on formal Board interpretations. During 1977 seven official staff interpretations of Regulation B were issued. Their subject matter includes names in which accounts may be carried, the effect of Regulation B on State loan-splitting laws, the scope of the real estate credit-monitoring requirements, use of credit-scoring systems in combination with judgmental credit evaluation methods, the application of notification and record retention requirements to business credit, information gathering by creditors for noncredit purposes, and whether or not adverse action can occur at the point of sale.

Two official staff interpretations, designated EC-0007 and EC-0008, are currently under reconsideration at the request of the FTC and the Department of Justice. On October 3, 1977, the Board issued alternative proposed amendments to Regulation B, which would cover the same issue as interpretation EC-0008, whether or not adverse action occurs at the point of sale. These are discussed in greater detail in the following section of this Report.

The FTC and Justice also petitioned the Board for a change in the procedures by which official staff interpretations are issued. They urged the Board to allow opportunity for public comment before official staff interpretations are issued in final form. This matter is currently under consideration.

3. *Amendments.* In order to resolve the questions raised by the requests for reconsideration of EC-0008, the Board issued alternative proposed amendments to Regulation B. Under the regulation, a creditor, in each instance of adverse action, must either provide a written explanation to the customer of the reason for the adverse action or advise the customer of the right to obtain an explanation upon request. Each proposal would amend the definition of "adverse

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action." The first would generally result in an affirmation of EC-0008; in general, adverse action commonly would not occur when use of an open-end credit account is denied at the point of sale. The other proposal would generally adopt the position of the FTC and the Justice Department; adverse action would occur at the point of sale in many instances. Approximately 200 comments on the proposed amendments have been received, and the matter is still under consideration.

Education

The past year has seen increased educational activity on the part of both the Federal Reserve System and the other agencies responsible for Regulation B compliance.

Within the Federal Reserve System, educational efforts included speeches and seminars involving consumers, creditors, school groups, professional associations, and others. Nearly 350 of these presentations were made by staff members of the Federal Reserve Banks during 1977 and about 60 by Board staff during the first 8 months of the year. In addition, Board and Reserve Bank staff on several occasions participated in radio and television programs relating to equal credit opportunity.

During 1977 the Board published two pamphlets to inform consumers of their rights under Regulation B. One deals with rights of women under the regulation and the other with credit discrimination on the basis of age. Approximately 4.4 million copies of the former and 2.9 million copies of the latter have been distributed. The Board also published a pamphlet summarizing Regulation B requirements applicable to small businesses and professionals who extend credit with no finance charge imposed. Approximately 1 million copies of this pamphlet have been distributed. Currently planned is a pamphlet on housing credit and a filmstrip explaining consumer protection laws, including equal credit opportunity.

During 1977 a nationwide survey of consumers was conducted for the Board in an effort to ascertain the extent of consumer knowledge of credit and consumer credit legislation. The results are currently being analyzed.

A number of the other enforcement agencies report similar educational efforts including slide presentations, consumer pamphlets, journal articles, seminars, and speeches.

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FEDERAL TRADE COMMISSION ACT

The Board of Governors of the Federal Reserve System is pleased to submit this third Annual Report (dated March 15, 1978) to the Congress on its activity in 1977 in fulfilling its responsibilities under Section 18(f) of the Federal Trade Commission Act. Those responsibilities are: (1) to identify unfair or deceptive banking practices and to adopt regulations prohibiting such practices; (2) to receive and take appropriate action upon complaints directed against State member banks; and (3) unless certain exceptions apply, to promulgate regulations applicable to banks that are substantially similar to rules prescribed by the Federal Trade Commission (FTC), within 60 days after such rules take effect.

Initiation of regulations by the Board

As indicated in the Board's last annual report, consumer complaints have not been found to be as useful as originally envisioned for pinpointing those bank practices that might warrant investigation on a larger scale. Consequently, the Board decided to canvass certain groups and persons who might have, by virtue of their occupation or position, a working knowledge of the banking industry's activities and dealings with consumers.

In early 1977 the Board sent approximately 400 letters to State agencies and legal service organizations across the country asking them to identify banking acts or practices that appeared to be prevalent and problematical. Close to 100 responses were received, analyzed, and discussed with representatives from the other Federal bank regulatory agencies.

The Board, relying in large part upon those responses, identified six bank practices that appeared to warrant further investigation. They are:

1. Failure to disclose to new depositors the contract terms governing use of their accounts, or failure to give reasonable advance notification to existing depositors of any change in contract terms.
2. Describing checking account services as being "free" when there are charges or preconditions to a depositor's actually receiving no-cost checking.
3. Attaching, freezing, or closing a depositor's account without promptly notifying the depositor.

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4. Imposing, as a matter of policy, a longer waiting period than needed for operational reasons before depositors can withdraw funds deposited in the form of checks.

5. Describing interest paid on savings accounts as being the "highest allowed by law."

6. Indicating in writing to a loan applicant that credit life or disability insurance is optional, but implying or stating that acquisition of such insurance is necessary for favorable consideration of the applicant's loan request.

An investigation is under way to ascertain more precisely the nature and prevalence of these six practices. The investigation will also focus on the basis for the practices and any consumer harm that may be caused by them. Working in concert with the FDIC and the Comptroller of the Currency, the Board's staff has developed a bank survey questionnaire. Examiners from all three bank regulatory agencies are incorporating that questionnaire into their normal consumer examinations for a 45-day period during the first quarter of 1978. The survey should thus encompass a fairly representative sampling of approximately 900 banks, and the data gathered should provide the Board with a good base for further consideration of the enumerated practices.

Consumer complaints

In 1976 the Board adopted Regulation AA, which provides guidance as to the form complaints should take and encourages consumers to bring any problems they might have with State member banks to the attention of the Federal Reserve System. In 1977 a computerized Consumer Complaint Information System for the Board and the 12 Federal Reserve Banks was placed in full operation. That system provides a chronology of each complaint processed, as well as summaries of complaints by type and Federal Reserve district, and also helps the Board to monitor the compliance of State member banks with consumer protection laws.

The Federal Reserve System receives complaints and inquiries about all areas of consumer activity. A statistical review of consumer complaints received in 1977 appears at the bottom of page 360. Those figures indicate that the most frequently received complaints involve either Regulation B or Z, or relate to problems that are not the subject of current regulation. The most common Regulation B com-

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plaints alleged credit denial due to lack of credit history or poor credit history. The most frequent type of Regulation Z complaint involved disputed amounts on open-end periodic billing statements. The next most frequent complaints were those alleging problems with escrow accounts maintained in connection with extensions of credit other than open end, and those expressing problems or confusion about the disclosure of finance charges and annual percentage rates.

The large number of complaints classified "Other" do not readily lend themselves to discrete categorizing. Of the nearly 1,700 such complaints shown as "Other" in the tabulation, the two most common types—that is, those involving disputes as to the amounts of deposits made or disagreements over the balance in accounts—together comprised only 13 per cent of the total. As in 1976, a lack of communication between consumer and bank is the cause of most

Statistical review of consumer complaints received by the Federal Reserve System in 1977

Number

Subject area:	
Regulation B	879
Regulation C	2
Regulation Q	145
Regulation T	1
Regulation U	1
Regulation Z	582
Fair Credit Reporting	124
Title VIII, Civil Rights	3
Transfer agents	1
Holder-in-due-course	13
Municipal securities dealer regulation	4
Other [1]	1,690
Total	3,445
Disposition:	
Cases completed:	
Regarding State member banks, and processed by System staff	787
Other than State member banks:	
Referred	1,711
Response provided by System staff	777
Cases pending as of December 31:	
Regarding State member banks	144
Other than State member banks	26
Total	3,445

[1] "Other" refers primarily to complaints that could not be categorized under identifiable consumer credit legislation administered by the Board, and includes complaints against business entities other than financial institutions.

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reported problems. Frequently, an individual will contact the Board or a Reserve Bank concerning a problem without first having attempted to resolve the difficulty at its source.

As the writer of many regulations regarding consumer credit, the Board receives numerous general inquiries and complaints that do not concern State member banks. If correspondence refers to an institution outside the Board's supervisory jurisdiction, the complaint is forwarded to the appropriate agency. If the complainant fails to name an institution, but describes a problem covered by the law, or inquires generally about the law, the Board provides an informational response or asks the complainant to furnish further details.

When a complainant describes a problem with a State member bank, any necessary investigation is conducted by the local Reserve Bank. The investigation includes gathering any necessary additional information, determining whether the complaint is well-founded, and taking appropriate action. The Board's staff reviews all complaints received by the Board that are referred to the Reserve Banks, and selectively reviews complaints filed directly with the Reserve Banks.

In September 1976 the Subcommittee on Consumer Affairs of the House Committee on Banking, Currency and Housing issued a staff report after having investigated the consumer complaint-handling procedures of the financial regulatory agencies. The subcommittee specifically recommended in its report that the Board "periodically evaluate the overall efficiency of its complaint handling system and implement changes which would improve its efficiency." Accordingly, starting on July 11, 1977, a form followup letter was sent to those individuals who had contacted the Board subsequent to April 1, 1977, about a problem involving a State member bank, in order to assist the Board in assessing the System's consumer complaint resolution efforts. Thirty-seven per cent of the complainants responded to the letter, and the majority of those were generally satisfied with the promptness and courtesy afforded them. Although fewer than 50 per cent of the complainants agreed with the final resolution of their problem, more than 70 per cent indicated their willingness to contact the Federal Reserve with future problems.

The Board is preparing a pamphlet that will explain briefly the complaint procedure for consumer protection laws that apply to banks. The pamphlet will contain a tear-out form that consumers can use to bring their complaints to the appropriate agencies' attention.

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Issuance of substantially similar regulations

During 1977 the FTC published no new rule-making proposals under the Federal Trade Commision Act. The Board's action on three pending proposals is described below.

Credit practices rule. This rule was originally proposed by the FTC on April 9, 1975, and shortly thereafter the Board published for comment a virtually identical version.

In the latter half of 1977 the FTC conducted a series of hearings on its proposal at several locations. A member of the Board's staff appeared and testified on the proposed rule on December 20, 1977. The testimony consisted of two documents: a memorandum analyzing the comments received by the Board according to type of commentator and number and substance of comments; and a second memorandum discussing possible technical problems with the rule. The Board is awaiting further action by the FTC on the proposal.

Preservation of consumers' claims and defenses. The FTC's proposed amendment to the "Holder rule" would obligate lenders to insert a specific contract provision in certain direct loan agreements. The effect of inserting that provision would be to permit a consumer to assert claims or defenses against a lender that may arise from defective goods or services. During 1977 a parallel rule was prepared that would impose upon banks requirements that are substantially similar to those imposed upon nonbank lenders by the FTC's proposal. That draft was forwarded to the FTC's staff for review, and was subsequently the subject of an interagency meeting and discussion.

The major changes in the parallel rule were intended to provide banks with specific guidance as to problems that might develop in connection with the extension of unsecured credit. In addition, the draft would permit banks to add language to the notice explaining that assertable claims and defenses include only those that relate to (1) the consumer credit contract itself, (2) the transaction underlying the contract, or (3) the goods or services purchased with the proceeds of the contract. Most of the other revisions were intended to incorporate into the rule itself the clarifications and guidance offered by the FTC and its staff in two interpretive statements published in 1976.

In early 1978 the Board transmitted its draft rule to the FTC for

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comment and is awaiting the final FTC staff report on the proposal before acting further.

Sale of used motor vehicles. This rule, proposed by the FTC on December 23, 1975, was also the subject of nationwide hearings during 1977. The rule, intended primarily to impose certain disclosure requirements upon used motor vehicle dealers, also appears to cover those bank creditors that engage in the sale of used motor vehicles after repossession or expiration of lease. Staff comments were transmitted to the FTC in October 1976; the Board is awaiting releases of the reports from the staff and hearing officer of the FTC before taking further action.

HOME MORTGAGE DISCLOSURE

Enforcement of the Home Mortgage Disclosure Act

The Board of Governors of the Federal Reserve System enforces the Home Mortgage Disclosure Act (HMDA) of 1975, as implemented by Regulation C, for State member banks. In 1977 the Board initiated a program of special examinations specifically designed to determine compliance with the consumer credit regulations, including Regulation C. During 1977 special examinations of the State member banks subject to the HMDA revealed a high degree of compliance.

Interpretations of Regulation C

On March 31, 1977, the Board of Governors adopted two technical interpretations of Regulation C. The act and implementing regulation require depositary institutions subject to the act to disclose publicly the geographic area in which they are making residential mortgage loans.

One interpretation, designated 203.001, permits a depositary institution that is majority owned by another depository to disclose its mortgage loan data separately from that of the parent. The other interpretation, designated 203.002, clarifies what disclosures must be made by depositories that were exempt from the provisions of the act but that subsequently lose their exemption (by the extension of a standard metropolitan statistical area (SMSA) to cover one or more of its offices, by the growth of its assets, or by the determination that applicable State disclosure law is not substantially similar to

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the Federal act). The interpretation permits a previously exempt institution that becomes subject to the act to compile mortgage lending data by postal ZIP code areas, in lieu of Census Bureau census tracts, for its last full fiscal year and any portion of its current fiscal year ending prior to the loss of exemption. The same treatment was given to depositories in the first year after Regulation C became effective on June 28, 1976.

Exemptions from the HMDA

During 1977 the Board received one application for exemption from the disclosure requirements of the HMDA. United Jersey Banks, a bank holding company operating six New Jersey-chartered banks, requested the exemption, on the ground that New Jersey law and implementing State regulations provide for disclosures substantially similar to those required by the HMDA and contain adequate provisions for enforcement. The exemption application was approved by the Board on February 15, 1978, and applies to all New Jersey-chartered depositary institutions that are subject to the New Jersey act.

Section 308 study

Section 308 of the HMDA directs the Board, in consultation with the U.S. Department of Housing and Urban Development (HUD),

> to carry out a study to determine the feasibility and usefulness of requiring depository institutions located outside standard metropolitan statistical areas . . . to make disclosures comparable to those required by [the act].

The results of the study must be submitted to the Congress by December 31, 1978.

The Board plans to divide the study into two major parts. The first will analyze the "usefulness" of HMDA data, and the second will examine the "feasibility" of employing alternative geographic bases (counties, townships, postal ZIP code areas, and census enumeration districts) for nonmetropolitan disclosure.

In determining the usefulness of HMDA data, the Board hopes to rely upon information gathered during the course of two other HMDA studies—one sponsored jointly by the Federal Home Loan Bank

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Board and the Federal Deposit Insurance Corporation and the other funded by HUD. The Board expects, however, to obtain additional data from Federal bank examiner reports and possibly from industry trade associations.

In the feasibility part of the study, the Board intends to identify the possible geographic units outside of SMSA's that could serve as bases for disclosure, to investigate the availability and cost of geocoding materials for nonmetropolitan disclosures as well as the convenience of using these materials, and to determine which of the possible alternative geographic units is most familiar to the public and which would be most effective for disclosure purposes.

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Securities Acts Amendments of 1975

Pursuant to the Securities Acts Amendments of 1975 (Public Law 94–29), the Board of Governors is designated "the appropriate regulatory agency" with respect to State member banks and bank holding companies that act as municipal securities dealers or as clearing agencies. As of December 31, 1977, 49 State member banks, including separately identifiable departments or divisions thereof, and one bank holding company were registered as municipal securities dealers. Municipal securities dealer activities of 47 of these organizations subject to Federal Reserve supervision were examined in 1977.

During 1977 the Board consulted with the Municipal Securities Rulemaking Board (MSRB) with respect to rules promulgated by that organization, as contemplated by Section 17(c)(1) of the Securities Exchange Act of 1934. In addition, the Board, acting with the other Federal bank regulatory agencies, adopted uniform forms (Forms MSD–4 and MSD–5) to be filed on behalf of certain persons associated with municipal securities dealers giving information with respect to their professional qualifications. Under a joint agreement with the Federal bank regulatory agencies, the computer facilities of the National Association of Securities Dealers, Inc., are utilized to verify, evaluate, and maintain this information.

As of December 31, 1977, four registered clearing agencies were members of the Federal Reserve System; all were examined during 1977. These examinations are designed to determine whether the clearing agency's activities are conducted in accordance with safe and sound banking practices and, if they are not, to evaluate the impact of their over-all condition and to recommend and enforce corrective action as appropriate under the circumstances.

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Government in the Sunshine

Under the Government in the Sunshine Act, more than a quarter of the meetings of the Board of Governors in 1977 were entirely or partially open to the public. Items considered in the closed sessions, pursuant to exemptions in the act, related primarily to bank and bank holding company supervision—discussions of which generally involve information from bank examination reports as well as commercial and financial information obtained in confidence by the Board; information whose premature release could cause financial speculation, such as certain monetary actions; and personnel matters.

In addition to appearing in the *Federal Register,* advance notices of meetings are available to the public at the Board's Freedom of Information and Public Affairs Offices and at the Treasury Department's press room, and copies are mailed to several public interest groups. Notices of open meetings are also sent to the Associated Press city wire. All notices invite the public to address inquiries to the Board's Public Affairs Office, which is prepared to provide details about any meeting. In the event of a change to an open meeting when advance written notice is unlikely to be received, media representatives who regularly attend such sessions are advised by telephone.

Members of the public who attend open meetings are provided with an agenda that summarizes, in detail, the issues that the Board members will be discussing. Following each open meeting a representative of the Public Affairs Office is available for further questioning about the proceedings.

Tape recordings or minutes, as required under the act, are maintained for all meetings that are closed to the public. These materials may be examined in the Board's Freedom of Information Office, except for those portions that the Board has determined should be withheld from the public under applicable exemptions.

During 1977 the Board held 114 meetings—13 were entirely open, 18 open with a portion closed, and 83 closed. Eighty-seven per cent of the meetings involved "expedited procedures," with the items falling under exemptions 4, 8, 9A, or 10 to the open meeting

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requirements of the Sunshine Act. The reason(s) for closing the 101 meetings are indicated in the following tabulation:

Under exemption—	Number of meetings	Under exemption—	Number of meetings
6	1	2, 4, 8, 10	1
8	1	4, 6, 8, 9B	1
9A(i)	6	4, 8, 9A(i), 9A(ii)	1
9B	1	4, 8, 9A(i), 10	2
		4, 8, 9A(ii), 9B	2
2, 9A(i)	1	4, 8, 9A(ii), 10	1
3, 8	1	6, 8, 9A(i), 9B	1
4, 8	3	8, 9A(i), 9A(ii), 9B	1
8, 9A(i)	2	8, 9A(i), 9B, 10	2
8, 9B	2	8, 9A(ii), 9B, 10	1
9A(i), 9B	3		
		2, 4, 6, 8, 9A(ii)	2
2, 4, 8	1	2, 4, 8, 9A(i), 9B	1
2, 8, 9A(i)	1	2, 4, 8, 9A(ii), 9B	1
2, 8, 9B	2	4, 5, 8, 9A(i), 9B	1
2, 9A(i), 9B	1	4, 6, 8, 9A(i), 9B	1
4, 8, 9A(i)	3	4, 8, 9A(i), 9A(ii), 9B	4
4, 8, 9A(ii)	2	4, 8, 9A(i), 9A(ii), 10	1
4, 8, 9B	4	4, 8, 9A(i), 9B, 10	1
4, 8, 10	2		
5, 8, 10	1	2, 3, 6, 8, 9A(i), 9B	1
6, 8, 9A(i)	1	2, 4, 6, 8, 9A(i), 9A(ii)	1
8, 9A(i), 9A(ii)	3	2, 4, 6, 8, 9A(i), 9B	3
8, 9A(i), 9B	4	2, 6, 8, 9A(i), 9A(ii), 10	1
8, 9B, 10	2	4, 5, 7, 8, 9A(ii), 10	1
9A(i), 9B, 10	1	4, 5, 8, 9A(i), 9A(ii), 9B	1
		4, 8, 9A(i), 9A(ii), 9B, 10	1
2, 4, 6, 8	3		
4, 6, 8, 9A(i)	1	2, 4, 5, 6, 8, 9A(i), 9B	1
4, 8, 9A(i), 9B	9	2, 5, 7, 9A(i), 9A(ii), 9B, 10	1
5, 8, 9A(i), 9B	1		
2, 4, 8, 9B	1	3, 4, 6, 8, 9A(i), 9A(ii), 9B, 10	1

In *Consumers Union of the United States, Inc.* v. *Board of Governors of the Federal Reserve System,* D.D.C., Civil Action No. 77–1800 (filed October 17, 1977), Consumers Union sued the Board of Governors following a written request for access to two memoranda prepared for the Board by its staff in connection with a matter that was discussed at a meeting of the Board open to public observation under the Government in the Sunshine Act. Even though the Board subsequently made the memoranda available in full to Consumers Union under the Freedom of Information Act, plaintiff sought a judicial declaration that it was also entitled to the memoranda under the Sunshine Act. On January 24, 1978, the suit was dismissed with prejudice.

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Legislative Recommendations

In exercising its responsibility to advise the Congress of statutory changes that would improve bank regulation, the performance of the banking industry, and the conduct of monetary policy, the Board of Governors has proposed the following recommendations:

PAYMENT OF INTEREST ON RESERVE BALANCES—NOW ACCOUNTS

During 1976 and 1977 the Board conducted a major review of the costs to commercial banks of Federal Reserve membership and of the continuing withdrawal of banks from the Federal Reserve System. The financial burden of membership—consisting of earnings foregone by member banks on reserves held in the form of non-interest-bearing deposits at the Federal Reserve—has resulted in banks leaving the Federal Reserve System at an accelerating rate. The Board concluded that this erosion of membership may be weakening both the soundness of the banking system and the Federal Reserve's control of monetary policy and has urged that legislation be enacted to reduce the burden of membership in order to halt the departure of banks from the System.

More specifically, the Board recommended confirming the authority to pay interest on required reserve balances held at Federal Reserve Banks and authorizing a reduction in the statutory limits on reserve requirements as part of a legislative package that includes the nationwide extension of NOW (negotiable orders of withdrawal) accounts. Reserve requirements would be imposed on such accounts for all depositary institutions and would be set by the Federal Reserve. The Board not only views the components of this legislative package as inseparable but also believes that such legislation would enhance the soundness of the banking system, improve monetary control, and guide in an orderly fashion the long-developing trend toward payment of interest on transaction balances.

In order to minimize the transition costs of NOW accounts to financial institutions, the Board has recommended provisions limiting NOW accounts to individuals, requiring that the maximum interest rate on NOW accounts be set below the rate on savings deposits at

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member banks, delaying the effective date of the legislation until 1 year after enactment, and establishing a reserve requirement range for NOW accounts that is lower than the demand deposit range.

STRENGTHENED SUPERVISORY POWERS

As a part of its continuing study of banking supervision and regulation, the Board has made a number of legislative recommendations to the Congress designed to improve the performance of banks and strengthen bank regulation.

The Board's recommendations include the granting of new supervisory powers authorizing the Board to—

. . Impose civil penalties for violation of (1) restrictions on bank lending to insiders and affiliates, (2) the reserve requirement and interest rate limitation sections of the Federal Reserve Act, (3) provisions of the Bank Holding Company Act, and (4) cease-and-desist orders.

. . Remove or suspend directors, officers, or other persons participating in the affairs of an insured bank for gross negligence in the operation or management of the bank or for continuing disregard for the safety or soundness of the bank as well as personal dishonesty; and extend the removal powers of the Board to bank holding companies and their nonbank subsidiaries.

. . Require divestiture by a bank holding company of a subsidiary or termination of nonbanking activities whenever the continuation of such ownership or activity threatens the safety, soundness, or stability of a bank holding company's subsidiary bank and is inconsistent with the law or with sound banking principles.

The proposals would also make clear that cease-and-desist orders may be issued under the Financial Institutions Supervisory Act directly against any director, officer, employee, agent, other person who participates in the conduct of the affairs of a bank, without regard to whether the bank itself is named in the proceeding; and would make clear the Board's cease-and-desist power with respect to officers, directors, employees, and agents of a bank holding company and to Edge Act and agreement corporations whether or not they are subsidiaries of a bank holding company.

The Board has also proposed further restrictions on insider loan transactions. Loans to a bank's officers and to 10-per-cent stockholders would be aggregated with loans to companies controlled by

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them in applying the limit on loans to a single borrower. Specific approval of two-thirds of the entire board of directors would be required, with the interested party abstaining, before a loan could be made to a director or to a more-than-10-per-cent stockholder, or to any company controlled by such a person when the amount of all such loans exceeds $25,000. All loans to a bank's officers, directors, and 10-per-cent stockholders and to companies controlled by them would have to be made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons.

The proposed bill would also authorize the Board to approve the acquisition by an out-of-State bank holding company of a troubled large bank in certain emergency and failing bank situations in order to avoid adverse potential impact when the failing bank is one of the largest in a State and when the public interest would best be served by an out-of-State acquisition.

The Board also has submitted draft legislation to establish a Federal Bank Examination Council consisting of the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, and the Chairman of the Board of Governors. The Council would establish uniform standards, procedures, and reporting forms for the examination of banks to be employed by each of the Federal banking agencies; establish and conduct schools for bank examiners; and develop uniform reporting systems for banks, bank holding companies, and nonbank subsidiaries.

REGULATION OF FOREIGN BANKS

The Board continues to recommend legislation to regulate foreign banks operating in the United States. In view of the dramatic rate at which foreign banking has grown in the United States in recent years and the increased importance of foreign banks in the functioning of U.S. money and credit markets, the Board is convinced of the necessity for a national policy on the entry and activity of foreign banking institutions operating in this country. The United States is practically alone among major industrial nations in having no Federal oversight of foreign banks within its borders.

In recommending legislation, the Board has been guided by two public policy considerations. The first is the adherence by our Federal Government to the principle of national treatment toward foreign

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banks operating in this country. The second is the establishment of a system of Federal supervision, regulation, and examination of foreign bank operations that is fairly comparable to the regulation of domestic banks.

The Board has emphasized the importance of subjecting foreign banking operations to Federal Reserve monetary policy controls. The Board has requested the authority to impose reserve requirements on U.S. branches, agencies, and commercial lending companies of foreign banking organizations having worldwide consolidated bank assets in excess of $1 billion as well as on State-chartered banks that are subsidiaries of such organizations. Such authority is necessary in order not to compromise the Federal Reserve's ability to affect the supply of money and credit in the U.S. economy. This would also ameliorate the competitive disadvantage that Federal Reserve member banks have in competing with such foreign lenders operating in U.S. markets.

The Board also believes that foreign bank operations should be subject to the same interstate branching restrictions as govern domestic banks and that FDIC insurance should be mandatory for deposits at foreign bank offices.

The Board's legislative recommendations would, in accordance with the principle of equality of treatment, empower the Comptroller of the Currency to license branches of foreign banks to conduct a banking business in any State on essentially the same basis as a national bank. Also, foreign banks would be allowed to establish Edge Act corporations, thereby enabling them to conduct an international banking and financing business throughout the United States on the same basis as domestic banks.

The Board has also recommended that the nonbanking prohibition of Section 4 of the Bank Holding Company Act (12 U.S.C. 1843) be made applicable to the U.S. operations of foreign banks. The Board has, however, recommended that existing U.S. nonbanking interests of foreign banks, including securities affiliates, be permanently grandfathered.

FINANCIAL TRANSACTIONS WITH AFFILIATES

During 1976 and 1977 the Board conducted a major review of Section 23A of the Federal Reserve Act. Section 23A is designed to

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protect member banks from potential abuse by restricting "non-arm's-length" financial transactions between these banks and affiliated companies. The Board's review of this statute was prompted in part by the discovery that several relatively large banks had been adversely affected by transactions with their affiliates.

One of the Board's major conclusions is that bank transactions with affiliates within the legal limits set by the statute have *not* produced substantial instability in the banking system. At the same time, the Board regards the present statute as inordinately complex and poorly drafted and, therefore, believes that it should be revised. In addition, the Board believes that the present statute contains numerous potentially dangerous "loopholes" that should be closed. Finally, there are several ways in which the present statute appears to be unduly restrictive and could be liberalized in a manner consistent with maintaining a sound banking system.

Section 23A naturally lends itself to a four-part structure as follows: (1) definition of "affiliate" for purposes of the statute, (2) types of financial transactions covered by the statute, (3) quantitative limitations on a bank's covered transactions with any affiliate and with all affiliates combined, and (4) collateral requirements for bank loans and extensions of credit to affiliates. Within this structure, the Board recommends numerous changes to the statute. Principal among these recommendations are those to (1) alter the treatment of sister bank subsidiaries within a bank holding company system to allow a holding company greater freedom to transfer funds among its subsidiary banks but disallow a bank from purchasing low-quality assets from a sister bank subsidiary, (2) add to the definition of "affiliate" real estate investment trusts and other such financial organizations that are sponsored and advised by a banking organization, and (3) expand the types of collateral permitted on bank loans and extensions of credit to affiliates but require relatively high percentages of collateral value to loan amounts.

INTERLOCKING RELATIONSHIPS

The Board of Governors has recommended to the Congress legislation that would prohibit interlocking director or management relationships between depositary institutions of all types. Section 8 of the Clayton Act presently prohibits interlocking relationships between a

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member bank and any other bank located in the same or an adjacent community.

In the Board's judgment interlocking relationships between institutions that compete for the funds of the public involve a risk of diminishing competition that the Board believes outweighs the reasonable expectation of benefits that might flow from such relationships. This reasoning not only applies to relationships between commercial banks but is equally applicable to interlocking management personnel relationships between any institutions engaged in the business of receiving deposits that may be in competition with each other: banks, savings and loan associations, mutual savings banks, credit unions, or other similar institutions.

The Board's proposed bill would apply the prohibition against interlocks between any depositary institutions and holding companies for depositary institutions located within the same metropolitan statistical area or within 50 miles of each other. In addition, regardless of location, the bill prohibits any interlock between an institution exceeding $1 billion in total assets and another exceeding $500 million in total assets.

Sufficient time would be allowed for a gradual phasing out of prohibited interlocks so that the legislation would not be unnecessarily disruptive to institutions in their efforts to maintain qualified management and directors. The Board, moreover, would have general regulatory authority to permit exceptions to the new requirements in situations that would warrant special treatment.

FEDERAL RESERVE NOTES

The Board recommends revision of the Federal Reserve Act to permit the printing of Federal Reserve notes without any designation by district. At present, all currency bears the designation of the Federal Reserve district of original issue.

Under the Board's recommendation, issues of Federal Reserve notes would conform to current practice under which currency circulates nationally without regard to Federal Reserve district boundaries. The change would result in a substantial saving in the printing and distribution of currency and would also make it possible to estimate the amounts of currency that are not circulating or have been lost or destroyed.

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COLLATERAL FOR FEDERAL RESERVE NOTES

The Board also recommends that the Congress authorize the use of U.S. Government agency securities as collateral for Federal Reserve notes and that this collateral back all notes on a national, rather than a district, basis. Collateral currently includes gold and special drawing rights (SDR) certificates, eligible paper, and U.S. Treasury securities.

At present, U.S. Government agency securities are eligible for purchase in the open market by the Federal Reserve but they may not be used as collateral for Federal Reserve notes. When the authority for Federal Reserve purchase of agency securities was enacted into law, no provision was made for using such securities as collateral for Federal Reserve notes. Insofar as collateral is concerned, there seems to be no good reason for the differing treatment of the two types of securities. A change in the law would add flexibility to System operations in the purchase and sale of Government securities and would provide additional leeway for collateralizing Federal Reserve notes.

TRUTH IN LENDING ACT SIMPLIFICATION

As a result of growing concern about the complexity of Truth in Lending, the Board launched a major effort in 1977 to recommend ways of simplifying the statute. Creditors acting in good faith have experienced difficulty in complying with Truth in Lending due to the complexity of the requirements. Likewise, the complexity of the disclosures appear to have diminished their usefulness to consumers.

In July 1977 the Board submitted a draft bill to the Congress to simplify closed-end credit disclosures and in September made additional recommendations to simplify and improve disclosures for open-end credit transactions.

The Board's proposal has several major elements. It is designed to emphasize the important cost disclosures, and it reduces the detail of the disclosures, for example, eliminating the itemization of the components of the finance charge and of the amount financed. The most important information on credit terms, such as annual percentage rate, would be retained and highlighted, while some subsidiary

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aspects of the transactions, such as whether the obligation is secured, would be summarized rather than presented in complete detail.

The disclosures required by Federal law would be segregated from other matters in the contract and from other information required to be disclosed by State law so that the Truth in Lending disclosures would not be lost among other provisions.

The credit cost terminology would be explained in plain English to make it more readily understandable to consumers. The Board would be required to develop and publish model forms and clauses that, if properly completed, would protect creditors from civil liability under the act. The proposal also contains extensive clarifications of a technical nature. (See Consumer Affairs, beginning on page 332.)

DISCLOSURE OF THE FOMC'S DOMESTIC POLICY DIRECTIVE

At each of its monthly meetings the Federal Open Market Committee (FOMC) adopts a domestic policy directive that guides the conduct of operations by the Manager of the Open Market Account for the month ahead. The directive includes ranges of tolerance that are acceptable for short-run growth rates in certain monetary aggregates and for changes in the Federal funds rate.

It has been the practice of the FOMC to delay the public release of the domestic policy directive for approximately 1 month following its adoption until it has been superseded by a new directive.

A November 1977 ruling of the Court of Appeals for the District of Columbia would require the FOMC to make each of its directives public immediately after the meeting at which it is adopted. The FOMC believes that such a practice would significantly impair its ability to discharge its statutory responsibility to carry out monetary policy and would be substantially contrary to the national interest.

Consequently, the Federal Reserve has requested the Congress to enact legislation that would require the deferral of any public release of the FOMC's domestic policy directive for approximately 1 month after the adoption of the directive, that is, until shortly after the next meeting of the FOMC.

LOANS TO BANK EXAMINERS

Title 18 of the U.S. Code, "Crimes and Criminal Procedures," prohibits loans to a bank examiner by any bank that the examiner is

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authorized to examine. For several years the Board has favored modification of this prohibition to permit a Federally insured bank to make a home mortgage loan to a bank examiner under appropriate statutory safeguards. The Board also believes that a bank examiner may experience difficulties in that he or she is prevented from obtaining other forms of bank credit, such as loans to finance the education of children, automobile loans, home improvement loans, credit-card loans, and other types of consumer credit. For that reason, the Board favors legislation to permit loans to a bank examiner to be made in accordance with regulations prescribed by the agency employing the examiner.

LENDING AUTHORITY OF FEDERAL RESERVE BANKS

The Board again urges enactment of legislation that would permit member banks to borrow from their Reserve Banks on the security of any sound assets without paying a "penalty" rate of interest whenever technically ineligible paper is presented as collateral.

Under Section 13 of the Federal Reserve Act, Federal Reserve Banks may extend short-term credit to member banks on their promissory notes that are secured by obligations eligible either for purchase or for discount by the Reserve Banks.

Under Section 10(b) the Reserve Banks are authorized to extend to member banks credit secured simply by collateral viewed as satisfactory by the Reserve Banks. However, Section 10(b) also provides that such credit extensions "shall bear interest at a rate not less than one-half of 1 per centum per annum higher than the highest discount rate in effect" at the Reserve Bank making the loan—except for such advances secured by mortgages on 1- to 4-family homes. The result is that many sound member bank loans cannot qualify as security for Federal Reserve advances except at the penalty rate of interest prescribed in Section 10(b). This is true even though the quality of the "ineligible" collateral may be equal to that of presently "eligible" paper.

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Litigation

During 1977 the Board of Governors was named in 15 additional lawsuits, compared with 22 filed in 1976 and 20 filed in 1975. Nine of the actions filed in 1977 raise questions under the Bank Holding Company Act; 16 such actions were filed in 1976. As of January 31, 1978, 28 cases remained pending, 17 of which raise questions under the Bank Holding Company Act. A brief description of each case that is still pending or that was disposed of in 1977 follows:

BANK HOLDING COMPANIES—ANTITRUST ACTION

In 1977 the U.S. Department of Justice filed no challenges under the antitrust laws of the United States to acquisitions by registered bank holding companies or bank mergers that had been previously approved by the Board, and there are no such cases pending from previous years.

BANK HOLDING COMPANIES—REVIEW OF BOARD ACTIONS

In *Bankers Trust New York Corporation* v. *Board of Governors,* No. 73-1805, filed May 25, 1973, U.S. Court of Appeals (U.S.C.A.) for the Second Circuit, petitioner requested the court to review and set aside a Board order (Federal Reserve *Bulletin,* May 1973, page 364) denying petitioner's application to engage in investment advisory activities through a newly formed subsidiary corporation in Palm Beach, Florida. In October 1973 the court granted petitioner's motion to hold the proceedings in abeyance pending the outcome on appeal of a suit in the U.S. District Court (U.S.D.C.) for the Northern District of Florida challenging the constitutionality of a Florida statute prohibiting out-of-State banking organizations from performing investment advisory services in Florida and upon which the Board had based its order. On April 14, 1975, the U.S. Supreme Court vacated the judgment of the district court in that suit, finding the suit inappropriate for a three-judge court, and remanded the case to the district court so that a new order might be entered from which a timely appeal can be taken to the U.S.C.A. for the Fifth Circuit

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(421 U.S. 901). The Florida suit is still pending, and petitioner's suit against the Board is thus in abeyance.

In *Investment Company Institute* v. *Board of Governors,* No. 74–697, filed on May 8, 1974, U.S.D.C. for the District of Columbia, the plaintiff challenged the validity under the Glass-Steagall Act of the Board's January 1972 amendment to Regulation Y (*Federal Register,* vol. 37, page 1463) permitting bank holding companies to engage in the business of acting as investment adviser to an investment company registered under the Investment Company Act of 1940. The district court dismissed the action on July 30, 1975, for lack of jurisdiction (398 F. Supp. 725). On January 14, 1977, the U.S.C.A. for the District of Columbia Circuit affirmed the district court decision, holding that Board regulations issued pursuant to the Bank Holding Company Act may be challenged only in the courts of appeals, but finding nevertheless that plaintiff may file a petition for reconsideration of the challenged regulation with the Board and obtain judicial review thereof (551 F.2d 1270). Pursuant to the court's order, plaintiff filed a petition for reconsideration and rescission of that portion of the regulation at issue and, by order dated August 31, 1977, the Board denied plaintiff's motions (Federal Reserve *Bulletin,* September 1977, page 856). On September 23, 1977, plaintiff filed a petition for review of the Board's order in the U.S.C.A. for the District of Columbia Circuit (No. 77–1862).

In *Alabama Association of Insurance Agents* v. *Board of Governors,* No. 74–2981, filed July 26, 1974, U.S.C.A. for the Fifth Circuit, and *Georgia Association of Independent Insurance Agents* v. *Board of Governors,* No. 74–3544, filed October 3, 1974, U.S.C.A. for the Fifth Circuit, petitioners challenged the Board's orders (Federal Reserve *Bulletin,* August 1974, page 596, and *Federal Register,* vol. 39, page 33414) permitting Southern Bancorporation, Birmingham, Alabama, and First National Holding Company, Atlanta, Georgia, to engage in certain insurance agency activities. On June 10, 1976, the court issued a decision upholding the Board's findings that the sale of property and casualty insurance by a bank holding company, when related to an extension of credit, is closely related to banking within the meaning of Section 4(c)(8) of the Bank Holding Company Act and Section 225.4(a) of the Board's Regulation Y and that the subject applications could reasonably be expected to produce public benefits that outweigh possible adverse effects. The court, however, determined that the sale of insurance

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for the holding company, the sale of insurance as a convenience for the purchaser, and general insurance agency activities in towns of fewer than 5,000 inhabitants are not activities closely related to banking and, therefore, are not permissible for bank holding companies (533 F.2d 224). On petitions for rehearing by the parties, the court, by order dated September 1, 1977 (558 F.2d 729), rejected petitioners' contentions that the sale of property and casualty insurance in connection with extensions of credit and other financial services should be restricted to only sales by bank subsidiaries of bank holding companies. The court also remanded to the Board the question of whether general insurance agency activities in towns of fewer than 5,000 inhabitants are closely related to banking. On November 10, 1977, petitioners filed a petition for certiorari in the Supreme Court.

In *Florida Association of Insurance Agents* v. *Board of Governors,* Nos. 75–3151, 75–3152, and 75–3153, filed August 12, 1975, U.S.C.A. for the Fifth Circuit, petitioners sought judicial review of three Board orders (*Federal Register,* vol. 40, pages 30869, 30872, and 30876) approving the application of four bank holding companies to engage in certain insurance agency activities in Florida to the extent permitted by State law. These cases were consolidated in the Fifth Circuit with the claims brought in *National Association of Insurance Agents, Inc.* v. *Board of Governors,* Nos. 75–3342, 75–3343, and 75–3358, U.S.C.A. for the District of Columbia Circuit, in which the petitioner challenged the same Board orders. These cases are currently pending before the court.

In *National Computer Analysts, Inc.* v. *Decimus Corporation, et al.,* No. 74–1684, filed November 24, 1975, U.S.D.C. for the District of New Jersey, the Board was joined as a defendant in an amended complaint challenging the 1974 *de novo* entry by Decimus Corporation, a subsidiary of BankAmerica Corporation, San Francisco, California, into data processing activities in the State of New Jersey. In an order dated April 30, 1976, the court dismissed plaintiff's claim under the Bank Holding Company Act for lack of jurisdiction. Plaintiff appealed the court's order to the U.S.C.A. for the Third Circuit (No. 76–2099), and that court, on May 6, 1977, affirmed the district court's dismissal of the Board as defendant.

Two other actions have been brought with respect to the conduct of data processing activities by BankAmerica Corporation, through its subsidiary, Decimus Corporation, in New Jersey and neighboring

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States. In *BankAmerica Corporation* v. *Board of Governors,* No. C77–1005 SW, filed May 13, 1977, BankAmerica Corporation sought a declaratory judgment that its proposal to expand geographically, and continue to engage in, data processing activities through the Decimus Corporation within a 500-mile radius of Piscataway, New Jersey, had been approved by operation of law because the Board failed to act on the proposal within the statutory 91-day period. On July 29, 1977, the district court ruled in favor of BankAmerica Corporation. The Board has appealed this decision to the U.S.C.A. for the Ninth Circuit (No. 77–3485). In the second case, *BankAmerica Corporation* v. *Board of Governors,* No. 77–2173, filed May 25, 1977, U.S.C.A. for the Ninth Circuit, BankAmerica Corporation sought judicial review of a Board order, dated May 20, 1977 (*Federal Register,* vol. 42, page 27293), providing for a hearing with respect to its application to engage in data processing activities through the Decimus Corporation. Both actions have been consolidated and are pending in the court of appeals.

In *First Lincolnwood Corporation* v. *Board of Governors,* No. 76–1114, filed February 5, 1976, U.S.C.A. for the Seventh Circuit, petitioner asked the court to review the Board's order of January 9, 1976 (Federal Reserve *Bulletin,* February 1976, page 153), denying, for inadequate financial resources, petitioner's application to become a bank holding company through acquisition of the First National Bank of Lincolnwood, Lincolnwood, Illinois. In a decision dated December 7, 1976 (546 F.2d 718), a panel of the court affirmed the Board's order, holding that substantial evidence supported the Board's findings, that the Board's order was issued within 91 days from the submission of the complete record, and that the Board complied with its own regulations governing applications to form a bank holding company. On petitioner's request for rehearing, the court *en banc,* in a decision dated July 13, 1977 (560 F.2d 258), set aside the Board's order, holding that under the Bank Holding Company Act the Board's authority to deny an application to form a bank holding company is limited to cases in which the formation would cause or enhance adverse financial conditions in the proposed subsidiary bank. The court found that the restructuring of bank ownership from individuals to a corporation owned by the same individuals was not likely to have such a result and that the Board improperly denied approval to First Lincolnwood Corporation. On December 10, 1977, the Board filed a petition for a writ of certiorari in the Supreme Court

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seeking review of the decision of the Seventh Circuit (No. 77–832).

In *Memphis Trust Company* v. *Board of Governors,* No. C76–64, filed February 19, 1976, U.S.D.C. for the Western District of Tennessee, plaintiff requested that the Board's order of April 10, 1975 (Federal Reserve *Bulletin,* May 1975, page 327), denying plaintiff's application to acquire Home Owners Savings and Loan Association, Collierville, Tennessee, be set aside. In a decision on June 4, 1976, the court held that plaintiff's application had been approved by operation of law because the Board had not acted on the application within 91 days after the submission of the complete record to the Board and that the district court had jurisdiction over plaintiff's suit. The Board has appealed to the U.S.C.A. for the Sixth Circuit (No. 76–2183). The case is pending.

In *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors,* No. 76–1186, filed February 23, 1976, U.S.C.A. for the Seventh Circuit, petitioners asked the court to review and set aside the Board's order of January 26, 1976 (Federal Reserve *Bulletin,* February 1976, page 148), that found that operation of a travel agency is not closely related to banking and therefore is not a permissible activity for bank holding companies. On January 12, 1978, the court denied the petition for review. The court held that the Board applied the proper legal standard in making its decision and that its findings with respect to the operation of travel agencies by banks are not arbitrary, capricious, or an abuse of discretion.

In *Grandview Bank and Trust Company* v. *Board of Governors,* No. 76–1236, filed March 25, 1976, U.S.C.A. for the Eighth Circuit, petitioner sought review of a Board order (*Federal Register,* vol. 41, page 12093) approving the application of Commerce Bancshares, Inc., Kansas City, Missouri, to acquire Commerce Bank of Grandview, N.A., Grandview, Missouri, a proposed new bank. In a decision dated March 2, 1977 (550 F.2d 415), the court affirmed the Board's order, holding that the acquisition would not violate Missouri branch-banking laws, that the Board's findings with respect to lack of anti-competitive effects and financial resources and future prospects were supported by substantial evidence, and that the Board's denial of a hearing on the application was proper. On October 3, 1977, the Supreme Court denied the petition for certiorari filed by petitioner in this case, 98 S. Ct. 64.

In *Farmers and Merchants Bank of Las Cruces, New Mexico* v.

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Board of Governors, No. 76–1367, filed April 19, 1976, U.S.C.A. for the District of Columbia Circuit, petitioner asked the court to review and set aside the Board's order of March 29, 1976 (Federal Reserve *Bulletin*, April 1976, page 373), approving the application of First New Mexico Bancshares Corporation, Albuquerque, New Mexico, to acquire the Bank of Las Cruces, N.A., Las Cruces, New Mexico, a proposed new national bank. On November 7, 1977, the court issued a decision affirming the Board's order. The court held that the Board's failure to hold a formal hearing on the application was not improper and that the Board's determinations on the competitive effects of the proposal and on alleged violations of the branch-banking laws of New Mexico were supported by substantial evidence.

In *North Lawndale Economic Development Corporation* v. *Board of Governors,* No. 76–1167, filed June 25, 1976, U.S.C.A. for the Seventh Circuit, petitioner sought judicial review of the Board's order of June 7, 1976 (Federal Reserve *Bulletin*, July 1976, page 639), denying petitioner's application to become a bank holding company through acquisition of a proposed new bank and to continue to engage in certain community development activities. On March 31, 1977, the court of appeals issued an order vacating the Board's order on the grounds that petitioner's application is deemed granted as a matter of law because the Board did not act on the application within 91 days from submission of the complete record to the Board (553 F.2d 23). On May 3, 1977, the court denied the Board's petition for rehearing.

In *Central Wisconsin Bancshares, Inc.* v. *Board of Governors,* No. 76–1603, filed June 25, 1976, U.S.C.A. for the Seventh Circuit, petitioner requested the court to review and set aside an order of the Board dated May 26, 1976 (Federal Reserve *Bulletin*, June 1976, page 538), denying petitioner's application to acquire Central National Bank of Wausau, Wausau, Wisconsin. Petitioner argued that the application was approved by operation of law because the Board failed to act on the application within the 91-day statutory period imposed in 12 U.S.C. Section 1842(b). The case has been submitted to the court.

In *International Bank* v. *Board of Governors, et al.,* No. 76–1380, filed July 23, 1976, U.S.D.C. for the District of Columbia, plaintiff sought a declaratory judgment that plaintiff's proposed acquisition of an impermissible nonbanking activity during the pendency of an

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administrative proceeding before the Board in which plaintiff was challenging its status under the Bank Holding Company Act would not constitute a criminal violation of the act. On January 15, 1977, the suit was dismissed without prejudice pursuant to a stipulation by the parties.

In *First State Bank of Clute, Texas* v. *Board of Governors,* No. 76–3073, filed July 30, 1976, U.S.C.A. for the Fifth Circuit, three banks brought an action to review and set aside the Board's order of July 1, 1976 (Federal Reserve *Bulletin,* July 1976, page 618), permitting First Freeport Corporation, Freeport, Texas, to acquire Chemical National Bank, Clute, Texas, a proposed new bank. On June 10, 1977, the court affirmed the Board's order (553 F.2d 950), holding that the Board's determinations that the proposal would not violate Texas branch-banking law and that the acquisition will have a procompetitive impact were supported by substantial evidence. The court also held that the Board was empowered under the Bank Holding Company Act to approve the acquisition of a proposed, but not yet operating, bank.

In *First Security Corporation* v. *Board of Governors,* No. 76–1783, filed August 27, 1976, U.S.C.A. for the Tenth Circuit, petitioner asked the court to set aside the Board's order of July 30, 1976 (Federal Reserve *Bulletin,* August 1976, page 701), denying petitioner a further extension of time to divest First Security Savings and Loan Association, Pocatello, Idaho, and declining to process petitioner's application to retain the savings and loan association. In a second case, *First Security Corporation* v. *Board of Governors,* No. 77–1188, filed March 21, 1977, U.S.C.A. for the Tenth Circuit, petitioner challenged a Board order dated February 22, 1977 (Federal Reserve *Bulletin,* March 1977, page 287), denying the same petitioner's request for reconsideration of the Board's previous order of July 30, 1976. The two cases were consolidated and on December 9, 1977, were dismissed on petitioner's motion.

In *Michigan National Corporation* v. *Board of Governors,* No. 76–2259, filed September 22, 1976, U.S.C.A. for the Sixth Circuit, petitioner sought judicial review of the Board's order of August 24, 1976 (*Federal Register,* vol. 41, page 36550), denying petitioner's application to acquire Peoples Bank and Trust Company, N.A., Trenton, Michigan. The suit was dismissed by the court on March 30, 1977, on petitioner's motion.

In *National Automobile Dealers Association, Inc.* v. *Board of*

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Governors, No. 76–2021, filed November 12, 1976, U.S.C.A. for the District of Columbia Circuit, petitioner challenged a Board order dated October 13, 1976 (Federal Reserve *Bulletin,* November 1976, page 930), in which the Board determined that automobile leasing is closely related to banking and made a general determination that automobile leasing is a proper incident to banking. The Board concluded that bank holding companies may continue to conduct automobile leasing activities in a manner consistent with the Board's personal property leasing regulation and amended its Regulation Y to provide that such leases be on a nonoperating basis. The case is pending before the court.

In *Farmers State Bank of Crosby* v. *Board of Governors,* No. 77–1039, filed January 12, 1977, U.S.C.A. for the Eighth Circuit, petitioner sought judicial review of the Board's order dated December 13, 1976 (Federal Reserve *Bulletin,* January 1977, page 63), approving an application by Dakota Bancorporation, Rapid City, South Dakota, to acquire the First National Bank of Crosby, Crosby, North Dakota. In a decision dated November 30, 1977, the court affirmed the Board's order. The court held that there was no foundation for petitioner's contention that the applicant made a misleading statement in an offering circular that applicant had issued in connection with an offering of its common stock. The court also held that the Board had no authority or duty to approve a proposed merger of applicant's national bank subsidiaries and thus was not required to conduct a hearing with respect to the merger.

In *First State Bank of Abilene, Texas* v. *Board of Governors,* No. 77–1703, filed August 5, 1977, U.S.C.A. for the District of Columbia Circuit, petitioner asked the court to set aside the Board's order of July 7, 1977 (Federal Reserve *Bulletin,* August 1977, page 744), approving the application of First International Bancshares, Inc., Dallas, Texas, to acquire the Texas State Bank, Abilene, Texas, a proposed new bank.

In *Plaza Bank of West Port* v. *Board of Governors,* No. 77–1730, filed September 14, 1977, U.S.C.A. for the Eighth Circuit, petitioner sought judicial review of a Board order dated August 15, 1977 (Federal Reserve *Bulletin,* September 1977, page 848), approving the application of Manchester Financial Corporation, St. Louis, Missouri, to acquire Manchester Bank West County, Maryland Heights, Missouri, a proposed new bank.

In *Central Bank* v. *Board of Governors,* No. 77–1937, filed Octo-

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ber 17, 1977, U.S.C.A. for the District of Columbia Circuit, petitioner asked the court to review a September 13, 1977, determination by the Board denying petitioner's request for a determination that the individual organizers of the Tri-City National Bank of West Allis, West Allis, Wisconsin, constitute a company under the Bank Holding Company Act.

In *Vickars-Henry Corporation* v. *Board of Governors,* No. 77–3890, filed December 13, 1977, U.S.C.A. for the Ninth Circuit, petitioner challenged a Board letter determination, dated November 15, 1977, that petitioner is not a bank holding company for purposes of the Bank Holding Company Tax Act of 1976.

In *Lionel J. Gelfand* v. *Board of Governors,* No. 77–3473, filed December 19, 1977, U.S.C.A. for the Fifth Circuit, petitioner seeks to overturn a November 22, 1977, decision by the Federal Reserve Bank of Chicago to extend, pursuant to Section 4(c)(2) of the Bank Holding Company Act, for 1 year the time within which First Chicago Corporation, Chicago, Illinois, must divest shares of Beacon Hill Corporation acquired by First Chicago in the course of securing or collecting a debt previously contracted in good faith.

OTHER LITIGATION INVOLVING CHALLENGES TO BOARD PROCEDURES AND REGULATIONS

In *Consumers Union of the United States, Inc., et al.* v. *Board of Governors,* No. 73–1766, filed September 14, 1973, U.S.D.C. for the District of Columbia, plaintiffs brought suit under the Freedom of Information Act to compel the Board to disclose certain data on interest rates for consumer loans furnished to the Board by individual banks for its composite G.10 statistical release. In June 1974 the court ordered the Board to release all information collected in the G.10 survey. The U.S.C.A. for the District of Columbia Circuit remanded the case to the district court with instructions to oversee a settlement. A settlement was reached between the parties and a stipulation filed as to the release of future consumer data. On March 29, 1976, the district court awarded plaintiffs attorneys' fees and other litigation costs pursuant to 5 U.S.C. Section 552(a)(4)(e), finding that plaintiffs had substantially prevailed in the case. The Board's appeal from the award of attorneys' fees and other litigation costs was dismissed by motion of the Government on June 9, 1977.

In *Louis J. Roussel* v. *Board of Governors,* No. 75–1044, filed

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April 5, 1975, U.S.D.C. for the Eastern District of Louisiana, plaintiff sought damages and an injunction against a removal action instituted against plaintiff by the Board under the Financial Institutions Supervisory Act (12 U.S.C. Section 1818(e)(2) and (4)). The court dismissed the request for injunctive relief following plaintiff's resignation from the board of directors of the National American Bank of New Orleans, New Orleans, Louisiana, and the entry of a consent order of prohibition concerning his participation in the affairs of that institution. Defendants subsequently filed an answer, and the case is pending.

In *Curvin Trone* v. *United States,* No. 135–75, filed April 24, 1975, U.S. Court of Claims, plaintiff, the trustee in bankruptcy for Westgate California Corporation, brought suit against the United States under the fifth amendment for the taking of property without due process of law. The amended complaint alleges that attempts of the Federal bank regulatory agencies, including the Board and the Federal Reserve Bank of San Francisco, to prevent the failure of the United States National Bank, San Diego, California, constitute a taking of property without just compensation. On February 4, 1977, the court granted defendants' motion for summary judgment because plaintiff had failed to state a claim upon which relief could be granted. On October 3, 1977, plaintiff's petition for certiorari was denied by the Supreme Court.

In a second case related to the failure of the United States National Bank, San Diego, California, *Roberts Farms, Inc.* v. *Comptroller of the Currency, et al.,* No. 75–0268, filed November 20, 1975, U.S.D.C. for the Southern District of California, plaintiff sought damages on the grounds that the Federal bank regulatory agencies negligently supervised the bank. The case has been stayed indefinitely pending the outcome of similar suits.

In *David R. Merrill* v. *Federal Open Market Committee of the Federal Reserve System,* No. 75–0736, filed May 8, 1975, U.S.D.C. for the District of Columbia, plaintiff brought suit under the Freedom of Information Act to compel the Federal Open Market Committee to disclose immediately records of policy actions taken by the Committee and memoranda of discussion at meetings of the Committee in January and February 1975. By order of March 9, 1976 (413 F. Supp. 494), the court ruled that the records of the Committee's policy actions must be made available to the public upon adoption and that reasonably segregable factual portions of the memoranda

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of discussion must also be disclosed. In addition, the court ordered the Committee to submit to the court for *in camera* inspection all portions of the discussion memoranda that the Committee wished to withhold from plaintiff. The Committee appealed to the U.S.C.A. for the District of Columbia Circuit the district court ruling concerning disclosure of records of policy actions (No. 76–1379). By stipulation of the parties, that portion of the case related to the memoranda of discussion was dismissed by the district court on March 22, 1977. The court of appeals issued its decision on November 10, 1977 (565 F.2d 778), affirming the ruling of the district court that the Committee's monthly policy actions, including its domestic policy directives and tolerance ranges for the money stock and the Federal funds rate must be publicly released upon adoption by the Committee. The court held that the directive and tolerance ranges are not covered by the fifth exemption of the Freedom of Information Act, which exempts from disclosure internal memoranda not available by law to a party other than an agency in litigation with the agency, because these records are not predecisional records and because disclosure would not harm the deliberative processes of the Committee. The mandate of the court of appeals has been stayed, and the Solicitor General is preparing to file a petition for certiorari asking the Supreme Court to review the decision of the court of appeals.

In *International Bank* v. *Board of Governors,* No. 75–2193, filed December 31, 1975, U.S.D.C. for the District of Columbia, plaintiff brought suit under the Freedom of Information Act to obtain access to certain Board records. The case was dismissed by the court without prejudice on January 21, 1977, pursuant to stipulation of the parties.

In *In Re: Franklin National Bank Securities Litigation,* MDL No. 196, cases consolidated on April 22, 1977, several plaintiffs brought actions for damages against various defendants who were connected with the Franklin National Bank, New York, New York, which was declared insolvent by the Comptroller of the Currency on October 8, 1974. Several defendants in these actions—the insurers and auditors of Franklin National Bank and its parent holding company—filed, or sought to file, third-party actions against the United States based on the alleged negligence of the banking regulatory agencies, including the Board and the Federal Reserve Bank of New York, in the supervision of the bank. In an opinion dated January 17, 1978, the court declined to dismiss completely the third-party

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actions against the United States. The court held that the United States may be liable for alleged negligent supervision by banking regulatory agencies if the activities of these agencies with respect to the bank substituted the agencies' decisions for those of the bank's management and induced management to rely on those decisions to the detriment of the bank.

In a related case, *Corbin* v. *Federal Reserve Bank of New York, et al.,* No. 77–C4896, filed October 6, 1977, U.S.D.C. for the Southern District of New York, plaintiff, the trustee in bankruptcy of Franklin National Bank's parent holding company, alleges that certain provisions in the agreement under which the Federal Deposit Insurance Corporation (FDIC) assumed the obligation to repay Franklin National Bank's indebtedness to the Federal Reserve Bank of New York are inequitable and unjust. The case is pending.

In *National Urban League, et al.* v. *Office of the Comptroller of the Currency, et al.,* No. 76–0718, filed April 26, 1976, U.S.D.C. for the District of Columbia, plaintiffs—nine civil rights organizations and the National Association of Real Estate Brokers—filed suit against the Board, the Comptroller of the Currency, the FDIC, and the Federal Home Loan Bank Board, alleging that the defendant agencies have failed to establish regulations and otherwise to enforce the provisions of Title VIII of the Civil Rights Act of 1968, which prohibits discrimination in home mortgage lending. The complaint has been dismissed with respect to the other Federal agency defendants after these agencies entered into settlement agreements with the plaintiffs. Defendant's motion to dismiss for lack of standing was denied as to the National Urban League but sustained as to all other plaintiffs. Plaintiff has moved for summary judgment, and the case is pending with respect to the Board.

In *Henry S. Reuss* v. *John J. Balles, et al.,* No. 76–1142, filed June 22, 1976, U.S.D.C. for the District of Columbia, plaintiff, a member of the U.S. House of Representatives, alleged that the provisions of the Federal Reserve Act governing the appointment of members of the Federal Open Market Committee violate the appointments clause of the Constitution, Article II, Section 2, Clause 2. On December 22, 1976, the court dismissed the complaint for lack of standing (73 F.R.D. 90). Plaintiff's appeal from the dismissal of the complaint is pending before the U.S.C.A. for the District of Columbia Circuit (No. 77–1012).

In *Department of Revenue of the State of Illinois* v. *Olympic Sav-*

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ings and Loan Association, et al., No. 77–L–8824, filed July 7, 1977, Circuit Court of Cook County, Illinois, the Board of Governors is named as defendant in a third-party action that challenges the constitutionality of the Federal Internal Revenue Code and the issuance of Federal Reserve notes.

In *Hansen* v. *The National Commission on Observance of International Women's Year,* No. 77–1158, filed September 21, 1977, U.S.D.C. for the District of Idaho, plaintiff, a U.S. Congressman, brought suit against the National Commission on Observance of International Women's Year and various Federal officials, including the Chairman of the Board, to prevent the expenditure of Federal funds in connection with the activities of the Commission. Defendants' motion to dismiss for lack of standing is pending.

In *Consumers Union* v. *Board of Governors,* No. 77–1800, filed October 17, 1977, U.S.D.C. for the District of Columbia, plaintiff sought to compel the Board to provide access under the Government in the Sunshine Act to internal memoranda and other materials to be discussed at meetings of the Board that the Board has opened to public observation. Access to the memoranda sought by Consumers Union had been granted under the Freedom of Information Act. The parties filed a stipulation of dismissal with prejudice on January 19, 1978.

In *Emch* v. *United States, et al.,* No. 77C–677, filed November 18, 1977, U.S.D.C. for the Eastern District of Wisconsin, plaintiff, a shareholder of the parent company of the American City Bank & Trust Co., N.A., Milwaukee, Wisconsin, a failed bank, alleged that the Board and other bank regulatory agencies were negligent in supervising and examining the bank. The United States filed a motion to dismiss the complaint on January 16, 1978.

Two cases were pending in 1977 involving challenges to the Board's employment practices. On June 29, 1977, the complaint in *Darnell Hilliard* v. *Arthur F. Burns, et al.,* No. 76–1655, filed December 8, 1976, U.S.D.C. for the District of Columbia, was dismissed. Plaintiff has filed a notice of appeal from that decision. In *Louis Hadigian* v. *Board of Governors,* No. 76–1694, filed September 17, 1976, U.S.D.C. for the District of Columbia, the case has been submitted to the court.

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Legislation Enacted

EMERGENCY UNEMPLOYMENT COMPENSATION EXTENSION

An Act of Congress approved April 12, 1977 (Public Law 95–19), among other things, extended the emergency unemployment compensation program through October 31, 1977; directs that the maximum duration of emergency benefits be limited to 13 weeks; requires that a recipient of emergency benefits provide tangible evidence of a systematic and sustained effort to find work during any week for which benefits are claimed; and precludes payment of emergency benefits to persons who refuse suitable jobs.

DEPOSITORY INSTITUTIONS AMENDMENTS

An Act of Congress approved April 19, 1977 (Public Law 95–22), among other things: re-established the flexible interest rate control authority until December 15, 1977; allows Federally chartered credit unions to offer 30-year mortgage loans, revolving lines of credit, and savings certificates; and makes other changes for Federal credit unions regarding loan limits, security for loans, reserve requirements, and the issuance of dividends.

TAX REDUCTION AND SIMPLIFICATION ACT

An Act of Congress approved May 23, 1977 (Public Law 95–30), among other things:

1. Provides a standard deduction of $2,200 on single-income tax returns and $3,200 on returns filed jointly;

2. Authorizes a "new jobs" tax credit for employers of up to $100,000 each, equal to 50 per cent of the first $4,200 of wages paid to each additional employee hired in 1977 and 1978 over the average number of workers on the payroll in 1976 after adjustment to allow for 2 per cent annual growth (with the amount of an employer's deduction for wages to be reduced by the amount of such credit);

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3. Extends for an additional year, through 1978, the tax credit of $35 per individual (or 2 per cent of the first $9,000 of taxable income) and the low-income credit for families earning less than $8,000;

4. Restores through December 31, 1976, the sick pay exclusion eliminated by the Tax Reform Act of 1976;

5. Waives penalties and interest incurred with respect to the 1976 tax year by individuals and corporations as a result of changes made by the 1976 act; and

6. Authorizes $435 million additional funding for Federal Work Incentive (WIN) programs for fiscal years 1978 and 1979 and an additional $2.25 billion for countercyclical revenue sharing with States and localities.

DEFENSE PRODUCTION ACT EXTENSION

An Act of Congress approved June 1, 1977 (Public Law 95–37), extends the Defense Production Act of 1950 to September 30, 1979. Section 301 of that act is the basis for guarantees of loans for defense production.

EXPORT ADMINISTRATION ACT AMENDMENTS

An Act of Congress approved June 22, 1977 (Public Law 95–52), re-enacts and amends the Export Administration Act of 1969 to, among other things, prohibit generally any U.S. person, including any individual or corporation, and any U.S.-controlled subsidiary or affiliate of any permanent U.S. establishment of a foreign concern from acting or knowingly agreeing to act in compliance with a foreign boycott of a friendly nation by—

1. Refusing or requiring another person to refuse to do business with or in the boycotted country, or with nationals, residents, or businesses organized under the laws of the boycotted country;

2. Refusing to employ or requiring any other person to refuse to employ or otherwise discriminating against U.S. persons on the basis of race, religion, sex, or national origin;

3. Furnishing information regarding another person's race, religion, nationality, or national origin;

4. Paying, confirming, or otherwise implementing a letter of credit containing boycott conditions or restrictions; or

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5. Furnishing information about any other person's actions with respect to the boycotted country, its nationals, or persons known or believed to be boycotted.

SMALL BUSINESS ACT AND SMALL BUSINESS INVESTMENT ACT AMENDMENTS

An Act of Congress approved August 4, 1977 (Public Law 95–89), among other things, amends the Small Business Act and Small Business Investment Act of 1958 to provide additional Federal assistance under such acts.

CONGRESSIONAL BUDGET RESOLUTIONS

By binding resolution adopted September 15, 1977, the Congress set the appropriate Federal budget deficit for the fiscal year beginning October 1, 1977, at $61.3 billion and the appropriate level of the public debt at $775.5 billion, based on Federal outlays of $458.3 billion and revenues of $397.0 billion. The final figures replaced targets set by an earlier resolution, adopted May 13, 1977 (Senate), and May 17, 1977 (House).

FAIR DEBT COLLECTION PRACTICES ACT

An Act of Congress approved September 20, 1977 (Public Law 95–109), effective March 20, 1978, among other things:

1. Prohibits certain practices by debt collectors, including use of false, deceptive, or misleading representations, intentional harassment of a debtor, and unfair or unconscionable means of collecting or attempting to collect any debt;
2. Authorizes civil damages for intentional violation of the act;
3. Declares that violations of the act are unfair or deceptive acts or practices, in violation of the Federal Trade Commission Act (15 U.S.C. 58); and
4. Lodges enforcement responsibility over Federally insured financial institutions with the appropriate Federal financial supervisory agency and with the Federal Trade Commission for others engaged in debt collection responsibilities, except that the Interstate Commerce

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Commission, the Civil Aeronautics Board, and the Secretary of Agriculture are given limited enforcement authority over certain persons within their respective regulatory jurisdictions.

INTERNATIONAL DEVELOPMENT ASSISTANCE ACT

An Act of Congress approved October 3, 1977 (Public Law 95–118), among other things, provides for increased participation by the United States in the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, the Asian Development Bank and the Asian Development Fund, and the African Development Fund.

DEBT CEILING EXTENSION

An Act of Congress approved October 4, 1977 (Public Law 95–120), temporarily increases the national debt limit by $352 billion to $752 billion through March 31, 1978. Earlier authorization (Public Law 94–334), which temporarily increased the ceiling to $700 billion, had expired on September 30, 1977, at which time the permanent statutory debt ceiling of $400 billion became applicable.

COUNCIL ON WAGE AND PRICE STABILITY ACT AMENDMENTS

An Act of Congress approved October 6, 1977 (Public Law 95–121), among other things, extends the termination date of the Council on Wage and Price Stability from September 30, 1977, to September 30, 1979; and requires the Council, in its hearings, to emphasize the purpose of controlling inflation and to focus on the need for full employment.

HOUSING AND COMMUNITY DEVELOPMENT ACT

An Act of Congress approved October 12, 1977 (Public Law 95–128), among other things, eliminates limitations on graduated rate mortgages insurable by the Department of Housing and Urban Development and eliminates State usury restrictions on the calculation

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of interest on such mortgages; increases insurable mortgage limits and decreases downpayment requirements for certain Federal Housing Administration loans; and authorizes $12.45 billion to fund additional community development block grant programs for fiscal years 1978–80.

Community Reinvestment Act—Title VIII of the Housing and Community Development Act, among other things, requires Federal financial supervisory agencies:

1. To require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions and to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operations of such institutions;

2. In examining Federally insured financial institutions, to assess each lending institution's record in meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations; and to take such records into account in its evaluation of an institution that applies for a Federal charter, or for deposit insurance, or to establish a domestic branch, or to relocate a home office or a branch office, or for merger, or for approval of a holding company acquisition;

3. To promulgate regulations implementing this act to take effect 390 days following its enactment; and

4. To report annually to the Congress on actions taken to carry out its responsibilities under this act.

EXPORT-IMPORT BANK ACT AMENDMENTS

An Act of Congress approved October 26, 1977 (Public Law 95–143), among other things, urges international agreement to reduce Government-subsidized export financing; directs that respect for human rights by an export recipient country is a condition for that country to receive exports supported by loans or financial guarantees; and requires the Secretary of State to report violations of international nuclear safeguards or detonations of nuclear devices by nonnuclear powers to the Congress, and prohibits extensions of credit in support of U.S. exports to any such country unless the President determines that the national interest requires otherwise.

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INTEREST ON TREASURY TAX AND LOAN DEPOSITS

An Act of Congress approved October 28, 1977 (Public Law 95–147), among other things:

1. Permits the Treasury Department to earn interest on its tax and loan deposits in private financial institutions;
2. Expands the class of institutions authorized to become tax and loan depositories to include Federally chartered and Federally or State insured credit unions, savings banks, and savings and loan associations;
3. Requires congressional approval for the expenditure of more than 25 million ounces of International Monetary Fund (IMF) gold for the benefit of the trust fund for lesser developed countries; and for the establishment of any additional trust fund for the benefit of a single member or a particular segment of the membership of the IMF;
4. Requires the President, upon the request of any congressional committee having legislative or oversight jurisdiction over monetary policy or the IMF, to provide that committee with any appropriate and relevant information furnished by the IMF to the Executive;
5. Requires the President to certify to the Congress that exigent or unique circumstances exist when a loan or credit extended to a foreign government or entity by the Exchange Stabilization Fund (31 U.S.C. 822a(a)) will have a maturity of more than 6 months;
6. Repeals the "Joint resolution to assure uniform value to the coins and currencies of the United States," approved June 5, 1933 (31 U.S.C. 463)—the intended effect of repeal being to permit the inclusion of gold and multicurrency clauses in private contracts.

FAIR LABOR STANDARDS ACT AMENDMENTS

An Act of Congress approved November 1, 1977 (Public Law 95–151), amends the Fair Labor Standards Act of 1938 to, among other things, increase the hourly minimum wage of $2.30 to $2.65 in calendar year 1978, to $2.90 in 1979, to $3.10 in 1980, and to $3.35 after December 31, 1980; and increase the maximum annual sales of small businesses exempt from Federal minimum wage requirements

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from $250,000 to $275,000 as of July 1, 1978, to $325,000 as of July 1, 1980, and to $362,500 after December 31, 1981.

RENEWAL OF FEDERAL RESERVE BANKS' DIRECT PURCHASE AUTHORITY

An Act of Congress approved November 7, 1977 (Public Law 95–154), amends Section 14(b) of the Federal Reserve Act (12 U.S.C. 355) to renew through April 30, 1978, the authority of Federal Reserve Banks to purchase U.S. obligations directly from the Treasury. Such purchases are limited in aggregate amount for the 12 Reserve Banks to $5 billion.

Earlier congressional action (Public Law 95–22, approved April 19, 1977) had renewed direct purchase authority to October 31, 1978; but this authority was subsequently shortened to September 30, 1977 (Public Law 95–128, approved October 12, 1977).

FEDERAL RESERVE REFORM ACT

An Act of Congress approved November 16, 1977 (Public Law 95–188), among other things:

1. Extends the authority for flexible interest rate control (Regulation Q) for 1 year, until December 15, 1978;
2. Requires the Board of Governors and the Federal Open Market Committee to maintain long-run monetary and credit aggregates commensurate with the economy's long-run potential to increase production so as to promote effectively goals of maximum employment, stable prices, and moderate long-term interest rates;
3. Requires the Board to appear quarterly, alternately before the House and Senate banking committees, and to testify concerning the ranges of monetary and credit aggregates for the upcoming 12 months;
4. Prohibits discrimination on the basis of race, creed, color, sex, or national origin in the selection of Reserve Bank directors;
5. Modifies qualifications for selection of Class B and Class C Reserve Bank directors by providing that such directors shall represent the public and shall be chosen with due but not exclusive consideration given to the interests of agriculture, commerce, industry, services, labor, and consumers;

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6. Requires Senate confirmation of the Chairman and Vice Chairman of the Board of Governors;

7. Applies Federal criminal conflict-of-interest provisions for Federal employees to Federal Reserve Bank directors, officers, and employees;

8. Amends Sections 2(a)(5)(D), 3(a), and 4(c)(2) of the Bank Holding Company Act (12 U.S.C. 1842(a)) to authorize the Board to extend the period, up to a maximum of 5 years, for disposition of shares acquired by a bank or bank holding company in the course of securing or collecting a debt previously contracted in good faith if such an extension of time would not be detrimental to the public interest;

9. Amends Section 3(b) of the Bank Holding Company Act to provide for expedited Board approval of bank and bank holding company acquisitions, consolidations, and mergers in emergency situations or when immediate action is necessary in order to prevent the probable failure of the bank or bank holding company involved in the transaction; and

10. Amends Section 11(b) of the Bank Holding Company Act to shorten the usual 30-day lag between the date of Board approval of a transaction and the earliest date on which the approved transaction may be consummated, by providing for immediate consummation in the case of a failing bank or bank holding company and by providing a 5-day lag between approval and consummation in emergency situations. In all cases, the time periods set the outside limits within which suits may be brought to challenge the Board's action as violative of the antitrust laws (except for violations alleged under Section 2 of the Sherman Antitrust Act, 15 U.S.C. 2).

SECURITIES EXCHANGE ACT AMENDMENT

An Act of Congress approved December 19, 1977 (Public Law 95–213), amends the Securities Exchange Act of 1934 to add a new title, the Foreign Corrupt Practices Act, which among other things, makes it unlawful for any issuer with a class of registered securities, or which is required to file reports under Section 15(d) of the act, or any domestic concern, to use the mails or any means of interstate commerce in furtherance of an offer or promise to pay or payment of

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anything of value to any foreign official or foreign political party or official for the purpose of influencing any act, or inducing such entity or person to use its or his influence to affect the act or decision of a foreign government; and provides that any officer, director, employee, stockholder, or agent of a domestic concern, upon conviction for a violation of this title, shall be personally liable for the fine.

SOCIAL SECURITY ACT AMENDMENTS

An Act of Congress approved December 20, 1977 (Public Law 95–216), among other things, increases the rate of tax on employees and employers alike for social security purposes to 5.05 per cent in 1978, to 5.08 per cent in 1979–80, to 5.35 per cent in 1981, to 5.40 per cent in 1982–84, to 5.70 per cent in 1985–89, and to 6.20 per cent after December 31, 1989; establishes maximum monthly benefit levels for retired and disabled persons and for benefits payable to beneficiaries of deceased persons entitled to benefits; and directs the Secretary of Health, Education, and Welfare to undertake a study of the coverage under social security programs, and specifically to examine the feasibility and desirability of extending social security coverage to Federal employees, State and local government employees, and employees of nonprofit organizations who are not now covered, and to report the results of that study to the Congress by December 30, 1979.

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Bank and Bank Holding Company Supervision and Regulation by the Federal Reserve System

DOMESTIC ACTIVITIES AND APPLICATIONS

Bank holding companies

The System meets its supervisory and regulatory responsibilities with regard to bank holding companies through two primary functions:

1. Monitoring the operations and performance of bank holding companies—mainly by "on-site" inspections and evaluations of reports and other information obtained from such companies.

2. Action on applications to form or expand bank holding companies.

A significant move toward more efficient performance of these two functions occurred during 1977 as the reorganization of the Board of Governors' Division of Banking Supervision and Regulation, initiated in 1976, was completed. This reorganization regrouped the work of the Division along functional lines in order to attain greater similarity within sections and to define more sharply individual responsibilities. All processing of bank holding company, bank merger, and international applications, for example, was placed under the responsibility of a senior Division official. Similarly, all surveillance and legally oriented activities have been organized into individual units, and the evaluation of research and policy matters was placed in a separate section under its own individual leadership.

A program of intensified supervision of bank holding companies was initiated during 1977 when a System task force developed a new standardized Report of Bank Holding Company Inspection. The new report, to be put into use on January 1, 1978, will subject 85 to 90 per cent of all bank holding company assets to Federal Reserve review each year. It is designed to ensure a minimum format of infor-

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mation when inspecting (1) bank holding companies with consolidated assets of more than $300 million; (2) bank holding companies with consolidated assets of less than $300 million that control significant credit-extending nonbank subsidiaries; and (3) any other bank holding company at the discretion of a Reserve Bank.

Most bank holding companies that are not required to report under the new inspection procedures will continue to be subject to inspection at least once every 3 years. For these holding companies, all of which will have less than $300 million in consolidated assets and have no significant credit-extending nonbank subsidiaries, an additional standardized report will be developed.

Annual reports for 1976 were obtained from all registered bank holding companies pursuant to the provisions of Section 5(c) of the act. At the end of 1977, there were 2,034 bank holding companies in operation.

Each action by the Board on an application to form a bank holding company or to expand an existing company through acquisition of a bank or existing nonbank company is effected by an order. Orders set forth the action taken, the voting record of the individual Board members participating, the essential facts of record, and the basis for the action.

Board orders with respect to applications, whether approved or denied, are released immediately to the public and the press. Orders are printed in full in the Federal Reserve *Bulletin* if they are accompanied by a concurring or dissenting statement of any kind, if they involve the denial of a proposal, or if they involve issues of more than routine interest. Otherwise only the names of the companies involved are listed in the *Bulletin* and copies of the orders are available from the Board's offices. Actions on applications taken by the Federal Reserve Banks on behalf of the Board under delegated authority are also reported to the public and the press. A complete listing of all holding company actions taken by the Board and the Reserve Banks is provided in the Board's weekly H.2 statistical release.

The number of applications processed in 1977 reached the highest level in 3 years, in part it appears because of the recovering economy and the improving financial condition of many banking organizations. In addition, the owners of many primarily rural and sub-

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urban banks appeared to have become more interested in benefits afforded by the creation of bank holding company "parents."

During 1977 the System experienced its best performance to date in the timely processing of applications. Although the Bank Holding Company Act requires System action within 91 days of submission of the complete record, the System measures its performance on the basis of a stricter, self-imposed processing schedule that aims for action within 90 days from the filing of a legally and informationally sufficient application. Notwithstanding delays arising from protests, pending judicial decisions, requests for updated financial data, and similar interruptions in processing, the System met that 90-day schedule 90 per cent of the time.

The numbers of proposals acted on during 1977 by the Board, and under the delegated authority by the Secretary's Office and the Federal Reserve Banks, were as shown below.

While some individual banking organizations continued to reflect financial problems, the banking system as a whole maintained a broad improvement in its financial health, with continued growth in

Section	Direct action		Delegated authority		
	Board [1]		Secretary's Office	Reserve Banks	
	Approved	Denied	Approved	Approved	Permitted
3(a)(1)	54	16	15	101	.....
3(a)(2)	1	.....	.....	.....	.....
3(a)(3)	88	13	9	37	.....
3(a)(5)	4	.....	.....	.....	.....
4(c)(8)	[2] 79 [3] (81)	[2] 2 [3] (5)	2	7	471
4(c)(12)	.....	.....	.....	.....	27
4(d)	.....	.....	.....	.....	.....

[1] Pursuant to Section 4(a)(2) of the act, the Board also made five determinations of "indefinite grandfather rights."

[2] The number of cases acted on by the Board.

[3] The number of individual companies with respect to which the Board acted. More than one company may have been included in a particular case.

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assets accompanied by relatively good earnings and significantly reduced loan losses. The volume of external financing accomplished during 1977 by banking organizations is particularly noteworthy.

In processing applications filed under the act during 1977, the Board continued to stress the financial soundness of bank holding companies, giving careful consideration to the impact of individual proposals upon the financial and managerial resources of the applicant organizations. In addition, the Board continued to emphasize the need for positive showings of public benefits, including, for example, improved financial services to the communities served.

Competition was increased in some markets through the encouragement of *de novo* entry, thereby adding a new competitor to the market, or by limiting entry to foothold, or relatively small, organizations. The Board reassessed somewhat its evaluation of the effects of the elimination of probable future competition—competition eliminated through a relatively large market acquisition by a likely entrant not already in the market. The Board continued to be concerned about such effects but noted that its concern might be tempered in certain situations. As in the past, the Board evaluated each proposal on its own merits. When the record evidenced a significant reduction in competition, and the public interest considerations would not, in the Board's judgment, clearly outweigh the adverse effects, the proposal was denied.

Early in the year the Board specifically noted that on a number of occasions it had recently been faced with difficult issues concerning the timing of divestitures required by either statute or Board order. In part due to the expected increase in the frequency of such situations, the Board on February 15, 1977, published a policy statement on divestitures as guidance for those affected by such decisions. The Board noted that affected companies should make divestitures or file applications as early as possible within the divestiture period to permit orderly compliance with the requirements of the act, and to allow time for securing other regulatory approvals. Divestiture plans and progress reports should generally be submitted by affected companies in order to keep the System apprised of progress to date. The Board stated that it was imperative that divestitures be accomplished in a timely manner, noting that extensions—to the extent permitted

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by statute—would be allowed only under compelling circumstances. The Reserve Banks were entrusted with the responsibility for supervising and enforcing divestitures.

The Board also highlighted the following special situations. If the transferee were indebted to the transferor, (1) divestiture would not be complete unless a requisite control inquiry under Section 2(g)(3) of the Bank Holding Company Act was acted upon favorably; and (2) the divesting company could be required to place the property with an independent trustee for divestiture by a certain date, and by public auction if necessary.

The so-called "10-year grandfather" divestiture deadline of December 31, 1980, is one divestiture situation in which the Board does *not* have extension authority. There are approximately 350 bank holding companies with more than 770 activities subject to the December 31, 1980, divestiture date for which appropriate System action has not been sought. In order to avoid hardships to those firms that wish to retain their activities and to provide for timely System processing of their requests, on October 13, 1977, the Board published a policy statement specifically addressing the nonextendible deadline of December 31, 1980. The Board designated June 30, 1980, as a voluntary target date for the submission of divestiture plans and retention applications. The Board also indicated that it would establish later a final cut-off date for the submission of such plans and applications. Reserve Banks have been in direct communication with the affected banking organizations, and the System is closely monitoring any developments.

Member banks

Each State member bank is subject to examination by direction of the Board of Governors or of the Federal Reserve Bank of the district in which it is located by examiners selected or approved by the Board. The established general policy is for the Federal Reserve Bank to conduct at least one full examination of each State member bank during each calendar year and to prepare a complete examination report. However, in those banks that clearly exhibit no major unsatisfactory features in their operations and financial condition and that have been operated prudently over time, a limited-scope

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examination may be conducted for 1 year and a brief report prepared, with a full examination to be conducted the following year. Banks with severe problems are examined fully at least once in each calendar year, with additional examinations during the year when considered necessary. In some States, concurrent examinations are made in cooperation with the State banking authorities, whereas in others, independent examinations are made.[1] All but 27 of the 1,027 State member banks were examined during 1977.

National banks, all of which are members of the Federal Reserve System, are subject to examination by direction of the Board or the Federal Reserve Banks. However, as a matter of practice, they are not examined by either because the law charges the Comptroller of the Currency directly with that responsibility. The Comptroller provides reports of examination of national banks to the Board upon request, and each Federal Reserve Bank purchases from the Comptroller copies of reports of examination of national banks in its district.

The Board makes its reports of examination of State member banks available to the Federal Deposit Insurance Corporation (FDIC), and the FDIC in turn makes its reports of insured nonmember State banks available to the Board upon request. Also, upon request, reports of examination of State member banks are made available to the Comptroller of the Currency.

In its supervision of State member banks, the Board receives, reviews, and analyzes reports of examination of State member banks and coordinates and evaluates the examination and supervisory functions of the System. Similar oversight is exercised with respect to bank holding companies, for which the Board has sole supervisory responsibility.

The Board passes on applications for admission of State banks to membership in the System; administers the public disclosure requirements of the Securities Exchange Act of 1934, as amended, with respect to equity securities of State member banks within its juris-

[1] As an experiment, the Federal Reserve Bank of Chicago assigns one examiner to accompany a full contingent of State examiners at each annual examination of State member banks in that portion of Indiana located in the Chicago Reserve District. The State examination report of these banks is accepted in lieu of a Federal Reserve report.

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diction under the 1934 act, and the provisions of the act giving responsibility to the Board for regulating security credit transactions; and under provisions of the Federal Reserve Act and other statutes, passes on applications of member banks for permission, among other things, to (1) merge, (2) establish domestic and foreign branches, (3) exercise expanded powers to create bank acceptances, (4) establish foreign banking and financing corporations, and (5) invest in bank premises an amount in excess of 100 per cent of the bank's capital stock. The Board also administers various consumer protection laws and regulations. Its policies and procedures regarding its enforcement responsibilities with respect to State-chartered banks that are members of the Federal Reserve System are described more fully on pages 329–31.

By an Act of Congress, approved September 12, 1964 (Public Law 88–593), each insured bank is required to inform the appropriate Federal banking agency of any change in ownership of the bank and of its loans secured by 25 per cent or more of the voting stock of an insured bank. In 1977, 17 such changes in ownership of the outstanding voting stock of State member banks were reported to the Reserve Banks as changes in control of these member banks. Arrangements continue among the three Federal supervisory agencies for appropriate exchanges of reports received by them pursuant to the act. The Reserve Banks send copies of all reports received to the appropriate district office of the FDIC, the Regional Administrator of National Banks of the Comptroller of the Currency, and the State bank supervisor.

Upon receipt of reports involving changes in control of State member banks, the Reserve Banks are under instructions to forward such reports promptly to the Board, together with a statement either that the new owner and management are known and acceptable to the Reserve Bank, or that they are not known and that an investigation is being made. The findings of any investigation and the conclusions of the Reserve Bank, based on such findings, are forwarded to the Board.

By an Act of Congress, approved July 3, 1967 (Public Law 90–44), each member bank of the Federal Reserve System is required to include with—but not as a part of—each report of condition and

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copy thereof a report of all loans to its executive officers since the date of submission of its previous report of condition. Data submitted by member banks during 1977, as required by law, appear below.

Loans to executive officers

Period covered (condition report dates)	Total loans to executive officers		Range of interest rates charged (per cent)
	Number	Amount (dollars)	
July 1, 1976—Sept. 30, 1976....	7,536	28,391,167	1–24
Oct. 1, 1976—Dec. 31, 1976....	7,679	31,576,018	1–20
Jan. 1, 1977—Mar. 31, 1977....	7,807	28,337,335	1–18
Apr. 1, 1977—June 30, 1977....	7,515	30,715,880	1–18
July 1, 1977—Sept. 30, 1977....	7,322	30,120,828	1–18
Oct. 1, 1977—Dec. 31, 1977....	[1]	[1]	[1]

[1] Compilation of data for condition reports of Dec. 31, 1977, has not been completed.

Federal Reserve membership

As of December 31, 1977, member banks accounted for 39 per cent of the number of all commercial banks in the United States and for 58 per cent of all commercial banking offices, and they held approximately 73 per cent of the total deposits in such banks—the same percentages as at the end of 1976. State member banks accounted for 10 per cent of the number of all State commercial banks in the United States and for 28 per cent of the banking offices, and they held 39 per cent of total deposits in State commercial banks.

Of the 5,669 banks that were members of the Federal Reserve System at the end of 1977, there were 4,655 national banks and 1,014 State banks. During the year there were net declines of 82 national and 9 State member banks. The decline in State member banks was offset in part by the organization of 39 new national banks and by the conversion of 5 nonmember banks to national banks. The decrease in State member banks reflected mainly 26 withdrawals from membership and 5 conversions to branches incident to mergers and absorptions.

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At the end of 1977 member banks were operating 22,187 branches, facilities, and additional offices, 842 more than at the close of 1976. During the year member banks established 1,286 *de novo* branches.

Detailed figures on changes in the banking structure during 1977 are shown in Table 19, pages 462 and 463.

Bank mergers

Under Section 18(c) of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)), the prior written consent of the Board of Governors must be obtained before a bank may merge, consolidate, or acquire the assets and assume the liabilities of another bank if the resulting bank is to be a State member bank.

In deciding whether to approve an application, the Board is required by Section 18(c) to consider the impact of the proposed transaction on competition, the financial and managerial resources and prospects of the existing and proposed institution, and the convenience and needs of the community to be served. The Board is precluded from approving "any proposed merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States." A proposed transaction "whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade," may be approved only if the Board is able to find that the anticompetitive effects of the transaction would be clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

Before acting on each application the Board must request reports from the Attorney General, the Comptroller of the Currency, and the FDIC on the competitive factors involved in each transaction. The Board in turn responds to requests by the Comptroller or the FDIC for reports on competitive factors involved when the resulting bank is to be a national bank or an insured nonmember State bank.

During 1977 the Board disapproved 1 and approved 4 of these applications and submitted 94 reports on competitive factors to the Comptroller of the Currency and 103 to the FDIC. In addition, the Federal Reserve Banks approved 6 merger applications on behalf of

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the Board pursuant to delegated authority. As required by Section 18(c) of the Federal Deposit Insurance Act, a description of each of the 10 applications approved by the Board or the Reserve Banks, together with other pertinent information, is shown in Table 21, pages 466–74.

Orders of the Board with respect to all bank merger applications, whether approved or disapproved, are released immediately to the press and the public. These orders set forth the factors considered, the conclusions reached, and the vote of each Board member present.

Miscellaneous actions under delegated authority

In addition to delegating certain bank holding company and bank merger applications, the Board of Governors has delegated to the Reserve Banks (1) authority to approve, on behalf of the Board, certain applications of State member banks to establish domestic branches, to invest in bank premises, and to grant or deny a waiver of 6 months' notice by a bank of its intention to withdraw from membership in the Federal Reserve System, and (2) certain other authorities.

The Board has also delegated certain authorities to the Director of the Division of Banking Supervision and Regulation. Among other things, the Board has delegated to the Director the authority to furnish to the Comptroller of the Currency and the FDIC certain reports on competitive factors under Section 18(c)(4) of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)(4)). The Director may furnish the reports if each of the appropriate departments or divisions of the Federal Reserve Bank and the Board are of the view that the proposed merger either would have no adverse competitive effects or would have only slightly adverse competitive effects, and if no member of the Board has indicated an objection prior to the forwarding of the report to the appropriate agency. Under this authority 176 competitive factor reports were furnished.

FOREIGN ACTIVITIES AND APPLICATIONS

Foreign branches of member banks

At the end of 1977 member banks had in active operation 738 branches in 84 foreign countries and overseas areas of the United

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States; 100 national banks were operating 637 of these branches, and 30 State member banks were operating 101 such branches. The number and location of these foreign branches are shown in the tabulation below, and the growth in the number and total assets of foreign branches is shown in the table on page 411.

Foreign branches of member banks

Country	Number	Country	Number
Argentina	32	Luxembourg	5
Austria	1	Malaysia	5
Bahamas	74	Mariana Islands	1
Bahrain	5	Marshall Islands	1
Barbados	6	Mauritius	1
Brunei	3	Mexico	5
Belgium	10	Monaco	1
Bolivia	4	Netherlands	6
Brazil	19	Netherlands Antilles	4
Canal Zone	2	Nicaragua	4
Cayman Islands	58	Okinawa	2
Chile	1	Oman	2
Channel Islands	2	Pakistan	4
Denmark	3	Panama	33
Dominican Republic	19	Paraguay	5
Ecuador	13	Peru	3
Egypt	5	Philippines	10
El Salvador	2	Puerto Rico	23
Fiji Islands	4	Qatar	1
France	18	Romania	1
Germany	28	Saudi Arabia	2
Gabon	1	Senegal	1
Greece	18	Seychelles	1
Guam	3	Singapore	21
Guatemala	3	Switzerland	9
Guyana	1	Taiwan	7
Haiti	4	Thailand	2
Honduras	3	Trinidad and Tobago	6
Hong Kong	30	Truk Islands	1
India	10	United Arab Emirates	9
Indonesia	5	United Kingdom	58
Ireland	4	Uruguay	6
Italy	13	Venezuela	4
Ivory Coast	1	Virgin Islands (U.S.)	25
Jamaica	8	Virgin Islands (Br.)	2
Japan	29	Yemen Arab Republic	1
Jordan	3	Other (West Indies)	6
Kenya	2		
Korea	6		
Lebanon	3		
Liberia	4	**Total**	**738**

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Federal Reserve Bank of St. Louis

Growth of major international operations of member banks

Year ending—	Number		Total assets (billions of dollars)	
	Foreign branches	Sections 25 and 25(a) corps.	Foreign branches [1]	Sections 25 and 25 (a) corps.
1971	577	85	55.1	5.5
1972	627	92	72.1	6.1
1973	699	103	108.8	6.9
1974	732	117	127.3	10.1
1975	762	116	145.3	9.1
1976	[2] 731	117	174.5	11.1
1977	738	122	n.a.	n.a.

n.a. Not available.

[1] These data are derived from reports of condition that were filed at the end of the year with the Comptroller of the Currency and the Federal Reserve System, and they differ in certain respects from other statistical reports covering aspects of overseas branch operations. The amounts shown are net of claims on other foreign branches of the same bank.

[2] This decrease from 1975 is due primarily to the conversion of 30 branches in Colombia into subsidiaries to conform with Colombian banking laws.

Under the provisions of the Federal Reserve Act (Section 25 for national banks and Sections 9 and 25 for State member banks), the Board of Governors during 1977 approved 45 applications made by member banks for permission to establish branches in foreign countries and overseas areas of the United States. During the year 31 overseas branches were opened by member banks and 24 were closed.

International corporations

At the end of 1977 six corporations were operating under agreements with the Board of Governors pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. During 1977 five of these "agreement" corporations were examined by examiners for the Board; the sixth corporation began business during the year.

During 1977, under the provisions of Section 25(a) of the Federal Reserve Act, the Board issued four final permits for corporations to engage in international or foreign financial operations. In addition, the Articles of Association were approved and preliminary permits

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Federal Reserve Bank of St. Louis

were issued for the formation of two other corporations, which, however, have not yet applied for final permits to begin business. At the end of the year there were 116 corporations in active operation under Section 25(a).

During 1977 the Board examined each of the previously existing corporations, except for a single dormant corporation, as well as one of the corporations that became operational during the year. Seven of these corporations continue to operate the same 15 foreign branches as during 1976. A table showing the growth of Section 25 and 25(a) corporations is shown on page 411.

Other foreign applications processed

During 1977, 184 other foreign applications were processed for action by the Board of Governors in accordance with Sections 25 and 25(a) of the Federal Reserve Act and with Sections 4(c)(9) and 4(c)(13) of the Bank Holding Company Act of 1956, as amended. Most of these involved proposed equity investments by Section 25 and 25(a) corporations, member banks, and bank holding companies.

SCHOOLS

In 1977 the Bank Examination School of the Board of Governors conducted two sessions of the School for Examiners, three sessions of the School for Assistant Examiners, one session of the School for Trust Examiners, and two sessions of the Bank Holding Company School. A Senior Trust Seminar was held in 1977 jointly with the Comptroller of the Currency and the FDIC.

Since the establishment of this program, 5,899 persons have attended the various sessions. This number includes representatives of the Federal bank supervisory agencies; the State Banking Departments of 36 States; the Treasury Department of the Commonwealth of Puerto Rico; the Division of Banking and Insurance, the Virgin Islands; and 28 foreign countries.

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Federal Reserve Bank of St. Louis

Condition of the Banking System

The ANNUAL REPORT for 1976 indicated that the condition of the banking system had improved during that year. By most traditional measures, this trend continued during 1977, and at the year-end the banking system, in the Board's judgment, was in good condition.

The condition of the banking system is closely linked to the condition of the U.S. economy. It is not surprising, therefore, that the difficult period experienced by banking in the mid-1970's coincided with the most severe recession in several decades. Likewise, the economic recovery from that recession has led to much of the improvement in banking over the last 2 years. Real gross national product increased 6 per cent in 1976 and about 5 per cent in 1977. This economic comeback has resulted in a decided improvement in the financial condition of many bank borrowers. It has also contributed to a decline in bank failures in 1977 to only 6, down from 17 in 1976 and 14 in 1975.

But the improvement in the condition of the banking system is due to more than a healthier economy. In the past several years bankers have demonstrated a more conservative approach to lending, capital, and liquidity than they had exhibited during the early 1970's. Moreover, bankers have been diligent in trying to work out satisfactory solutions for the large amount of loans that became questionable during the recession.

Despite a reasonably positive picture of the condition of the banking system, problems and challenges still remain. The number of problem banks is still large by historical standards, and the volume of questionable loans in bank portfolios is still high. These and other problems will continue to require the close attention of both bankers and bank supervisors.

INDEXES OF BANK SOUNDNESS

One of the most important factors affecting bank soundness is the quality of bank assets. During 1977 the amount of loans of insured

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Federal Reserve Bank of St. Louis

banks that were classified by bank examiners as being of questionable quality declined by about 10 per cent, after having more than tripled between 1973 and 1975. Moreover, the amount of assets classified by examiners as "doubtful" and "loss"—the two most serious classifications—declined by approximately 20 per cent. The group of banks with assets exceeding $5 billion experienced a slightly greater relative decline in classified assets than did the rest of the banking system. However, these large banks still have a much higher level of classified assets relative to their capital than do other banks.

Other measures of bank asset quality also have shown marked improvement. Available data indicate that nonperforming assets, which include nonaccruing loans, renegotiated loans, and real estate acquired in foreclosure, fell roughly 15 per cent during 1977—despite a 13 per cent rise in total bank assets.

In one area in particular—real estate loans—banks still have too many problem loans. Most of these loans were made during the real estate boom of the early 1970's to finance projects that became at least temporarily unsalable. Many banks have been forced to carry large amounts of such loans on a nonearning basis, thereby depressing their earnings. During 1977 the demand for real estate continued to pick up, and as projects were sold off, the quality of bank real estate portfolios improved. However, this improvement has been slow, and still more time and progress in certain segments of the real estate sector will be required before these loans are worked down to a more reasonable level.

The liquidity position of banks deteriorated sharply during the early 1970's, culminating in a "credit crunch" in the summer of 1974. During 1975 and 1976, however, banks greatly improved their liquidity by adding large amounts of U.S. Government securities to their portfolios. During 1977 banks increased significantly their reliance on large time deposits and on purchases of Federal funds. In contrast, bank holdings of securities with maturities of less than 1 year declined slightly. Even with this over-all decline in their liquidity in 1977, banks still appear to be in a satisfactory liquidity position.

From the end of World War II through 1974, bank capital ratios declined almost steadily. Moreover, this decline picked up momentum during the early 1970's when rapid growth of assets, particularly abroad, far outdistanced the growth of capital. It was during this

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Federal Reserve Bank of St. Louis

period that the capital ratios of some of the Nation's major banks declined to unacceptable levels. Since 1974 capital ratios generally have improved; they rose sharply in 1975, and then increased somewhat more in 1976 before declining moderately in 1977. A primary factor in the moderate decline in capital ratios in 1977 was the substantial—13 per cent—growth in bank assets.

In recent years banks have relied principally on retained earnings to build up their capital. In the aggregate, banks retain about 60 per cent of their net income. Banks have obtained most of their external capital financing from bank holding companies, which own almost all of the Nation's largest banks. These holding companies in turn have resorted largely to long-term debt issues to obtain funds. One reason for this heavy reliance on long-term debt, at least since 1974, is that the market values of bank holding company stock have been depressed. During 1977 the stocks of many of the Nation's largest holding companies sold at only six to eight times earnings, and many also sold well below book value. Unfavorable market conditions make it very costly for banking organizations to add to their equity capital through the sale of common stock. As an alternative, several large holding companies have resorted to issuing preferred stock.

One of the most impressive aspects of bank performance during 1977 was the sizable rise in bank earnings. Preliminary data indicate that net income rose about 13 per cent over the 1976 level—about double the average annual rate of increase during the three previous years. Several factors were primarily responsible for this good earnings performance in 1977. First was a rapid growth in earnings assets, with loans alone up more than 15 per cent. Second, provisions for loan losses declined about 11 per cent, reflecting an even sharper drop in actual net charge-offs. Third, the amount of loans on which interest was not accruing was reduced significantly.

On the other hand, narrower spreads in 1977 between yields on earnings assets and costs of funds had a negative impact on bank earnings. For example, the spread between the prime rate, which banks charge their best domestic customers, and the rate that banks pay on their large certificates of deposit averaged only 1.3 percentage points, compared with 1.7 percentage points during 1976. It also appears that banks experienced some reduction in yield spreads on their foreign business during 1977. These reductions in spreads, both here

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and abroad, are evidence of increasing competition among financial institutions.

Perhaps the ultimate criterion for evaluating the condition of the banking system is the state of public confidence in the safety and soundness of banks. As is well known, public confidence is essential for banks to carry out their primary functions effectively. Throughout almost all of the period since World War II, confidence in banks has remained high. However, in 1974 public confidence declined sharply. This decline was due in part to the failure of several large banks, particularly Franklin National Bank, as well as to the realization that many banks had a rapidly growing amount of nonperforming loans.

While public confidence in banks cannot be measured directly, it appears that confidence began to increase during 1975. Moreover, this favorable trend apparently continued in 1976 and 1977.

POTENTIAL PROBLEM AREAS

Several potential problem areas for banks have recently received considerable public attention. The first area is the agricultural sector, where net income from farm operations in 1977 was about one-third below the prosperous years of 1973–74. This decline has been due both to escalating costs of production and to declines in commodity prices. In contrast to declining income, farm debt has risen about 60 per cent from $74 billion at the beginning of 1974 to $119 billion at the beginning of 1978. With debt mounting and income falling, the ability of farmers to service debt from farm operations has declined markedly compared with the 1973–74 period.

These unfavorable financial trends are now being reflected in the portfolios of banks located in the agricultural States. In recent months these banks have experience slower repayment of loans and increases in requests for loan extensions.

So far, problems in the agricultural sector have not had a major adverse effect on the quality of loans held by farm banks. Moreover, while many banks in agricultural areas now have significantly higher loan-to-asset ratios than normal, these banks in general have not experienced serious liquidity problems. Finally, it should be noted that the value of farm assets, especially land, has risen sharply in recent years. This increase should give farm-area banks added loan protection in the form of collateral.

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Federal Reserve Bank of St. Louis

Another area of concern is the financial condition of New York City. The near-default of the city in 1975, following the severe recession and the failure of several large banks, sent shock waves throughout the financial community. Since 1975 the city has made progress toward putting its financial house in order. However, it has not been able to regain access to capital markets, and since 1975 it has had to rely on the Federal Government for financial support in the form of seasonal loans. Continuation of some form of Federal aid beyond this June was being considered by the Congress during the spring of 1978.

In order to determine the exposure of U.S. banks to a possible default by New York City on its obligations, the three Federal bank supervisory agencies early in 1978 completed a survey of the ownership of New York securities by commercial banks. The obligations covered included those issued by New York City, by New York State, by New York State agencies, and by the Municipal Assistance Corporation. The institutions covered were the 954 banks that in a 1975 survey had reported holdings of New York obligations with face value amounting to at least 20 per cent of their equity capital.

In brief, the early 1978 survey indicated that 236 of the 954 banks held New York securities amounting to between 20 and 50 per cent of capital, while 70 more held securities amounting to 50 per cent or more of capital. Institutions located in New York State constituted the majority of banks in the latter, higher-concentration category. New York City obligations account for only about one-tenth—and Municipal Assistance Corporation obligations, less than one-third—of the $5.5 billion of New York securities at the 306 banks with holdings amounting to 20 per cent or more of capital. The number of banks with large holdings of New York City-related securities has declined substantially since November 1975, but it remained sizable.

In analyzing the potential impact of a default on banks that hold New York City securities, it is important to recognize that a default on an obligation by a State, municipality, or related agency need not lead to a loss on the investment amounting to all, or even a sizable part, of the principal value. Unlike a business firm, which may not survive a default, a governmental entity will continue to exist, its economy will remain a source of tax revenue, and the default will

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have to be cured in some manner so that the unit can regain its financial standing. Therefore, if New York City were to default on a portion of its indebtedness, investors would be more likely to suffer a temporary loss of liquidity and some loss of current earnings rather than a permanent loss of face value of the securities held. As a consequence, a reading simply of the total holdings of New York securities by banks greatly overstates the potential losses and the consequences of a default on the strength of the banking system.

INTERNATIONAL ACTIVITIES

A considerable amount of attention was given to the international activities of U.S. banks in the ANNUAL REPORT for 1976. That review focused on the elements that have contributed to the substantial expansion of the role of U.S. banks in international lending both from offices here and through offices abroad. In the context of that review, some concern was expressed about the rapidity with which international loan portfolios were being expanded and the increased risk exposure of our banks.

International lending by U.S. banks again rose substantially in 1977. However, data indicate a slowing in the pace of that lending compared with the previous year's. Foreign assets held at both domestic offices and foreign branches as of the year-end amounted to $236 billion, 14 per cent higher than 12 months earlier. This rate of increase was about half the size of the average growth for the three preceding years. The slower rate of growth was most marked in lending in major financial centers and among non-oil developing countries.

As domestic demand for loans picked up during 1977, it appears that foreign demand for credit from domestic offices slowed. Moreover, a number of countries to which U.S. banks have traditionally been large lenders reduced their demands for international credits. Such reductions reflected measures taken in those countries to restore a greater measure of internal financial stability and a better balance in their external payments.

During 1977 U.S. bank supervisory authorities made considerable progress in adding to the information available on the external lending of U.S. banks. A comprehensive report—developed jointly by the Office of the Comptroller of the Currency, the Federal Deposit In-

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Federal Reserve Bank of St. Louis

surance Corporation, and the Board of Governors of the Federal Reserve System—now obtains information from the major banks about the country distribution of their international loan portfolios with breakdowns by broad category of customer and by maturities.[1] This information is structured to provide a better assessment of the country risks in the banks' international credits. As such, it allows the banking agencies to be more watchful about these risks in individual banks.

The aggregate data obtained from these reports will also furnish valuable information to the banks in their own efforts to assess, control, and monitor their international lending. Internationally, too, cooperative efforts among central banks and international institutions continued in 1977 to add to the information available to commercial banks about external borrowings and external indebtedness of the main borrowing countries.

Several countries to which U.S. banks have made loans are having serious economic and financial problems and are having difficulty in servicing their external debt promptly. Also, relative to their capital and reserves some U.S. banks have a rather sizable exposure in individual countries. These situations need careful attention by bankers and bank supervisors alike. In 1977 the banks continued their efforts to improve their control systems on the risks in international lending. The three Federal bank supervisory agencies, in turn, have been working together to improve their surveillance and analysis of the banks' international portfolios and of the ways they are managed.

While situations and conditions in various countries are a proper subject for concern, proper perspective must be maintained on the country exposures of U.S. banks. Actual defaults by countries on their external debts, public or private, have been rare in recent experience. The risks to the banks, therefore, are less in terms of ultimate collection of credits than in terms of liquidity and income resulting from failure of countries to service properly their external borrowings.

Another subject of concern is that interest rate spreads on international loans have narrowed and that maturities have lengthened. Concern for this aspect of a bank's international activities is prompted by

[1] The report was used experimentally in June and has now been made a semiannual report.

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Federal Reserve Bank of St. Louis

the facts that international earnings now constitute a substantial portion of the total earnings of our largest banks and that earnings remain the principal source by which their capital positions can be strengthened further as needed.

IMPROVED SUPERVISION

The Federal Reserve took steps during 1977 to improve its policies and procedures for supervising State member banks and bank holding companies. Some of these changes have resulted from problems that had surfaced in recent years. In November 1977 the Board approved an expanded program for the inspection of large bank holding companies. The two essential elements of the program are an increased frequency of inspections and the standardization of the inspection report.

All bank holding companies with consolidated assets in excess of $300 million will now be inspected annually—unless nonbanking activity and parent-company debt are considered minimal, in which case inspections will continue to be conducted once every 3 years. The impact of the increased frequency of inspections will be approximately to double the number of large holding companies inspected on an annual basis and to increase the percentage of total holding company assets inspected annually from about 45 per cent in 1976 to 85 per cent when the program is fully operational.

The standardization of the report form is expected to provide a variety of benefits, including the framework for a comprehensive review of nonbank assets and holding company debt levels, greater consistency, an increase in the on-site efficiency of the inspection process, the capacity for centralized training of inspection personnel, and the ability to allocate personnel more efficiently among the Reserve districts.

In 1977 the Board, in conjunction with the Federal Reserve Banks, implemented a bank surveillance system that aids in the identification of actual and potential financial problems of banks. In addition, several new bank holding company surveillance capabilities were developed to enhance existing screening techniques, data collection systems, and analytical reports. Recently, resources have been devoted to improving the regulatory reports used in the surveillance

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process, to streamlining the reports so as to reduce reporting burden on respondents, and to expediting the use of the data.

CONCLUSION

As indicated in this review, the condition of the U.S. banking system generally continued to improve during 1977. However, problems and challenges remain. In evaluating recent performance, it is important to recognize that the banking system has had to sustain some unusual shocks in the last few years. Pre-eminent among these was the deep recession of 1974–75. In addition to shocks, the banking system has had to operate in an environment that was undergoing substantial change. One change has been the increasing integration of the world economy, which has required banks to provide a wider range of services to their customers over a broader geographic area. Another change has been greatly stepped-up disclosure requirements, which have subjected banks to more intensive scrutiny by the market. A final change has been further developments in electronic funds transfers, which has required banks to adjust certain operational procedures.

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Federal Reserve Banks

PAYMENTS MECHANISM DEVELOPMENTS

During 1977 the 48 Federal Reserve offices that process checks handled more than 13.3 billion items, an increase of 8.1 per cent over the number in 1976.

Six additional automated clearing houses (ACH's) were established during the year, bringing the number of such facilities operated by the Federal Reserve to 33. The volume of commercial ACH payments processed through these centers in 1977 increased substantially, with 24.5 million being cleared. A pilot test to determine the feasibility of exchanging payments among ACH's was successfully conducted, and in December the Board requested comment on plans to implement a nationwide system for clearing ACH transactions. At that time the Board also requested comment on plans to provide nationwide settlement services to Bankwire, an association of financial institutions that provide interbank funds transfer services.

In 1977 two more Government agency retirement programs—those of the Veterans Administration and the Air Force—were added to the Department of the Treasury's Direct Deposit of Federal Recurring Payments Program. The Treasury program allows recipients of Government payments to have their benefits deposited directly in a financial institution by electronic transfer. During 1977 more than 80.7 million electronic payments by the Treasury were processed through Federal Reserve facilities.

In September 1977 the Board implemented a section of Regulation J (Subpart B) that governs the handling of wire transfers of funds by the Federal Reserve Banks.

During the year the staff of the Board of Governors continued to provide support for the work of the National Commission on Electronic Fund Transfers. In October the Commission submitted its final report to the President and the Congress.

EXAMINATION

The Board's Division of Federal Reserve Bank Examinations and Budgets examined the 12 Federal Reserve Banks and 25 branches during 1977, as required by Section 21 of the Federal Reserve Act.

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Federal Reserve Bank of St. Louis

In conjunction with the examination of the Federal Reserve Bank of New York, the Board's examiners audited the accounts and holdings related to the System Open Market Account and the foreign currency operations conducted by that Bank in accordance with policies formulated by the Federal Open Market Committee and rendered reports thereon to the Committee. The procedures followed by the Board's examiners were surveyed and appraised by a private firm of certified public accountants, pursuant to the policy of having such reviews made on an annual basis.

EARNINGS AND EXPENSES

The accompanying table summarizes the earnings, expenses, and distribution of net earnings of the Federal Reserve Banks for 1977 and 1976.

Current earnings of $6,891 million in 1977 were 4 per cent higher than in 1976. The principal changes in earnings were increases of $332 million on U.S. Government securities and $22 million on loans, and decreases of $23 million on acceptances and $25 million on foreign currencies. All other earnings decreased $37 million, reflecting the liquidation of the note due from the Federal Deposit Insurance Corporation on the loan resulting from the closing of the Franklin National Bank in 1974.

Current expenses were $624 million. The expenses include $5 million for depreciation on furniture and equipment, which is capitalized and charged to expenses under uniform depreciation schedules. The net book value of furniture and equipment on December 31, 1977, was $46 million compared with $26 million in the previous year when capitalization of purchases was limited to operating equipment costing more than $10,000.

There was a $177 million net deduction in the profit and loss account, primarily because of net realized losses of $146 million on foreign exchange transactions and $50 million on sales of U.S. Government securities, and a nonrecurring credit of $18 million to establish a deferred account for the printing costs of new currency on hand at the beginning of the year. Under a new procedure designed to improve inter-Bank expense comparisons, the cost of printing new currency is being charged to expenses when new notes are paid into circulation. The expense charges were previously timed to deliveries of the new notes by the Bureau of Engraving and Printing.

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Federal Reserve Bank of St. Louis

Statutory dividends to member banks totaled $60 million, $3 million more than in 1976. This rise reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Federal Reserve Banks.

Payments to the Treasury as interest on Federal Reserve notes totaled $5,937 million for the year, compared with $5,870 million in 1976. This amount consists of all net earnings after dividends and the amount necessary to bring surplus to the level of paid-in capital.

A detailed statement of earnings and expenses of each Federal Reserve Bank during 1977 is shown in Table 6 on pages 444 and 445, and a condensed historical statement in Table 7 on pages 446 and 447. A detailed statement of assessments and expenditures of the Board of Governors begins on page 428.

Earnings, expenses, and distribution of net earnings of Federal Reserve Banks, 1977 and 1976

In thousands of dollars

Item	1977	1976
Current earnings	6,891,318	6,623,220
Current expenses	623,860	606,948
Current net earnings	6,267,458	6,016,272
Net addition or deduction (−) from current net earnings	−177,034	7,310
Assessment for expenditures of Board of Governors:		
Operating expenses	40,569	39,247
Capital outlays	6,797	2,581
Net earnings before payments to U.S. Treasury	6,043,058	5,981,754
Dividends paid	60,182	57,351
Payments to U.S. Treasury (interest on F.R. notes)	5,937,148	5,870,463
Transferred to surplus	45,728	53,940

FEDERAL RESERVE BANK PREMISES

During 1977 the Federal Reserve Bank of Boston occupied its new quarters. With approval of the Board of Governors, the Baltimore and Miami Branches acquired properties for future building sites, and properties adjacent to the Federal Reserve Bank of Cleveland and to the Omaha Branch were acquired for future expansion.

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Table 8 on page 448 shows the cost and book value of bank premises owned and occupied by the Federal Reserve Banks and of real estate acquired for banking-house purposes.

HOLDINGS OF LOANS AND SECURITIES

The accompanying table shows holdings, earnings, and average interest rates on loans and securities of the Federal Reserve Banks during the past 3 years.

Average daily holdings of loans and securities during 1977 amounted to $104,710 million—an increase of $7,187 million over 1976. Holdings of U.S. Government securities increased $7,168 million, loans increased $380 million, and acceptances decreased $367 million.

The average rates of interest on holdings decreased from 6.70 to 6.56 per cent on U.S. Government securities and from 5.89 to 5.27 per cent on acceptances, and increased slightly from 5.65 to 5.68 per cent on loans.

Loans and securities of Reserve Banks, 1975–77

Item and year	Total	U.S. Govt. securities [1]	Loans	Acceptances
	In millions of dollars			
Average daily holdings: [2]				
1975	89,442	88,461	195	786
1976	97,523	96,834	85	604
1977	104,710	104,002	465	237
Earnings:				
1975	6,149.5	6,081.1	12.5	55.9
1976	6,528.2	6,487.8	4.8	35.6
1977	6,859.0	6,820.1	26.4	12.5
	In per cent			
Average rate of interest:				
1975	6.88	6.87	6.41	7.11
1976	6.69	6.70	5.65	5.89
1977	6.55	6.56	5.68	5.27

[1] Includes Federal agency obligations.

[2] Based on holdings at opening of business.

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LOAN GUARANTEES FOR DEFENSE PRODUCTION

Under the Defense Production Act of 1950, the Departments of the Army, Navy, and Air Force; the Defense Logistics Agency of the Department of Defense; the Departments of Commerce, Interior, Agriculture, and Energy; the General Services Administration; the National Aeronautics and Space Administration; and the Nuclear Regulatory Commission are authorized to guarantee loans for defense production made by commercial banks and other private financing institutions. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies under the Board's Regulation V.

During 1977 the guaranteeing agencies authorized the issuance of two new guarantee agreements. Loan authorizations outstanding on December 31, 1977, totaled $3.5 million, all of which represented outstanding loans. Of total loans outstanding, 33 per cent on the average was guaranteed. During the year approximately $4 million was disbursed on two guaranteed loans.

Authority for the V-loan program will terminate on September 30, 1979.

Table 16 on page 456 shows guarantee fees and maximum interest rates applicable to Regulation V loans.

FOREIGN ACCOUNTS

Assets held for account of foreign countries at the Federal Reserve Banks increased $28,125 million in 1977. At the end of the year such assets amounted to $115,515 million. This amount included $379 million in dollar deposits plus the following items held in custody by the New York Bank: $11,857 million of earmarked gold (valued at $42.22 per fine ounce); $91,962 million of U.S. Treasury securities (including securities payable in foreign currencies); $370 million of bankers acceptances purchased through Federal Reserve Banks; and $10,947 million of miscellaneous assets. The last item consists mainly of debt securities of U.S. Federally sponsored agencies and U.S. corporations, and dollar bonds issued by foreign countries and international and regional organizations.

The Federal Reserve Bank of New York continued to act as depository and fiscal agent for international and regional organizations. As fiscal agent of the United States, the Bank operated the Exchange Stabilization Fund pursuant to authorization and instruc-

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Federal Reserve Bank of St. Louis

tions of the Secretary of the Treasury. Also on behalf of the Treasury Department, it administered foreign assets control regulations pertaining to blocked assets in the United States.

VOLUME AND COST OF OPERATIONS

Table 9 on page 449 shows the volume of operations in the principal departments of the Federal Reserve Banks for 1974–77. Table 10 on page 450 shows the cost of the larger operations of the Reserve Banks.

The number of checks received for collection on commercial banks rose 8 per cent to 13.3 billion, and the dollar amount rose to $5.5 trillion. Transfers of funds through the Reserve Banks increased 18 per cent to 24.6 million transfers, or $43.2 trillion in value. The number of pieces of paper money received and counted totaled 8.2 billion, an increase of about 2 per cent over 1976, and amounted to $75.9 billion. The volume of coin processed increased about 4 per cent to 16.6 billion pieces.

A new expense accounting system was initiated in 1977 to provide for full costing of Reserve Bank services and to assist in budgeting and monitoring the efficiency of these services. The principal services and their percentage of total Reserve Bank expenses over the year were as follows: check clearing, 38 per cent; currency operations, 25 per cent; fiscal agency services for the U.S. Treasury and Government agencies, 12 per cent; bank supervision and regulation, 8 per cent; and monetary and economic policy, 5 per cent.

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Board of Governors

INCOME AND EXPENSES

The accounts of the Board for the year 1977 were audited by the public accounting firm of Touche Ross & Co.

ACCOUNTANTS' OPINION

Board of Governors of the
Federal Reserve System
Washington, D.C.

We have examined the balance sheets of the Board of Governors of the Federal Reserve System as of December 31, 1977 and 1976, and the related statements of assessments and expenses and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the Board of Governors of the Federal Reserve System at December 31, 1977 and 1976, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.
Certified Public Accountants

Washington, D.C.
February 10, 1978

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Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEET

Assets	December 31 1977	December 31 1976
Operating Fund:		
Cash	$ 4,897,185	$ 4,166,901
Miscellaneous receivables and advances	847,867	348,019
Stockroom and cafeteria inventories—at cost (first-in, first-out method)	168,368	168,149
Total operating fund	5,913,420	4,683,069
Property Fund:		
Land and improvements	1,255,864	1,489,223
Buildings	49,860,720	49,701,894
Furniture and equipment	4,479,586	4,389,940
Construction-in-progress	4,834,267	824,935
Computer	3,342,122	3,971,412
Total property fund	63,772,559	60,377,404
	$69,685,979	$65,060,473
Liabilities and Fund Balances		
Operating Fund:		
Accounts payable and accrued expenses	$ 2,261,657	$ 1,073,249
Income taxes withheld	95,479	137,226
Accrued payroll	1,234,635	1,237,969
Retention on construction-in-progress	132,311	....
	3,724,082	2,448,444
Fund balance:		
Balance, beginning of year	2,234,625	(442,572)
Assessments over (under) expenses	(45,287)	2,677,197
Balance, end of year	2,189,338	2,234,625
Total operating fund	5,913,420	4,683,069
Property Fund:		
Fund balance:		
Balance, beginning of year	60,377,404	58,980,631
Additions—at cost	7,556,266	1,483,853
Disposals—at cost	(4,161,111)	(87,080)
Net increase	3,395,155	1,396,773
Total property fund, end of year	63,772,559	60,377,404
	$69,685,979	$65,060,473

See notes to financial statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF ASSESSMENTS AND EXPENSES

	Year ended December 31	
	1977	1976
ASSESSMENTS LEVIED ON FEDERAL RESERVE BANKS:		
For Board expenses and additions to property	$47,366,100	$41,827,700
For expenditures made on behalf of the Federal Reserve Banks	50,543,541	46,186,376
Total assessments	97,909,641	88,014,076
EXPENSES:		
For the Board:		
Salaries	29,021,842	26,514,723
Retirement and insurance contributions	5,383,462	3,819,114
Travel expenses	1,040,702	927,239
Legal, consultant and audit fees	607,008	481,281
Contractual services	613,700	344,105
Printing and binding—net	1,088,676	812,317
Equipment, office space and other rentals	1,670,001	1,640,745
Telephone and telegraph	789,649	654,517
Postage and expressage	371,930	364,280
Stationery, office and other supplies	380,739	354,481
Heat, light and power	836,954	773,623
Operation of cafeteria—net	271,714	261,608
Repairs, maintenance and alterations	372,398	391,692
Books and subscriptions	119,764	122,187
System membership, Center for Latin American Monetary Studies	88,876	85,488
Miscellaneous—net	99,303	132,519
	42,756,718	37,679,919
For additions to property—net of recovery on disposals of $2,901,597 in 1977 and $13,269 in 1976	4,654,669	1,470,584
	47,411,387	39,150,503
Expenditures for printing, issue and redemption of Federal Reserve notes, paid on behalf of the Federal Reserves Banks	50,543,541	46,186,376
Total expenses	97,954,928	85,336,879
ASSESSMENTS OVER (UNDER) EXPENSES	$ (45,287)	$ 2,677,197

See notes to financial statements.

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Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31	
	1977	1976
SOURCE OF FUNDS:		
Assessments over (under) expenses	$ (45,287)	$2,677,197
Net increase in property fund	3,395,155	1,396,773
Increase in accounts payable and accrued expenses	1,188,408	....
Increase in retention on construction-in-progress	132,311	....
Increase in accrued payroll	....	336,625
Increase in income taxes withheld	....	20,477
Property fund disposals—at cost:		
Land and improvements	344,388	....
Furniture and equipment	134,633	87,080
Computer	3,682,090	....
	4,161,111	87,080
APPLICATION OF FUNDS:	8,831,698	4,518,152
Property fund additions—at cost:		
Land and improvements	111,029	19,929
Buildings	158,826	537,291
Furniture and equipment	224,279	242,086
Construction-in-process	4,009,332	684,547
Computer	3,052,800	....
	7,556,266	1,483,853
Increase in miscellaneous receivables and advances	499,848	278,769
Decrease in income taxes withheld	41,747	....
Decrease in accrued payroll	3,334	....
Increase in stockroom and cafeteria inventories	219	13,385
Decrease in retention on construction-in-progress	....	76,194
Decrease in accounts payable and accrued expenses	....	20,300
	8,101,414	1,872,501
INCREASE IN CASH	$ 730,284	$2,645,651

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 1977 AND 1976

SIGNIFICANT ACCOUNTING POLICIES

Assessments made by the Board on the Federal Reserve Banks for Board expenses and additions to property are calculated based upon expected cash needs and are accrued when assessed. Board expenses and property additions are recorded on the accrual basis of accounting.

Assessments and expenditures made on behalf of the Federal Reserve Banks for the printing, issue and redemption of Federal Reserve notes are recorded on the cash basis and produce results which are not materially different from those which would have been produced on the accrual basis of accounting.

The Board does not charge depreciation as an operating expense. Property additions are charged to expense in the operating fund in the year of acquisition; recoveries on the disposal of property are recorded as a reduction in expense in the operating fund in the year of disposal. When property is acquired or sold, the property accounts in the Property Fund are increased or reduced at full cost, with a corresponding increase or decrease in the property fund balance. Because of the short duration and temporary nature of the Board's leases, leasehold improvements have not been capitalized in the Property Fund.

The Board is self-insured against loss of its buildings and furniture and equipment from

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Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS—CONTINUED

YEARS ENDED DECEMBER 31, 1977 AND 1976

fire or other casualty. The construction-in-progress is covered by builder's risk insurance for a portion of the cost of the work to December 31, 1977. Coverage for other customarily insured risks, such as workmen's compensation insurance and comprehensive general liability insurance, is carried by the Board.

CONSTRUCTION-IN-PROGRESS

The construction-in-progress represents amounts expended for the renovation of the Board Building. The costs include both building costs and costs relating to furniture and equipment. When construction and furnishings are completed in 1978, the final costs will be allocated to the appropriate property fund accounts.

The retention on construction-in-progress as of December 31, 1977 represents amounts withheld on contracts for the renovation and furnishing of the Board Building and landscaping of surrounding property.

BUILDING

Included in the cost of buildings is $7,209,687 relating to the cost of the North Garage of the Martin Building. Over the next 36 years and 7 months, the Board will receive approximately $4,395,700 from the Department of Interior for the use of parking spaces in the garage. The $10,013 monthly payment received from Interior has been offset against miscellaneous expense.

LONG-TERM LEASES

The Board leases outside office, storage and parking space under leases expiring from June 30, 1979 to July 31, 1980. Because the leases may generally be terminated with six months notice commencing in 1978, at December 31, 1977, the only fixed future rental commitment is $386,600 for 1978. Rent expense for outside office, storage, and parking space for the years ended December 31, 1977 and 1976 was approximately $843,700 and $799,700, respectively.

RETIREMENT PLANS

There are two major retirement programs for employees of the Board. Approximately 86% of the employees are covered by the Federal Reserve Board Plan. All new members of the staff who do not come directly from a position in the Government are covered by the Plan. The second Plan, the Civil Service Retirement Plan, covers all new employees who come directly from Government service. Employee contributions are the same under both Plans, and benefits are similar, being based upon the Civil Service Plan.

Under the Civil Service Plan, Board contributions match employee payroll deductions while under the Federal Reserve Plan, Board contributions are actuarially determined annually.

Additionally, employees of the Board participate in the Federal Reserve System's Thrift Plan. Under this Plan, the Board adds a fixed percentage to allowable employee savings.

Board contributions to these Plans totalled $4,797,588 in 1977 and $3,289,038 in 1976.

CONTINGENT LIABILITIES

Litigation involving the Board generally arises from challenges to, or appeals from, actions or proposed actions of the Board pursuant to statutory requirement or authorization. In essence, such lawsuits seek injunctive or declaratory relief against the Board rather than monetary awards.

At December 31, 1977, there were pending six lawsuits involving substantial monetary demands in which the Board was named as one of the defendants. Based upon realistic appraisal of the real potential for recovery and upon the Board's previous experience in suits involving gross claims, Board counsel is of the opinion that these actions do not present any real probability of substantial liability to the Board.

RECLASSIFICATIONS

For presentation purposes only, reclassifications have been made in certain 1976 property fund accounts to reflect the transfer in 1977 of the costs of the North and East Parks from buildings to land and improvements.

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Statistical Tables

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Federal Reserve Bank of St. Louis

1. Detailed statement of condition of all Federal Reserve Banks combined, December 31, 1977

In thousands of dollars

ASSETS

Item				
Gold certificates on hand			1,278	
Gold certificates due from U.S. Treasury			11,717,245	
Total gold certificate account				**11,718,523**
Special Drawing Rights certificate account				**1,250,000**
Coin				**281,849**
Loans to member banks secured by—				
U.S. Govt. and agency obligations		233,101		
Other eligible paper		29,000		
Other paper (Sec. 10(b))		2,425	264,526	
Loans to others			....	
Total loans			**264,526**	
Acceptances:				
Bought outright			....	
Held under repurchase agreement			**953,597**	
Federal agency obligations:				
Bought outright			**8,003,735**	
Held under repurchase agreement			**451,000**	
U.S. Govt. securities:				
Bought outright:				
Bills	**41,560,485**			
Notes	**50,513,672**			
Bonds	**8,843,761**			
Total bought outright		**100,917,918**		
Held under repurchase agreement		**1,901,000**		
Total U.S. Govt. securities			**102,818,918**	
Total loans and securities				**112,491,776**
Cash items in process of collection:				
Transit items			9,613,641	
Exchanges for clearing house			228,062	
Other cash items			1,701,110	
Total cash items in process of collection				**11,542,813**
Bank premises:				
Land			63,070	
Buildings (including vaults)		150,521		
Building machinery and equipment		95,091		
Construction account		207,569		
Total bank premises		453,181		
Less depreciation allowances		138,899	314,282	
Bank premises, net				**377,352**
Other assets:				
Furniture and equipment		56,360		
Less depreciation		9,990		
Total furniture and equipment, net			46,370	
Due from FDIC—Account closed bank			....	
Denominated in foreign currencies			18,432	
Interest accrued			1,356,566	
Premium on securities			184,043	
Real estate acquired for banking-house purposes			42,172	
Suspense account			289,841	
Overdrafts			27,549	
All other [1]			98,508	
Total other assets				**2,063,481**
Total assets				**139,725,794**

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1.—Continued

LIABILITIES

F.R. notes:			
Outstanding (issued to F.R. Banks)		100,535,296	
Less: Held by issuing F.R. Banks		7,381,518	
Total F.R. notes, net			**93,153,778**
Deposits:			
Member bank reserves		**26,709,380**	
U.S. Treasury—General account		**7,113,335**	
Foreign		**378,768**	
Other deposits:			
Nonmember bank—Clearing accounts	2,019		
Officers' and certified checks	23,670		
Reserves of corporations doing foreign banking or financing	237,986		
International organizations	262,743		
Secretary of Treasury special account	51,025		
All other	609,205		
Total other deposits		**1,186,648**	
Total deposits			**35,388,131**
Deferred availability cash items			**7,892,267**
Other liabilities:			
Unearned discount		744	
Discount on securities		1,146,046	
Sundry items payable		18,200	
Suspense accounts		54,745	
All other		13,879	
Total other liabilities			**1,233,614**
Total liabilities			**137,667,790**

CAPITAL ACCOUNTS

Capital paid in	**1,029,002**
Surplus	**1,029,002**
Other capital accounts [2]	....
Total liabilities and capital accounts	**139,725,794**

[1] Includes U.S. agency coupons in process of collection.
[2] During the year this item includes the net earnings, expenses, profit and loss items, and accrued dividends, which are closed out on Dec. 31; see Table 7, pp. 446 and 447.

NOTE.—Amounts in boldface type indicate items in the Board's weekly statement of condition of the F.R. Banks.

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Federal Reserve Bank of St. Louis

2. Statement of condition of each Federal Reserve Bank, December 31, 1977 and 1976

In millions of dollars

Item	Total		Boston		New York		Philadelphia		Cleveland		Richmond	
	1977	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977	1976
ASSETS												
Gold certificate account	11,718	11,598	541	542	3,492	3,350	631	641	934	939	982	992
Special Drawing Rights certif. acct.	1,250	1,200	62	60	313	300	74	71	107	103	113	109
F.R. notes of other F.R. Banks [1]	....	1,863	....	97	....	361	....	103	....	64	....	204
Coin	282	364	17	18	18	29	13	11	40	46	28	41
Loans:												
Secured by U.S. Govt. and agency obligations	226	19	10	1	103	2	11	2	2	....	13	....
Other	40	7	....	....	....	1	4	....	....	....	....	....
Acceptances:												
Bought outright	....	196	....	....	....	196	....	....	....	....	....	....
Held under repurchase agreement	954	795	....	....	954	795	....	....	....	....	....	....
Federal agency obligations:												
Bought outright	8,004	6,794	374	314	1,889	1,598	427	377	670	560	655	545
Held under repurchase agreement	451	278	....	....	451	278	....	....	....	....	....	....
U.S. Govt. securities:												
Bought outright [2]	100,918	93,268	4,715	4,310	23,819	21,937	5,384	5,174	8,448	7,690	8,250	7,486
Held under repurchase agreement	1,901	3,753	....	....	1,901	3,753	....	....	....	....	....	....
Total loans and securities	112,494	105,110	5,099	4,625	29,117	28,560	5,826	5,553	9,120	8,250	8,918	8,031
Cash items in process of collection	11,542	10,128	335	330	1,450	1,832	342	207	461	604	1,866	1,351
Bank premises	378	363	106	106	9	17	56	56	23	24	72	48
Operating equipment	....	25	....	....	....	6	....	2	....	2	....	....
Other assets:												
Denominated in foreign currencies	18	170	1	6	4	44	1	8	1	15	1	9
All other	2,046	2,624	94	70	489	1,289	104	114	138	114	155	122
Interdistrict Settlement Account	....	....	*−23*	*+212*	*−1,313*	*−3,763*	*−389*	*−233*	*−42*	*+216*	*+247*	*+27*
Total assets	139,728	133,445	6,232	6,066	33,579	32,025	6,658	6,533	10,782	10,377	12,382	10,934

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Item												
LIABILITIES												
F.R. notes	93,153	85,594	4,761	4,213	23,678	21,692	4,936	4,827	7,987	7,382	8,329	7,666
Deposits:												
Member bank reserves	26,709	25,059	642	724	5,784	4,820	891	763	1,650	1,327	1,534	1,448
U.S. Treasury—General account	7,114	10,393	428	684	1,399	2,466	452	584	451	789	598	725
Foreign	379	352	10	9	174	177	12	11	24	20	15	13
All other [3]	1,187	2,113	23	34	688	1,048	34	61	43	68	57	87
Total deposits	35,389	37,917	1,103	1,451	8,045	8,511	1,389	1,419	2,168	2,204	2,204	2,273
Deferred availability cash items	7,894	6,871	249	286	991	1,041	183	149	361	549	1,625	814
Other liabilities and accrued dividends	1,234	1,097	55	46	331	279	62	52	92	74	114	73
Total liabilities	137,670	131,479	6,168	5,996	33,045	31,523	6,570	6,447	10,608	10,209	12,272	10,826
CAPITAL ACCOUNTS												
Capital paid in	1,029	983	32	35	267	251	44	43	87	84	55	54
Surplus	1,029	983	32	35	267	251	44	43	87	84	55	54
Other capital accounts	....	....	....	....	....	....	....	....	....	....	....	....
Total liabilities and capital accounts	139,728	133,445	6,232	6,066	33,579	32,025	6,658	6,533	10,782	10,377	12,382	10,934
F.R. NOTE STATEMENT												
F.R. notes:												
Issued to F.R. Bank by F.R. Agent and outstanding	100,534	89,303	4,977	4,397	25,038	22,392	5,383	5,039	8,360	7,657	8,897	7,936
Less held by issuing Bank, and forwarded for redemption	7,381	3,709	216	184	1,360	700	447	212	373	275	568	270
F.R. notes, net [4]	93,153	85,594	4,761	4,213	23,678	21,692	4,936	4,827	7,987	7,382	8,329	7,666
Collateral held by F.R. Agent for notes issued to Bank:												
Gold certificate account	11,713	11,596	541	542	3,491	3,350	631	641	933	939	982	992
Special Drawing Rights certif. acct	880	643	62	60	313	300	....	....	107	....	109	....
Acceptances	....	....	....	....	....	....	....	....	....	....	....	....
U.S. Govt. securities	89,675	78,100	4,400	3,830	21,550	18,850	4,800	4,500	7,500	6,810	7,950	7,025
Total collateral	102,268	90,339	5,003	4,432	25,354	22,500	5,431	5,141	8,540	7,749	9,041	8,017

For notes see end of table.

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2. Statement of condition of each Federal Reserve Bank, December 31, 1977 and 1976—Continued

In millions of dollars

Item	Atlanta		Chicago		St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
	1977	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977	1976
ASSETS														
Gold certificate account	560	599	1,736	1,704	469	466	225	222	393	397	456	421	1,299	1,325
Special Drawing Rights certif. acct.	64	62	198	190	53	50	25	24	44	42	48	46	149	143
F.R. notes of other F.R. Banks [1]	....	285	....	77	....	57	....	27	....	93	....	218	....	277
Coin	28	39	24	36	20	27	9	14	43	43	12	21	30	39
Loans:														
Secured by U.S. Govt. and agency obligations	....	2	40	7	7	*	1	....	11	3	23	1	5	1
Other	7	1	2	....	....	....	....	....	1	4	1	1	25	....
Acceptances:														
Bought outright	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Held under repurchase agreement	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Federal agency obligations:														
Bought outright	395	364	1,282	1,088	340	277	196	155	321	269	400	323	1,055	924
Held under repurchase agreement	....	....	....	....	....	....	....	....	....	....	....	....	....	....
U.S. Govt. securities:														
Bought outright [2]	4,982	4,996	16,166	14,936	4,283	3,803	2,471	2,133	4,049	3,692	5,046	4,430	13,305	12,681
Held under repurchase agreement	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Total loans and securities	5,384	5,363	17,490	16,031	4,630	4,080	2,668	2,288	4,382	3,968	5,470	4,755	14,390	13,606
Cash items in process of collection	1,127	976	1,367	1,183	565	320	573	455	924	898	887	807	1,645	1,165
Bank premises	14	14	16	16	13	13	30	31	18	17	12	12	9	9
Operating equipment	....	3	....	....	....	4	....	1	....	....	....	3	....	4
Other assets:														
Denominated in foreign currencies	1	13	3	26	1	6	1	5	1	7	1	9	2	22
All other	151	110	259	213	74	54	46	34	75	55	96	62	365	387
Interdistrict Settlement Account	*−277*	*−220*	*+89*	*+570*	*−115*	*+271*	*+13*	*+230*	*+362*	*+340*	*+290*	*+359*	*+1,158*	*+1,991*
Total assets	7,052	7,244	21,182	20,046	5,710	5,348	3,590	3,331	6,242	5,860	7,272	6,713	19,047	18,968

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LIABILITIES														
F.R. notes	3,669	3,893	15,428	13,973	3,912	3,593	1,999	1,750	3,461	3,022	4,071	3,702	10,922	9,881
Deposits:														
Member bank reserves	1,952	1,801	3,591	3,714	817	765	720	602	1,156	1,260	1,922	1,713	6,050	6,122
U.S. Treasury—General account	511	572	705	825	474	574	276	398	637	589	453	572	730	1,615
Foreign	21	18	41	36	9	8	8	7	12	10	15	13	38	30
All other[3]	77	166	90	222	23	58	13	64	22	130	34	37	83	138
Total deposits	2,561	2,557	4,427	4,797	1,323	1,405	1,017	1,071	1,827	1,989	2,424	2,335	6,901	7,905
Deferred availability cash items	602	589	834	837	363	248	483	433	822	731	603	524	778	670
Other liabilities and accrued dividends	64	55	179	143	48	36	29	19	46	36	58	42	156	242
Total liabilities	6,896	7,094	20,868	19,750	5,646	5,282	3,528	3,273	6,156	5,778	7,156	6,603	18,757	18,698
CAPITAL ACCOUNTS														
Capital paid in	78	75	157	148	32	33	31	29	43	41	58	55	145	135
Surplus	78	75	157	148	32	33	31	29	43	41	58	55	145	135
Other capital accounts	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Total liabilities and capital accounts	7,052	7,244	21,182	20,046	5,710	5,348	3,590	3,331	6,242	5,860	7,272	6,713	19,047	18,968
F.R. NOTE STATEMENT														
F.R. notes:														
Issued to F.R. Bank by F.R. Agent and outstanding	4,524	4,422	16,111	14,273	4,329	3,767	2,143	1,810	4,030	3,176	4,888	3,873	11,854	10,561
Less held by issuing Bank, and forwarded for redemption	855	529	683	300	417	174	144	60	569	154	817	171	932	680
F.R. notes, net[4]	3,669	3,893	15,428	13,973	3,912	3,593	1,999	1,750	3,461	3,022	4,071	3,702	10,922	9,881
Collateral held by F.R. Agent for notes issued to Bank:														
Gold certificate account	559	599	1,736	1,704	468	466	225	222	393	396	456	420	1,298	1,325
Special Drawing Rights certif. acct.	62	62	....	....	53	50	25	24	42	42	48	46	59	59
Acceptances	....	....	....	....	....	....	....	....	....	....	....	....	....	....
U.S. Govt. securities	4,000	4,000	14,500	12,600	3,850	3,350	2,010	1,610	3,700	2,800	4,415	3,425	11,000	9,300
Total collateral	4,621	4,661	16,236	14,304	4,371	3,866	2,260	1,856	4,135	3,238	4,919	3,891	12,357	10,684

[1] Effective Jan. 1, 1977, F.R. notes of other F.R. Banks were merged into the liability account for F.R. notes.

[2] *Includes* securities loaned—fully guaranteed by U.S. Govt. securities pledged with F.R. Banks—and *excludes* (if any) securities sold and scheduled to be bought back under matched sale–purchase transactions.

[3] Beginning July 1973, this item includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with F.R. Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System's program of credit restraint.

As of Dec. 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at F.R. Banks that are associated with marginal reserves are no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States, and (2) Euro-dollar liabilities.

[4] Includes F.R. notes held by U.S. Treasury and by F.R. Banks other than the issuing Bank.

NOTE.—Beginning Jan. 1, 1977, "Other cash" account was changed to "Coin," and "Operating equipment" was transferred to "Other assets."

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3. Federal Reserve Bank holdings of U.S. Government and Federal agency securities, December 31, 1975–77

In millions of dollars

Description of issue	Rate of interest (per cent)	December 31			Increase or decrease (−) during—	
		1977	1976	1975	1977	1976
Treasury bonds:						
1975–85	4¼	156	156	156		
1978–83	3¼	87	87	87		
1980—Feb.	4	266	261	261	5	
Nov.	3½	74	74	74		
1981—Aug.	7	123	123	123		
1982—Feb.	6⅜	364	364	358		6
1984—Aug.	6⅜	355	355	334		21
1985—May	3¼	47	47	47		
1986—Nov.	6⅛	310	310	310		
1987–92	4¼	509	509	509		
1988–93	4	24	24	24		
	7½	380	352	264	28	88
1989–94	4⅛	77	77	77		
1990—Feb.	3½	84	84	84		
May	8¼	285	240	155	45	85
1992—Aug.	7¼	76			76	
1993—Feb.	6¾	70	70	70		
1993–98	7	157	157	148		9
1994–99	8½	955	900	830	55	70
1995—Feb.	3	2	2	2		
1995–2000	7⅞	517	455	286	62	169
	8⅜	902	842	707	60	135
1996–2001	8	430	341		89	341
1998—Nov.	3½	31	31	31		
2000–2005	8¼	950	864	585	86	279
2002–2007	7⅝	1,379			1,379	
	7⅞	240			240	
Total		8,848	6,725	5,522	2,123	1,203
Treasury notes:						
Feb. 15, 1976—A	6¼			2,507		−2,507
—F	5⅞			1,232		−1,232
Mar. 31, 1976—H	8			97		−97
May 15, 1976—B	6½			360		−360
—E	5¾			496		−496
May 31, 1976—M	6			80		−80
June 30, 1976—I	8¾			692		−692
Aug. 15, 1976—C	7½			748		−748
—G	6½			1,649		−1,649
Aug. 31, 1976—L	5⅞			43		−43
Sept. 30, 1976—J	8¼			320		−320
Oct. 31, 1976—O	6½			50		−50
Nov. 15, 1976—D	6¼			100		−100
Nov. 30, 1976—N	7⅛			126		−126
Dec. 31, 1976—K	7¼			231		−231
Feb. 15, 1977—A	8		2,481	2,462	−2,481	19
Feb. 28, 1977—F	6		150	112	−150	38
Mar. 31, 1977—G	6½		516	422	−516	94
Apr. 30, 1977—H	7⅜		84	48	−84	36
May 15, 1977—C	6⅞		525	440	−525	85
—D	9		2,994	2,973	−2,994	21
May 31, 1977—I	6¾		171	92	−171	79
June 30, 1977—J	6½		260	251	−260	9
July 31, 1977—K	7½		59	33	−59	26
Aug. 15, 1977—B	7¾		848	831	−848	17
Aug. 31, 1977—L	8¼		120	88	−120	32
Sept. 30, 1977—M	8⅜		48	38	−48	10
Oct. 31, 1977—N	7½		166	56	−166	110
Nov. 15, 1977—E	7¾		1,231	1,218	−1,231	13
Nov. 30, 1977—Q	6⅝		81		−81	81
Dec. 31, 1977—P	7¼	328	259	203	69	56
Jan. 31, 1978—J	6⅜	272	250		22	250
Feb. 15, 1978—A	6¼	2,650	2,628	2,606	22	22
Feb. 28, 1978—G	8	53	35	20	18	15
Mar. 31, 1978—K	6¾	312	241		71	241
Apr. 30, 1978—L	6½	391	360		31	360
May 15, 1978—D	7⅛	953	921	850	32	71
—F	7⅞	1,539	1,503	1,499	36	4
May 31, 1978—M	7⅛	175	152		23	152
June 30, 1978—N	6⅞	771	723		48	723
July 31, 1978—P	6⅞	259	208		51	208

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3.—Continued

Description of issue	Rate of interest (per cent)	December 31			Increase or decrease (−) during—	
		1977	1976	1975	1977	1976
Treasury notes—Cont.						
Aug. 15, 1978—C	8¾	633	629	619	4	10
—E	7⅝	2,571	2,549	2,516	22	33
Aug. 31, 1978—Q	6⅝	173	145	...	28	145
Sept. 30, 1978—R	6¼	415	346	...	69	346
Oct. 31, 1978—S	5⅞	192	117	...	75	117
Nov. 15, 1978—B	6	2,468	2,448	2,447	20	1
Nov. 30, 1978—T	5¾	234	143	...	91	143
Dec. 31, 1978—H	8⅛	177	140	51	37	89
Dec. 31, 1978—U	5¼	446	352	...	94	352
Jan. 31, 1979—L	5⅞	88	...	...	88	...
Feb. 15, 1979—H	7	1,724	1,700	...	24	1,700
Feb. 28, 1979—M	5⅞	308	...	...	308	...
Mar. 31, 1979—N	6	570	...	...	570	...
Apr. 30, 1979—P	5⅞	118	...	...	118	...
May 15, 1979—D	7⅞	538	491	465	47	26
May 31, 1979—Q	6⅛	209	...	...	209	...
June 30, 1979—E	7¾	119	70	42	49	28
—R	6⅛	265	...	...	265	...
July 31, 1979—S	6¼	111	...	...	111	...
Aug. 15, 1979—A	6¼	630	599	590	31	9
—J	6⅞	838	814	...	24	814
Aug. 31, 1979—T	6⅝	210	...	...	210	...
Sept. 30, 1979—F	8½	222	210	125	12	85
—U	6⅝	248	...	...	248	...
Oct. 31, 1979—V	7¼	248	...	...	248	...
Nov. 15, 1979—B	6⅝	890	875	872	15	3
—K	6¼	228	121	...	107	121
—C	7	362	351	341	11	10
Nov. 30, 1979—W	7⅛	261	...	...	261	...
Dec. 31, 1979—G	7½	107	92	...	15	92
Feb. 15, 1980—G	6½	1,452	...	...	1,452	...
Mar. 31, 1980—C	7½	167	111	...	56	111
May 15, 1980—A	6⅞	5,267	5,264	5,244	3	20
June 30, 1980—D	7⅝	288	231	...	57	231
Aug. 15, 1980—B	9	2,427	2,422	2,385	5	37
—H	6¾	489	...	...	489	...
Sept. 30, 1980—E	6⅞	141	33	...	108	33
Nov. 15, 1980—J	7⅛	658	...	...	658	...
Dec. 31, 1980—F	5⅞	33	8	...	25	8
Feb. 15, 1981—A	7	349	338	304	11	34
—C	7⅜	914	826	646	88	180
Mar. 31, 1981—H	6⅞	55	...	...	55	...
May 15, 1981—D	7⅜	175	109	...	66	109
June 30, 1981—J	6¾	67	...	...	67	...
Aug. 15, 1981—F	7⅝	241	129	...	112	129
Sept. 30, 1981—K	6¾	48	...	...	48	...
Nov. 15, 1981—B	7¾	1,591	1,554	1,464	37	90
—G	7	83	14	...	69	14
Dec. 31, 1981—L	7¼	13	...	...	13	...
Feb. 15, 1982—D	6⅛	35	...	...	35	...
May 15, 1982—A	8	1,439	1,421	1,370	18	51
—E	7	14	...	...	14	...
Aug. 15, 1982—B	8⅛	1,110	1,065	1,013	45	52
Nov. 15, 1982—C	7⅞	715	633	524	82	109
—F	7⅛	4	...	...	4	...
Feb. 15, 1983—A	8	2,101	2,075	...	26	2,075
Nov. 15, 1983—B	7	95	81	...	14	81
Feb. 15, 1984—A	7¼	3,659	...	...	3,659	...
Aug. 15, 1984—B	7¼	337	...	...	337	...
May 15, 1986—A	7⅞	852	695	...	157	695
Aug. 15, 1986—B	8	1,941	1,757	...	184	1,757
Nov. 15, 1987—A	7⅝	448	...	...	448	...
Total	...	50,509	47,972	43,989	2,537	3,983
Treasury bills:						
Due—						
Within 3 mos.	...	20,106	19,529	20,495	577	−966
3–6 mos.	...	15,690	14,277	12,342	1,413	1,935
After 6 mos.	...	5,765	4,765	4,371	1,000	394
Total	...	41,560	38,572	37,207	2,989	1,365

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3. Federal Reserve Bank holdings of U.S. Government and Federal agency securities, December 31, 1975–77

In millions of dollars

Description of issue	Rate of interest (per cent)	December 31			Increase or decrease (−) during—	
		1977	1976	1975	1977	1976
Repurchase agreements	....	1,901	3,753	1,217	−1,852	2,536
U.S. Govt. securities—Total	....	**102,819**	**97,021**	**87,934**	**5,798**	**9,087**
Maturing—						
Within 90 days	....	25,309	26,429	25,450	−1,120	979
91 days to 1 year	....	32,539	25,889	21,704	6,650	4,185
1–5 years	....	27,516	30,710	30,273	−3,194	437
5–10 years	....	10,388	9,045	6,426	1,343	2,619
Over 10 years	....	7,067	4,949	4,082	2,118	867
Federal agency obligations:						
Held outright:						
Banks for coops	....	112	78	60	34	18
Export-Import Bank	....	106	118	135	−12	−17
Fed. farm credit banks	....	58	....	....	58	....
Fed. home loan banks	....	2,151	1,786	1,603	365	183
Fed. inter. credit banks	....	465	414	317	51	97
Federal land banks	....	1,352	946	736	406	210
Farmers Home Admin.	....	238	295	285	−57	10
Fed. Natl. Mort. Assn.	....	3,266	2,899	2,702	367	197
Govt. Natl. Mort. Assn.—PC's	....	87	90	87	−3	3
U.S. Postal Service	....	37	37	37	0	0
Wash. Metro. Area Transit Authority	....	117	117	98	0	19
General Services Admin.	....	14	14	12	0	2
Total	....	8,004	6,794	6,072	1,210	722
Held under Rp's	....	451	278	118	173	160

NOTE.—Details may not add to totals because of rounding.

4. Federal Reserve Bank holdings of special short-term Treasury certificates purchased directly from the United States, 1970–77

In millions of dollars

Date	Amount	Date	Amount	Date	Amount	Date	Amount
1970	none	1972		1974		1975	
		Sept. 12	38	Nov. 6	131	Aug. 7	474
						11	204
		1973				12	543
1971		Aug. 15	351	1975		13	399
June 8	79	Sept. 7	73	Mar. 11	626	15	481
9	582	8	73	12	1,043		
10	610	9 [1]	73	13	315		
11	593	10	42	14	820		
12	593	11	485	15	820	1977	
13 [1]	593	12	169	16 [1]	820	Sept. 30	2,500
14	243	14	319	17	832	Oct. 1	2,500
15	588	15	319	Aug. 5	656	2 [1]	2,500
16	349	16 [1]	319	6	965	3	2,500

[1] Sunday or holiday.

NOTE.—Under authority of Section 14(b) of the Federal Reserve Act.
Throughout the period shown the interest rate paid on such securities was ¼ per cent below prevailing discount rate of F.R. Bank of New York. For data for prior years, beginning with 1942, see previous ANNUAL REPORTS. No holdings on dates not shown.

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5. Open market transactions of the Federal Reserve System, 1977

In millions of dollars

Month	Outright transactions in U.S. Govt. securities, by maturity (excluding matched sale–purchase transactions)								
	Treasury bills			Others within 1 year [1]			1–5 years		
	Gross purchases	Gross sales	Redemptions	Gross purchases	Gross sales	Exch., maturity shifts, or redemptions	Gross purchases	Gross sales	Exch. or maturity shifts
January	2,535	313	....	45	....	252	475	....	−252
February	110	801	....	107	....	63	348	....	−880
March	....	368	....	41	....	−266	174	....	266
April	1,671	260	19	20	....	374	327	....	−374
May	681	489	400	....	....	−1,209	....	....	−865
June	2,696	1,154	600	89	....	478	200	....	−478
July	118	753	500	....	....	238	....	....	−238
August	812	176	....	....	....	2,321	....	....	−1,664
September	2,005	303	317	2,616	....	320	681	....	−320
October	....	1,877	....	....	....	−2,545	....	....	45
November	....	436	300	....	....	1,352	....	....	−1,267
December	3,109	311	....	99	....	623	628	....	−623
Total	13,738	7,241	2,136	3,017	....	1,999	2,833	....	−6,649

Month	Outright transactions (cont.)						Total outright			Matched sale–purchase transactions (U.S. Govt. securities)	
	5–10 years			Over 10 years							
	Gross purchases	Gross sales	Exch. or maturity shifts	Gross purchases	Gross sales	Exch. or maturity shifts	Gross purchases	Gross sales	Redemptions	Gross sales	Gross purchases
January	128	....	....	48	....	....	3,229	313	....	24,595	22,544
February	151	....	517	81	....	300	797	801	....	22,674	23,447
March	46	....	....	37	....	....	298	368	....	30,115	30,828
April	104	....	....	38	....	....	2,160	260	19	32,287	32,852
May	....	....	1,174	....	....	900	681	489	400	28,532	27,306
June	68	....	....	114	....	....	3,167	1,154	600	36,258	36,449
July	....	....	....	....	....	....	118	753	500	27,947	27,301
August	....	....	−782	....	....	125	812	176	....	45,831	46,170
September	96	....	....	128	....	....	5,526	303	317	39,552	39,694
October	....	....	....	....	....	....	....	1,877	2,500	48,204	44,772
November	....	....	−325	....	....	240	....	436	300	56,899	57,477
December	166	....	....	108	....	....	4,110	311	....	32,320	35,001
Total	758	....	584	553	....	1,565	20,898	7,241	4,636	425,214	423,841

Month	Repurchase agreements (U.S. Govt. securities)		Net change in U.S. Govt. securities	Federal agency obligations			Bankers acceptances, net		Net change [2]
				Outright		Repurchase agreements, net			
	Gross purchases	Gross sales		Gross purchases	Sales or redemptions		Outright	Repurchase agreements	
January	23,820	27,573	−2,887	....	4	−278	−5	−795	−3,969
February	13,853	12,921	1,702	....	24	77	−18	149	1,886
March	14,368	14,860	151	....	36	−23	−19	−23	50
April	13,397	11,862	3,980	346	....	70	−51	653	4,998
May	29,308	30,448	−2,573	....	*	−114	−45	−729	−3,461
June	14,748	11,506	4,845	380	33	600	−15	528	6,305
July	13,973	15,719	−3,528	....	....	−266	−24	−204	−4,020
August	4,397	5,648	−276	....	69	−194	−15	−247	−801
September	16,700	15,469	6,279	....	25	159	*	351	6,764
October	9,578	11,889	−10,118	....	....	−310	−4	−478	−10,910
November	6,472	4,433	1,880	....	*	131	....	248	2,260
December	18,071	18,208	6,342	707	32	320	....	705	8,042
Total	178,683	180,535	5,798	1,433	223	173	−196	159	7,143

[1] Includes special certificates acquired when the Treasury borrows directly from the Federal Reserve, as follows: Sept., $2,500 million (redeemed in Oct.).

[2] Net change in U.S. Govt. securities, Federal agency obligations, and bankers acceptances.

* Less than $500,000.

NOTE.—Sales, redemptions, and negative figures reduce System holdings; all other figures increase them. Details may not add to totals because of rounding.

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5. Earnings and expenses of Federal Reserve Banks during 1977

In dollars

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
CURRENT EARNINGS													
Loans	26,417,417	1,608,613	5,126,395	1,880,230	835,661	2,841,197	2,519,527	2,762,653	1,327,143	521,398	2,180,210	2,723,562	2,090,828
Acceptances	12,461,026	...	12,461,026	...	...	...	...	...	...	...	...	...	...
U.S. Govt. securities	6,820,111,327	314,728,738	1,655,796,358	364,810,999	563,140,792	541,531,105	342,040,056	1,082,419,285	283,429,041	162,186,989	270,022,214	332,863,131	907,142,619
Foreign currencies	2,798,065	102,008	716,943	122,233	241,272	154,532	213,291	421,625	92,336	80,505	117,519	156,692	379,109
All other [1]	29,529,662	22,667	28,640,003	9,815	51,403	53,829	100,608	239,831	39,152	255,451	59,091	36,858	20,954
Total	6,891,317,497	316,462,026	1,702,740,725	366,823,277	564,269,128	544,580,663	344,873,482	1,085,843,394	284,887,672	163,044,343	272,379,034	335,780,243	909,633,510
CURRENT EXPENSES													
Salaries	315,176,795	21,250,802	75,600,006	15,112,329	18,931,688	24,601,651	28,576,811	39,953,641	16,982,647	12,549,508	19,578,180	15,205,599	26,833,933
Retirement and other benefits	84,308,487	5,657,063	19,204,047	4,346,477	5,311,482	6,431,157	7,200,328	10,966,827	4,737,974	3,124,609	5,426,426	4,053,097	7,849,000
Fees—Directors and others	4,322,560	280,704	1,492,735	284,752	221,609	215,245	149,104	271,206	204,778	242,103	186,664	122,786	650,874
Travel	7,285,166	448,729	1,316,435	217,236	549,204	571,680	723,969	826,454	342,686	410,742	549,342	412,617	916,072
Postage	11,601,790	542,975	1,904,811	385,166	625,099	919,282	777,090	1,171,529	941,751	821,351	1,318,943	532,719	1,661,074
Expressage	59,357,444	3,553,536	7,432,049	2,420,329	6,037,324	6,895,284	7,517,953	7,944,541	4,133,452	2,130,343	3,215,610	2,908,330	5,168,693
Telephone and telegraph	11,210,563	781,240	2,326,824	440,840	727,250	1,024,284	1,023,510	1,382,803	489,775	577,097	745,333	659,183	1,032,424
Printing and supplies	24,778,451	1,689,583	4,721,129	1,265,175	1,336,006	2,161,094	2,597,596	3,455,727	1,545,933	949,080	1,698,550	1,091,018	2,267,560
Taxes on real estate	13,846,256	3,014,444	2,427,632	1,225,982	736,788	579,913	610,433	1,501,986	450,073	1,577,415	483,648	459,595	778,347
Bank premises:													
Depreciation	8,399,990	760,630	294,744	1,700,029	1,237,544	560,949	287,371	389,542	564,206	1,567,060	546,776	177,207	313,932
Maintenance and repairs	5,356,184	231,454	579,890	477,134	357,652	266,625	305,054	1,436,183	414,138	322,284	268,503	409,667	287,600
Utilities	11,910,940	2,024,665	2,209,396	1,382,076	1,067,216	625,713	806,794	1,000,035	621,723	460,945	613,351	525,200	573,826
Rent	8,842,532	1,147,717	4,285,372	19,771	144,387	903,010	768,037	818,641	150,558	55,690	22,436	9,823	517,090
Furniture and equipment:													
Rentals	43,381,842	3,337,096	5,912,516	1,954,410	3,161,562	4,776,556	3,824,186	6,590,597	1,964,411	1,499,597	4,197,880	2,637,778	3,525,253
Depreciation	5,049,609	43,839	1,425,267	542,594	307,158	254,494	373,946	150,781	481,397	116,814	148,832	461,796	742,691
Cost of F.R. currency	55,008,163	3,152,915	10,130,551	3,185,252	3,381,031	5,166,651	4,866,948	7,728,771	2,645,549	1,549,059	2,866,618	3,282,155	7,052,663
All other	14,455,634	1,458,475	3,384,731	685,875	1,011,996	979,833	930,674	1,171,701	584,926	777,087	850,817	927,749	1,691,770
Total [2]	681,877,556	49,375,867	144,648,135	35,645,427	45,144,996	[2] 54,518,570	61,339,804	86,760,966	37,255,977	28,730,784	42,717,909	33,876,319	61,862,802
Reimbursements and recoveries	58,017,973	3,571,112	12,969,933	2,887,208	4,766,659	3,734,417	6,105,429	7,391,207	3,637,013	1,910,382	3,765,000	1,984,865	5,294,748
Net expenses	623,859,583	45,804,755	131,678,202	32,758,219	40,378,337	50,784,153	55,234,375	79,369,759	33,618,964	26,820,402	38,952,909	31,891,454	56,568,054

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PROFIT AND LOSS

Current net earnings	6,267,457,915	270,657,271	1,571,062,523	334,065,058	523,890,791	493,796,510	289,639,107	1,006,473,635	251,268,708	136,223,941	233,426,125	303,888,790	853,065,456
Additions to current net earnings	20,544,148	980,011	3,740,033	2,219,531	1,025,154	2,262,832	895,543	2,237,578	1,179,409	740,277	1,343,817	1,483,426	2,436,537
Deductions from current net earnings:													
Losses on sales of U.S. Govt. securities	49,834,399	2,335,189	11,783,644	2,648,278	4,185,456	3,966,090	2,435,910	7 994,439	2,128,689	1,232,320	2,005,460	2,511,669	6,607,255
Losses on foreign exchange transactions [3]	146,384,339	5,269,836	37,474,391	6,294,527	12,589,053	8,051,138	11,125,210	21,957,651	4,830,683	4,245,146	6,148,142	8,197,523	20,201,039
All other	1,358,872	17,897	659,297	11,760	47,345	28,887	56,562	97,481	48,767	28,186	18,558	151,129	193,003
Total deductions	197,577,610	7,622,922	49,917,332	8 954,565	16,821,854	12,046,115	13,617,682	30,049,571	7,008,139	5,505,652	8,172,160	10,860,321	27,001,297
Net deduction from current net earnings	177,033,463	6,642,911	46,177,299	6,735,034	15,796,700	9,783,284	12,722,139	27,811,993	5,828,730	4,765,375	6,828,343	9,376,895	24,564,760
Assessment for expenditures of Board of Governors [4]	47,366,100	1,657,000	12,048,600	2,061,800	4,057,700	2,597,200	3,624,700	7,152,500	1,562,800	1,383,100	1,978,600	2,666,700	6,575,400
Net earnings before payments to U.S. Treasury	6,043,058,352	262,357,360	1,512,836,624	325,268,224	504,036,391	481,416,026	273,292,268	971,509,142	243,877,178	130,075,466	224,619,182	291,845,195	821,925,296
Dividends paid	60,182,278	1,973,285	15,319,899	2,606,405	5,142,729	3,279,713	4,604,434	9,144,005	1,962,681	1,777,080	2,542,017	3,411,215	8,418,815
Payments to U.S. Treasury (interest on F.R. notes)	5,937,148,424	263,534,575	1,482,064,725	321,384,019	496,089,262	476,974,463	266,134,984	953,289,737	242,329,047	126,158,086	219,502,415	285,415,130	804,271,981
Transferred to surplus	45,727,650	−3,150,500	15,452,000	1,277,800	2,804,400	1,161,850	2,552,850	9,075,400	−414,550	2,140,300	2,574,750	3,018,850	9,234,500
Surplus, January 1	983,274,200	35,373,000	251,256,950	42,870,600	84,214,250	53,931,900	75,056,700	147,957,550	32,551,450	28,589,900	40,904,450	55,203,800	135,363,650
Surplus, December 31	1,029,001,850	32,222,500	266,708,950	44,148,400	87,018,650	55,093,750	77,609,550	157,032,950	32,136,900	30,730,200	43,479,200	58,222,650	144,598,150

[1] Includes earnings on note due from FDIC account Franklin National Bank. Earnings from this source amounted to $63,998,374 in 1976 and $26,186,215 in 1977.

[2] The total expense for Richmond has been adjusted to exclude $2,414,851, which was allocated to the expenses of other Reserve Banks for operation of the Federal Reserve Communication System.

[3] Does not include unrealized gains and losses.

[4] See pp. 430–432 for additional details.

NOTE.—Details may not add to totals because of rounding.

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Federal Reserve Bank of St. Louis

7. Earnings and expenses of Federal Reserve Banks, 1914–77

In dollars

Period or Bank	Current earnings	Current expenses	Net additions or deductions (−)	Assessment for expenditures of Board of Governors	Dividends paid	Payments to U.S. Treasury: Franchise tax	Payments to U.S. Treasury: Under Sec. 13b	Payments to U.S. Treasury: Interest on F.R. notes	Transferred to surplus (Sec. 13b)	Transferred to surplus (Sec. 7)
All F.R. Banks, by years:										
1914–15	2,173,252	2,018,282	5,875	302,304	217,463	...	...	...	...	...
1916	5,217,998	2,081,722	−193,001	192,277	1,742,775	...	...	...	...	...
1917	16,128,339	4,921,932	−1,386,545	237,795	6,804,186	1,134,234	...	...	...	1,134,234
1918	67,584,417	10,576,892	−3,908,574	382,641	5,540,684	...	...	...	...	48,334,341
1919	102,380,583	18,744,815	−4,673,446	594,818	5,011,832	2,703,894	...	...	...	70,651,778
1920	181,296,711	27,548,505	−3,743,907	709,525	5,654,018	60,724,742	...	...	...	82,916,014
1921	122,865,866	33,722,409	−6,314,796	741,436	6,119,673	59,974,466	...	...	...	15,993,086
1922	50,498,699	28,836,504	−4,441,914	722,545	6,307,035	10,850,605	...	...	...	−659,904
1923	50,708,566	29,061,539	−8,233,107	702,634	6,552,717	3,613,056	...	...	...	2,545,513
1924	38,340,449	27,767,886	−6,191,143	663,240	6,682,496	113,646	...	...	...	−3,077,962
1925	41,800,706	26,818,664	−4,823,477	709,499	6,915,958	59,300	...	...	...	2,473,808
1926	47,599,595	26,628,458	−3,637,668	721,724	7,329,169	818,150	...	...	...	8,464,426
1927	43,024,484	26,739,327	−2,457,792	779,116	7,754,539	249,591	...	...	...	5,044,119
1928	64,052,860	26,207,133	−5,026,029	697,677	8,458,463	2,584,659	...	...	...	21,078,899
1929	70,955,496	28,909,469	−4,861,642	781,644	9,583,911	4,283,231	...	...	...	22,535,597
1930	36,424,044	27,533,141	−93,136	809,585	10,268,598	17,308	...	...	...	−2,297,724
1931	29,701,279	26,322,110	311,451	718,554	10,029,760	...	...	...	...	−7,057,694
1932	50,018,817	25,562,571	−1,413,192	728,810	9,282,244	2,011,418	...	...	...	11,020,582
1933	49,487,318	28,422,677	−12,307,074	800,160	8,874,262	...	...	...	...	−916,855
1934	48,902,813	27,869,374	−4,430,008	1,372,022	8,781,661	...	...	...	−60,323	6,510,071
1935	42,751,959	30,171,545	−1,736,758	1,405,898	8,504,974	...	297,667	...	27,695	607,422
1936	37,900,639	28,194,457	485,817	1,679,566	7,829,581	...	227,448	...	102,880	352,524
1937	41,233,135	27,052,234	−1,631,274	1,748,380	7,940,966	...	176,625	...	67,304	2,616,352
1938	36,261,428	27,186,684	2,232,134	1,724,924	8,019,137	...	119,524	...	−419,140	1,862,433
1939	38,500,665	27,025,391	2,389,555	1,621,464	8,110,462	...	24,579	...	−425,653	4,533,977
1940	43,537,805	27,461,466	11,487,697	1,704,011	8,214,971	...	82,152	...	−54,456	17,617,358
1941	41,380,095	31,123,609	720,636	1,839,541	8,429,936	...	141,465	...	−4,333	570,513
1942	52,662,704	36,877,718	−1,568,208	1,746,326	8,669,076	...	197,672	...	49,602	3,554,101
1943	69,305,715	41,129,934	23,768,282	2,415,630	8,911,342	...	244,726	...	135,003	40,237,362
1944	104,391,829	46,879,564	3,221,880	2,296,357	9,500,126	...	326,717	...	201,150	48,409,795
1945	142,209,546	46,376,762	−830,007	2,340,509	10,182,851	...	247,659	...	262,133	81,969,625
1946	150,385,033	54,975,323	−625,991	2,259,784	10,962,160	...	67,054	...	27,708	81,467,013
1947	158,655,566	62,753,308	1,973,001	2,639,667	11,523,047	...	35,605	75,223,818	86,772	8,366,350
1948	304,160,818	69,466,518	−34,317,947	3,243,670	11,919,809	...	...	166,690,356	...	18,522,518
1949	316,536,930	74,235,176	−12,122,274	3,242,500	12,329,373	...	...	193,145,837	...	21,461,770

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1950	275,838,994	77,138,071	36,294,117	3,433,700	13,082,992	....	....	196,628,858	....	21,849,490
1951	394,656,072	91,373,589	−2,127,889	4,095,497	13,864,750	....	....	254,873,588	....	28,320,759
1952	456,060,260	100,572,489	1,583,988	4,121,602	14,681,788	....	....	291,934,634	....	46,333,735
1953	513,037,237	109,415,220	−1,058,993	4,099,800	15,558,377	....	....	342,567,985	....	40,336,862
1954	438,486,040	105,558,331	−133,641	4,174,600	16,442,236	....	....	276,289,457	....	35,887,775
1955	412,487,931	105,865,923	−265,456	4,194,100	17,711,937	....	....	251,740,721	....	32,709,794
1956	595,649,092	115,842,696	−23,436	5,339,800	18,904,897	....	....	401,555,581	....	53,982,682
1957	763,347,530	124,306,103	−7,140,914	7,507,900	20,080,527	....	....	542,708,405	....	61,603,682
1958	742,068,150	131,804,455	124,175	5,917,200	21,197,452	....	....	524,058,650	....	59,214,569
1959	886,226,116	138,232,106	98,247,253	6,470,600	22,721,687	....	....	910,649,768	....	−93,600,791
1960	1,103,385,257	147,348,575	13,874,702	6,533,700	23,948,225	....	....	896,816,359	....	42,613,100
1961	941,648,170	155,009,475	3,481,628	6,265,100	25,569,541	....	....	687,393,382	....	70,892,300
1962	1,048,508,335	169,481,234	−55,779	6,654,900	27,412,241	....	....	799,365,981	....	45,538,200
1963	1,151,120,060	179,700,557	614,835	7,572,800	28,912,019	....	....	879,685,219	....	55,864,300
1964	1,343,747,303	188,740,689	725,948	8,655,200	30,781,548	....	....	1,582,118,614	....	−465,822,800
1965	1,559,484,027	195,713,790	1,021,614	8,576,396	32,351,602	....	....	1,296,810,053	....	27,053,800
1966	1,908,499,896	198,379,526	996,230	9,021,600	33,696,336	....	....	1,649,455,164	....	18,943,500
1967	2,190,403,752	209,351,250	2,093,876	10,769,596	35,027,312	....	....	1,907,498,270	....	29,851,200
1968	2,764,445,943	228,152,172	8,519,996	14,198,198	36,959,336	....	....	2,463,628,983	....	30,027,250
1969	3,373,360,559	259,953,236	−557,553	15,020,084	39,236,599	....	....	3,019,160,638	....	39,432,450
1970	3,877,218,444	300,145,586	11,441,829	21,227,800	41,136,551	....	....	3,493,570,636	....	32,579,700
1971	3,723,369,921	344,550,798	94,266,075	32,634,002	43,488,074	....	....	3,356,559,873	....	40,403,250
1972	3,792,334,523	379,371,852	−49,615,790	35,234,499	46,183,719	....	....	3,231,267,663	....	50,661,000
1973	5,016,769,328	450,705,676	−80,653,488	44,411,700	49,139,682	....	....	4,340,680,482	....	51,178,300
1974	6,280,090,965	506,424,874	−78,487,237	41,116,600	52,579,643	....	....	5,549,999,411	....	51,483,200
1975	6,257,936,784	551,488,714	−202,369,615	33,577,201	54,609,555	....	....	5,382,064,098	....	33,827,600
1976	6,623,220,383	606,948,264	7,310,500	41,827,700	57,351,487	....	....	5,870,463,382	....	53,940,050
1977	6,891,317,498	623,859,582	−177,033,463	47,366,100	60,182,278	....	....	5,937,148,425	....	45,727,650
Total 1914–77	68,023,754,729	7,882,637,932	−403,299,068	485,294,208	1,171,771,645	149,138,300	2,188,893	56,771,754,290	−3,657	1,157,674,049
Aggregate for each F.R. Bank, 1914–77:										
Boston	3,353,056,513	540,452,362	−13,681,410	22,796,486	59,683,319	7,111,395	280,843	2,666,597,962	135,411	42,317,325
New York	17,493,095,990	1,671,072,443	−105,625,115	130,891,986	336,080,421	68,006,262	369,116	14,877,518,539	−433,413	303,965,521
Philadelphia	3,714,666,323	434,424,162	−13,176,904	27,119,418	72,686,672	5,558,901	722,406	3,102,208,577	290,661	58,478,622
Cleveland	5,411,489,179	597,176,944	−36,330,224	43,545,890	108,764,910	4,842,447	82,930	4,520,503,297	−9,906	100,252,443
Richmond	4,909,189,942	610,142,316	−18,716,215	25,211,176	57,069,791	6,200,189	172,493	4,130,775,721	−71,517	60,973,558
Atlanta	3,597,100,783	606,330,198	−34,766,220	30,962,560	66,191,510	8,950,561	79,264	2,766,938,889	5,491	82,876,090
Chicago	10,840,428,943	1,059,286,385	−67,467,138	71,575,772	162,703,365	25,313,526	151,045	9,281,558,326	11,682	172,361,704
St. Louis	2,611,773,212	450,848,154	−13,755,072	16,624,472	39,955,143	2,755,629	7,464	2,050,597,265	−26,515	37,256,528
Minneapolis	1,473,001,567	307,886,139	−8,983,693	11,913,215	28,093,282	5,202,900	55,615	1,076,194,436	64,874	34,607,413
Kansas City	2,733,781,896	463,816,636	−15,308,438	19,872,709	46,897,670	6,939,100	64,213	2,133,272,654	−8,674	47,619,150
Dallas	2,995,683,666	395,161,762	−23,409,070	25,572,773	58,807,648	560,049	102,083	2,429,514,816	55,337	62,500,128
San Francisco	8,890,486,715	746,040,431	−52,079,571	59,207,751	134,837,914	7,697,341	101,421	7,736,073,808	−17,089	154,465,567
Total	68,023,754,729	7,882,637,932	−403,299,068	485,294,208	1,171,771,645	149,138,300	2,188,893	56,771,754,290	−3,657	[1] 1,157,674,049

[1] The $1,157,674,049 transferred to surplus was reduced by direct charges of $500,000 for charge-off on Bank premises (1927), $139,299,557 for contributions to capital of the Federal Deposit Insurance Corporation (1934), and $3,657 net upon elimination of Sec. 13b surplus (1958), and was increased by $11,131,013 transferred from reserves for contingencies (1945), leaving a balance of $1,029,001,848 on Dec. 31, 1977.

NOTE.—Details may not add to totals because of rounding.

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8. Bank premises of Federal Reserve Banks and branches, December 31, 1977

In dollars

F.R. Bank or branch	Cost				Net book value	Other real estate [2]
	Land	Buildings (including vaults) [1]	Building machinery and equipment	Total		
oston	20,235,047	86,749,890	...	106,984,937	106,325,337	4,397,218
Annex	27,840	89,202	44,538	161,580	145,985	...
ew York	5,215,656	13,016,452	12,048,844	30,280,952	6,354,075	9,344,584
Annex	592,679	1,491,116	716,472	2,800,267	477,862	...
uffalo	673,076	2,679,944	1,604,053	4,957,073	2,375,092	...
hiladelphia	1,369,997	56,693,881	...	58,063,878	55,777,044	...
leveland	1,295,490	6,699,266	3,588,241	11,582,997	1,154,257	1,224,363
incinnati	1,479,874	13,537,723	7,521,727	22,539,324	17,425,692	...
ittsburgh	1,848,317	4,353,305	2,937,674	9,139,296	4,245,550	...
Richmond	2,342,874	65,032,260	2,506,471	69,881,605	63,687,954	326,403
Annex 1	146,875	256,000	2,313	405,188	146,875	...
Annex 2	522,733	3,659,933	3,511,136	7,693,802	5,024,065	...
Baltimore	801,779	2,333,402	1,171,435	4,306,616	2,138,683	3,831,490
Charlotte	347,071	1,069,026	650,398	2,066,495	971,203	1,634,312
Atlanta	1,304,755	6,488,356	3,558,581	11,351,692	6,142,087	3,977,150
Birmingham	410,775	2,000,619	1,019,618	3,431,012	1,576,297	...
Jacksonville	164,004	1,718,157	749,369	2,631,530	1,033,605	...
Annex	107,925	76,236	15,842	200,003	163,450	...
Nashville	592,342	1,474,678	1,141,280	3,208,300	1,585,735	...
New Orleans	1,557,663	2,754,271	1,448,181	5,760,115	3,724,845	...
Chicago	6,275,490	17,847,133	10,995,702	35,118,325	12,801,864	...
Annex	50,000	173,197	93,916	317,113	409,414	...
Detroit	1,147,734	3,170,322	1,787,882	6,105,938	2,474,733	...
St. Louis	1,675,780	3,886,293	3,058,393	8,620,466	1,853,651	...
Little Rock	800,104	2,037,868	1,015,628	3,853,600	2,660,881	...
Louisville	700,075	2,859,819	1,159,753	4,719,647	2,475,212	...
Memphis	1,135,623	4,216,382	2,126,755	7,478,760	5,842,925	...
Minneapolis	1,394,384	23,606,389	10,928,091	35,928,864	29,281,002	...
Helena	71,390	126,400	62,977	260,767	91,312	76,059
Kansas City	1,390,369	9,669,673	3,778,724	14,838,766	6,749,830	276,274
Denver	2,997,746	3,206,456	2,324,013	8,528,215	5,940,641	...
Oklahoma City	647,686	2,449,326	1,477,169	4,574,181	3,629,457	...
Omaha	1,030,226	1,576,662	817,214	3,424,102	1,960,775	457,973
Dallas	3,723,160	4,826,832	3,570,804	12,120,796	6,172,789	...
El Paso	262,477	787,728	393,301	1,443,506	831,958	...
Houston	1,959,770	1,488,120	714,187	4,162,077	3,102,759	...
San Antonio	448,596	1,400,390	570,847	2,419,833	1,430,021	...
San Francisco	684,340	3,818,155	1,936,512	6,439,007	1,254,055	16,626,504
Annex	247,201	124,000	30,000	401,201	324,081	...
Los Angeles	1,022,695	4,636,416	1,740,769	7,399,880	2,872,137	...
Portland	207,380	1,678,512	649,432	2,535,324	1,544,268	...
Salt Lake City	480,222	2,002,130	707,574	3,189,926	1,816,743	...
Seattle	274,772	1,941,773	1,085,244	3,301,789	1,355,304	...
Total	69,663,992	369,703,693	95,261,060	534,628,745	377,351,505	42,172,330

[1] Includes expenditures for construction at some offices pending allocation to appropriate accounts.
[2] Includes both acquisitions for banking-house purposes and Bank premises formerly occupied and being held pending sale.

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9. Volume of operations in principal departments of Federal Reserve Banks, 1974–77

Operation	1977	1976	1975	1974
	Millions of pieces handled [1]			
Loans	(2)	(2)	(2)	(2)
Currency received and counted	8,186	r 8,061	7,666	7,303
Currency verified and destroyed	2,609	2,671	2,625	2,713
Coin received and counted	16,563	15,925	15,412	15,089
Checks handled:				
U.S. Govt. checks	740	768	844	723
Postal money orders	139	169	176	169
All other [3]	13,312	12,287	11,410	10,820
Collection items handled:				
U.S. Govt. coupons paid	6	8	9	10
All other	4	4	16	28
Issues, redemptions, and exchanges of U.S. Govt. securities	286	289	277	283
Transfers of funds	25	21	17	15
Food stamps redeemed	1,901	2,003	2,493	2,513
	Amounts handled (millions of dollars)			
Loans	77,511	17,697	39,822	361,231
Currency received and counted	75,933	71,011	66,065	61,943
Currency verified and destroyed	14,952	14,606	14,279	14,800
Coin received and counted	2,239	2,109	2,120	2,005
Checks handled:				
U.S. Govt. checks	416,386	399,468	349,957	318,984
Postal money orders	5,661	6,305	8,524	5,687
All other [3]	5,499,856	4,645,069	4,256,924	4,104,275
Collection items handled:				
U.S. Govt. coupons paid	3,276	4,748	6,175	6,337
All other	26,959	23,929	26,973	28,795
Issues, redemptions, and exchanges of U.S. Govt. securities	8,835,730	7,051,978	4,575,365	3,085,911
Transfers of funds	43,165,467	35,617,756	31,392,865	30,361,778
Food stamps redeemed	7,422	7,883	7,940	5,679

r Revised.
1 Packaged items handled as a single item are counted as one piece.
2 Number handled (in thousands): 1977, 12; 1976, 4; 1975, 6; 1974, 35.
3 Exclusive of checks drawn on the F.R. Banks.

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10. Principal operations of Federal Reserve Banks, including total expenses, average number of employees, and ratio of total expense for each operation to total expenses, 1974–77

Expenses and number of employees in thousands; ratios in per cent

Operation	1977[1]	1976	1975	1974
Check clearing operations:[2]				
Total expense	$246,981	$135,209	$130,024	$124,962
Ratio to total expenses	36.2	20.5	21.7	22.8
Average number of employees	6.5	6.3	7.1	7.5
Currency function:				
Total expense	182,875	114,036	99,306	88,486
Ratio to total expenses	26.8	17.3	16.6	16.1
Average number of employees	2.2	2.3	2.4	2.6
Fiscal agency operations:				
Total expense	73,002	48,158	45,307	41,342
Ratio to total expenses	10.7	7.3	7.6	7.5
Average number of employees	2.0	2.3	2.4	2.3
Bank supervision:				
Total expense	52,702	23,322	19,936	17,302
Ratio to total expenses	7.7	3.5	3.3	3.2
Average number of employees	1.3	1.1	1.0	1.0
Other operations:[3]				
Total expense	126,318	29,919	27,623	24,946
Ratio to total expenses	18.6	4.6	4.6	4.5
Average number of employees	2.2	1.4	1.5	1.4
General administration and support:				
Total expense	....	307,806	277,014	252,133
Ratio to total expenses	....	46.8	46.2	45.9
Average number of employees	10.1	11.1	11.3	11.1
Accounting	....	23,298	21,702	20,306
Auditing	....	8,050	7,289	6,637
Bank administration	....	38,519	33,226	28,717
Data processing	....	39,814	34,652	30,567
Occupancy	....	64,292	58,391	52,532
Personnel	....	27,219	26,449	24,384
Protection	....	24,501	22,255	20,728
Other	....	82,113	73,050	68,262
Total expenses	$681,878	$658,450	$599,210	$549,171
Less reimbursements	58,018	51,502	47,721	42,747
Net expenses	$623,860	$606,948	$551,489	$506,424

[1] Under a new expense accounting system, certain support activities were reclassified as operations, and all general administration and support costs were allocated to operations. See p. 427 for discussion.

[2] Includes automated clearinghouse and noncash collections.

[3] Includes mainly economic research and statistics, foreign operations, and lending and credit.

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Federal Reserve Bank of St. Louis

11. Number and salaries of officers and employees of Federal Reserve Banks, December 31, 1977

Federal Reserve Bank (including branches)	President	Other officers		Employees			Total	
	Annual salary (dollars)	Number	Annual salaries (dollars)	Number: Full-time	Number: Part-time	Annual salaries (dollars)	Number	Annual salaries (dollars)
Boston	77,500	45	1,496,530	1,409	147	19,161,394	1,602	20,735,424
New York	110,000	124	5,133,900	4,547	110	65,655,509	4,782	70,899,409
Philadelphia	66,000	37	1,209,350	1,098	62	13,527,790	1,198	14,803,140
Cleveland	74,000	40	1,270,000	1,501	43	17,029,844	1,585	18,373,844
Richmond	64,250	66	2,131,600	2,016	83	22,843,524	2,166	25,039,374
Atlanta	83,000	63	1,982,400	2,333	63	26,249,297	2,460	28,314,697
Chicago	90,000	60	1,986,000	2,947	120	35,173,010	3,128	37,249,010
St. Louis	69,960	44	1,398,013	1,309	60	14,975,974	1,414	16,443,947
Minneapolis	55,000	30	1,017,000	866	14	10,482,260	911	11,554,260
Kansas City	58,000	50	1,500,500	1,548	79	17,135,700	1,678	18,694,200
Dallas	63,000	39	1,170,300	1,199	38	13,410,908	1,277	14,644,208
San Francisco	90,000	69	2,238,000	1,764	77	23,291,131	1,913	25,619,131
Total	900,710	667	22,533,593	22,537	896	278,936,341	24,114	302,370,644

12. Federal Reserve Bank interest rates, December 31, 1977

Per cent per annum

Federal Reserve Bank	Loans to member banks— Under Secs. 13 and 13a [1]	Under Sec. 10(b) [2]: Regular rate	Under Sec. 10(b) [2]: Special rate [3]	Loans to all others under last par. Sec. 13 [4]
Boston	6	6½	7	9
New York	↑	↑	↑	↑
Philadelphia	|	|	|	|
Cleveland	|	|	|	|
Richmond	|	|	|	|
Atlanta	|	|	|	|
Chicago	|	|	|	|
St. Louis	|	|	|	|
Minneapolis	|	|	|	|
Kansas City	|	|	|	|
Dallas	↓	↓	↓	↓
San Francisco	6	6½	7	9

[1] Discounts of eligible paper and advances secured by such paper or by U.S. Govt. obligations or any other obligations eligible for F.R. Bank purchase.
[2] Advances secured to the satisfaction of the F.R. Bank. Advances secured by mortgages on 1- to 4-family residential property are made at the Section 13 rate.
[3] Applicable to special advances described in Section 201.2(e)(2) of Regulation A.
[4] Advances to individuals, partnerships, or corporations other than member banks secured by direct obligations of, or obligations fully guaranteed as to principal and interest by, the U.S. Govt. or any agency thereof.

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13. Member bank reserve requirements

Per cent of deposits

Through July 13, 1966

Effective date [1]	Net demand deposits [2]			Time deposits (all classes of banks)
	Central reserve city banks	Reserve city banks	Country banks	
1917—June 21	13	10	7	3
1936—Aug. 16	19½	15	10½	4½
1937—Mar. 1	22¾	17½	12¼	5¼
May 1	26	20	14	6
1938—Apr. 16	22¾	17½	12	5
1941—Nov. 1	26	20	14	6
1942—Aug. 20	24	...	...	...
Sept. 14	22	...	...	...
Oct. 3	20	...	...	...
1948—Feb. 27	22	...	...	...
June 11	24	...	...	...
Sept. 24, 16	26	22	16	7½
1949—May 5, 1	24	21	15	7
June 30, July 1	...	20	14	6
Aug. 1	...	...	13	...
Aug. 11, 16	23½	19½	12	5
Aug. 18	23	19	...	...
Aug. 25	22½	18½	...	...
Sept. 1	22	18	...	...
1951—Jan. 11, 16	23	19	13	6
Jan. 25, Feb. 1	24	20	14	...
1953—July 9, 1	22	19	13	...
1954—June 24, 16	21	...	...	5
July 29, Aug. 1	20	18	12	...
1958—Feb. 27, Mar. 1	19½	17½	11½	...
Mar. 20, Apr. 1	19	17	11	...
Apr. 17	18½	...	...	...
Apr. 24	18	16½	...	...
1960—Sept. 1	17½	...	...	...
Nov. 24	...	...	12	...
Dec. 1	16½	...	...	...
1962—July 28	([3])	...	...	...
Oct. 25, Nov. 1	...	...	...	4

July 14, 1966, through Nov. 8, 1972 (deposit intervals are in millions of dollars)

Effective date [1]	Net demand deposits [2]				Time deposits [4] (all classes of banks)		
	Reserve city banks		Country banks		Savings	Other time	
	0–5	Over 5	0–5	Over 5		0–5	Over 5
1966—July 14, 21	[5] 16½		[5] 12		[5] 4	[5] 4	5
Sept. 8, 15	...		...		...	...	6
1967—Mar. 2	...		...		3½	3½	...
Mar. 16	...		...		3	3	...
1968—Jan. 11, 18	16½	17	12	12½	...	...	...
1969—Apr. 17	17	17½	12½	13	...	...	...
1970—Oct. 1	...	...	...	...	...	...	5

[1] Reserves required during the period from inception of the Federal Reserve System until June 20, 1917, were not strictly comparable with later requirements; they were based on aggregate amounts of deposits, and reserve balances with the Reserve Banks were increased in stages. When two dates are shown, the first applies to the change at central reserve or reserve city banks and the second to the change at country banks.

[2] (a) Demand deposits subject to reserve requirements, which beginning with Aug. 23, 1935, have been total demand deposits minus cash items in process of collection and demand balances due from domestic banks (also minus war loan and Series E bond accounts during the period Apr. 13, 1943—June 30, 1947).

(b) All required reserves were held on deposit with F.R. Banks June 21, 1917, until late 1959. Since then, member banks have also been allowed to count vault cash as reserves, as follows: country banks—

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13.—Continued

Beginning Nov. 9, 1972 (deposit intervals are in millions of dollars)

Effective date	Net demand deposits[2,6]					Time deposits[4]						
						Savings	Other time					
							0-5, maturing in—			Over 5[7], maturing in—		
	0-2	2-10	10-100	100-400	Over 400		30-179 days	180 days to 4 yrs.	4 yrs. or more	30-179 days	180 days to 4 yrs.	4 yrs. or more
1972—Nov. 9	8	10	12	[8]16½	17½	[5]3	[5]3			[5]5		
Nov. 16	......	......	......	13	......	......	......	......	......	......	......	......
1973—July 19	......	10½	12½	13½	18	......	......	......	......	......	......	......
1974—Dec. 12	......	......	......	......	17½	......	......	......	......	6	3	
1975—Feb. 13	7½	10	12	13	16½	......	......	......	......	......	......	......
Oct. 30	......	......	......	......	......	......	3		[9]1	......	3	[9]1
1976—Jan. 8	......	......	......	......	......	......	3	[9]2½	......	......	[9]2½	......
Dec. 30	7	9½	11¾	12¾	16¼	......	......	......	......	......	......	......
In effect Dec. 31, 1977	7	9½	11¾	12¾	16¼	3	3	[9]2½	[9]1	6	[9]2½	[9]1

Legal limits—Dec. 31, 1977:	Minimum	Maximum
Net demand deposits:		
Reserve city banks	10	22
Other banks	7	14
Time deposits	3	10

in excess of 4 and 2½ per cent of net demand deposits effective Dec. 1, 1959, and Aug. 25, 1960, respectively; central reserve city and reserve city banks—in excess of 2 and 1 per cent effective Dec. 3, 1959, and, Sept. 1, 1960, respectively; all member banks were allowed to count all vault cash as reserves effective Nov. 24, 1960.

[2] (c) In graduated requirement schedules, each deposit interval applies to that part of the deposits of each bank.

(d) Since Oct. 16, 1969, Regulation M has required reserves against (1) net balances due from domestic offices to their foreign branches and (2) foreign branch loans to U.S. residents; Regulation D imposes a similar requirement against (3) borrowings from foreign banks by domestic offices of a member bank. Limited reserve-free base amounts, originally permitted under Regulation M, were eliminated for (2) effective June 21, 1973, and for (1) and (3) they were gradually removed until eliminated effective Mar. 14, 1974. Beginning June 21, 1973, loans aggregating $100,000 or less to any U.S. resident have been excluded from computations, as have total loans of a bank to U.S. residents if not exceeding $1 million. The applicable reserve percentage was 10 per cent originally, was increased to 20 per cent on Jan. 7, 1971, was reduced to 8 per cent on June 21, 1973, and was further reduced to 4 per cent effective May 22, 1975. Effective Dec. 1, 1977, the reserve required against deposits that foreign branches of U.S. banks use for lending to U.S. residents was reduced to 1 per cent. For details, see Regulations D and M as described in Record of Policy Actions of the Board of Governors in previous ANNUAL REPORTS.

[3] Authority of the Board of Governors to classify or reclassify cities as central reserve cities was terminated effective July 28, 1962.

[4] Time deposits such as Christmas and vacation club accounts became subject to the same requirements as savings deposits, effective Jan. 5, 1967. Negotiable orders of withdrawal (NOW) accounts were defined in the Board's Regulation Q as savings deposits beginning Jan. 1, 1974.

Notes 2(b), 2(c), and 2(d) above are also relevant to time deposits.

[5] See columns above for effective date of this rate.

[6] Effective Nov. 9, 1972, a new criterion was adopted to designate reserve cities, and on the same date requirements for reserves against net demand deposits of member banks were restructured to provide that each member bank will maintain reserves related to the size of its net demand deposits. The new reserve city designations are as follows: A bank having net demand deposits of more than $400 million is considered to have the character of business of a reserve city bank, and the presence of the head office of such a bank constitutes designation of that place as a reserve city. Cities in which there are F.R. Banks or branches are also reserve cities. Any banks, wherever located, having net demand deposits of $400 million or less are considered to have the character of business of banks outside of reserve cities and are permitted to maintain reserves at ratios set for banks not in reserve cities.

[7] From June 21, 1973, through Dec. 11, 1974, member banks, except as noted below, were subject to a marginal reserve requirement against increases in the aggregate of the following types of obligations: (a) outstanding time deposits of $100,000 or more, (b) outstanding funds obtained by the bank through issuance by a bank's affiliate of obligations subject to the existing reserve requirements on time deposits, and (c) beginning July 12, 1973, funds from sales of finance bills. For the period June 21 through Aug. 29, 1973, (a) included only single-maturity time deposits. The requirement applied to balances above a specified base, but was not applicable to banks having obligations of these types aggregating less than $10 million. Including the basic requirement (5 per cent during the entire period), requirements were: 8 per cent for (a) and (b) from June 21 through Oct. 3, 1973, and for (c) from July 12 through Oct. 3, 1973; 11 per cent from Oct. 4 through Dec. 26, 1973; and 8 per cent from Dec. 27, 1973, through Sept. 18, 1974. Beginning Sept. 19, the 8 per cent requirement applied to only those obligations in (a), (b), and (c) with initial maturities of less than 120 days, and effective Dec. 12, 1974, the remaining marginal reserve on this type of obligation issued to mature in less than 4 months, was removed. For details, see Record of Policy Actions of the Board of Governors in 1973 and 1974 ANNUAL REPORTS.

[8] The 16½ per cent requirement applied for 1 week, only to former reserve city banks. For other banks, the 13 per cent requirement was continued in this deposit interval.

[9] The average of reserves on savings and other time deposits must be at least 3 per cent, the legal minimum.

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14. Maximum interest rates payable on time and savings deposits

Per cent per annum

Nov. 1, 1933—July 19, 1966

Type of deposit	Effective date							
	Nov. 1, 1933	Feb. 1, 1935	Jan. 1, 1936	Jan. 1, 1957	Jan. 1, 1962	July 17, 1963	Nov. 24, 1964	Dec. 6, 1965
Savings deposits:								
12 months or more	3	2½	2½	3	4	4	4	4
Less than 12 months					3½	3½		
Postal savings deposits: [1]								
12 months or more	3	2½	2½	3	4	4	4	4
Less than 12 months					3½	3½		
Other time deposits: [2]								
12 months or more	3	2½	2½	3	4			
6–12 months					3½	4	4½	
90 days to 6 months	3	2½	2	2½	2½			5½
Less than 90 days (30–89 days)	3	2½	1	1	1	1	4	

July 20, 1966—June 30, 1973

Type of deposit	Effective date			
	July 20, 1966	Sept. 26, 1966	Apr. 19, 1968	Jan. 21, 1970
Savings deposits	4	4	4	4½
Other time deposits: [2]				
Multiple maturity: [3]				
30–89 days	4	4	4	4½
90 days to 1 year				5
1–2 years	5	5	5	5½
2 years or more				5¾
Single-maturity:				
Less than $100,000:				
30 days to 1 year				5
1–2 years	5½		5	5½
2 years or more				5¾
$100,000 or more:				
30–59 days			5	(4)
60–89 days			5¾	(4)
90–179 days	5½	5½	6	(4)
180 days to 1 year			6¼	(4)
1 year or more				(4)

Beginning July 1, 1973

Type of deposit	Effective date				
	July 1, 1973	Nov. 1, 1973	Nov. 27, 1974	Dec. 23, 1974	July 6, 1977
Savings deposits	5	5	5	5	5
Other time deposits (multiple- and single-maturity): [2, 3]					
Less than $100,000:					
30–89 days	5	5	5	5	5
90 days to 1 year	5½	5½	5½	5½	5½
1–2½ years	6	6	6	6	6
2½ years or more	6½	6½	6½	6½	6½
Minimum denomination of $1,000: [5]					
4–6 years	(6)	7¼	7¼	7¼	7¼
6 years or more				7½	7½
Governmental units	(7)	(7)	7½	7¾	7¾
Individual retirement accounts and Keogh (H.R. 10) plans [8]	...	...	...	...	7¾
$100,000 or more	(4)	(4)	(4)	(4)	(4)

[1] Closing date for the Postal Savings System was Mar. 28, 1966.
[2] For exceptions with respect to foreign time deposits, see ANNUAL REPORTS for 1962, p. 129; 1965, p. 233; and 1968, p. 69.
[3] Multiple-maturity time deposits include deposits that are automatically renewable at maturity without action by the depositor and deposits that are payable after written notice of withdrawal.

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15. Margin requirements

Per cent of market value

Period		For credit extended under Regulations T (brokers and dealers), U (banks), and G (others than brokers, dealers, or banks)						
Beginning date	Ending date	On margin stocks			On convertible bonds			On short sales (T)
		T	U	G	T	U	G	
1937—Nov. 1	1945—Feb. 4	40						50
1945—Feb. 5	July 4	50						50
July 5	1946—Jan. 20	75						75
1946—Jan. 21	1947—Jan. 31	100						100
1947—Feb. 1	1949—Mar. 29	75						75
1949—Mar. 30	1951—Jan. 16	50						50
1951—Jan. 17	1953—Feb. 19	75						75
1953—Feb. 20	1955—Jan. 3	50						50
1955—Jan. 4	Apr. 22	60						60
Apr. 23	1958—Jan. 15	70						70
1958—Jan. 16	Aug. 4	50						50
Aug. 5	Oct. 15	70						70
Oct. 16	1960—July 27	90						90
1960—July 28	1962—July 9	70						70
1962—July 10	1963—Nov. 5	50						50
1963—Nov. 6	1968—Mar. 10	70						70
1968—Mar. 11	June 7		70			50		70
June 8	1970—May 5		80			60		80
1970—May 6	1971—Dec. 3		65			50		65
1971—Dec. 6	1972—Nov. 22		55			50		55
1972—Nov. 24	1974—Jan. 2		65			50		65
Effective Jan. 3, 1974			50			50		50

Note.—Regulations G, T, and U, prescribed in accordance with the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry margin stocks that may be extended on securities as collateral by prescribing a maximum loan value, which is a specified percentage of the market value of the collateral at the time the credit is extended; margin requirements are the difference between the market value (100 per cent) and the maximum loan value. The term margin stocks is defined in the corresponding regulations.

Regulation G and special margin requirements for bonds convertible into stocks were adopted by the Board of Governors effective Mar. 11, 1968.

For earlier data, see *Banking and Monetary Statistics, 1914–1941*, 2nd printing (Part I only), August 1976, Table No. 145, p. 504.

Notes to Table 14 on opposite page:

[4] Maximum rates on all single-maturity time deposits in denominations of $100,000 or more have been suspended. Rates that were effective Jan. 21, 1970, and the dates when they were suspended are:

30–59 days	6¼ per cent	June 24, 1970
60–89 days	6½ per cent	
90–179 days	6¾ per cent	May 16, 1973
180 days to 1 year	7 per cent	
1 year or more	7½ per cent	

Rates on multiple-maturity time deposits in denominations of $100,000 or more were suspended July 16, 1973, when the distinction between single- and multiple-maturity deposits was eliminated.

[5] The $1,000 minimum denomination requirement does not apply to time deposits representing funds contributed to an individual retirement account established pursuant to 26 U.S.C. (I.R.C. 1954), Section 408, or to a Keogh (H.R. 10) plan established pursuant to 26 U.S.C. (I.R.C. 1954), Section 401. These exceptions were effective Dec. 4, 1975, and Nov. 8, 1976, respectively.

[6] Between July 1 and Oct. 31, 1973, there was no ceiling for certificates maturing in 4 years or more with minimum denominations of $1,000. The amount of such certificates that a bank could issue was limited to 5 per cent of its total time and savings deposits. Sales in excess of that amount were subject to the 6½ per cent ceiling that applies to time deposits maturing in 2½ years or more.

Effective Nov. 1, 1973, a ceiling rate of 7¼ per cent was imposed on certificates maturing in 4 years or more with minimum denominations of $1,000. There is no limitation on the amount of these certificates that banks may issue.

[7] Prior to Nov. 27, 1974, no distinction was made between the time deposits of governmental units and of other holders, insofar as Regulation Q ceilings on rates payable were concerned. Effective Nov. 27, 1974, governmental units were permitted to hold savings deposits and could receive interest rates on time deposits with denominations under $100,000 irrespective of maturity, as high as the maximum rate permitted on such deposits at any Federally insured depositary institution.

[8] Three-year minimum maturity.

Note.—Maximum rates that may be paid by member banks are established by the Board of Governors under provisions of Regulation Q; however, a member bank may not pay a rate in excess of the maximum rate payable by State banks or trust companies on like deposits under the laws of the State in which the member bank is located. Beginning Feb. 1, 1936, maximum rates that may be paid by nonmember insured commercial banks, as established by the Federal Deposit Insurance Corporation, have been the same as those in effect for member banks.

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16. Fees and rates under Regulation V on loans guaranteed pursuant to Defense Production Act of 1950, December 31, 1977

Fees payable to guaranteeing agency by financing institution on guaranteed portion of loan

Percentage of loan guaranteed	Guarantee fee (percentage of interest payable by borrower)	Percentage of any commitment fee charged borrower
70 or less	10	10
75	15	15
80	20	20
85	25	25
90	30	30
95	35	35
Over 95	40–50	40–50

Maximum rates financing institution may charge borrower

Interest rate	7½ per cent per annum [1]
Commitment rate	½ per cent per annum

[1] Except that the agency guaranteeing a particular loan may from time to time prescribe a higher rate if it determines the loan to be necessary in financing any contract or other operation deemed by such agency to be essential to the national defense.

NOTE.—In any case in which the rate of interest on the loan is in excess of 6 per cent, the guarantee fee shall be computed as though the interest rate were 6 per cent.

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17. Principal assets and liabilities, and number of commercial and mutual savings banks, by class of bank, December 31, 1977 and 1976

Asset and liability items shown in millions of dollars

Item	All banks	Commercial banks								Mutual savings banks		
		Total	Member banks [1]			Nonmember banks [1]				Total	Insured	Noninsured
			Total	National [2]	State	Total	Insured	Noninsured				
December 31, 1977												
Loans and investments, gross	1,080,209	939,199	675,518	523,000	152,518	263,681	239,265	24,415		141,009	126,407	14,601
Loans:												
Gross	774,631	680,200	494,969	384,722	110,247	185,230	162,543	22,686		94,431	84,188	10,243
Net	753,240	658,808	479,912	372,702	107,210	178,896	156,411	22,484		94,431	84,188	10,243
Investments	305,577	258,999	180,548	138,277	42,271	78,450	76,721	1,728		46,577	42,219	4,357
U.S. Treasury securities	111,551	100,212	70,424	52,244	18,179	29,788	28,909	879		11,338	10,072	1,265
Other	194,025	158,786	110,124	86,033	24,091	48,662	47,812	849		35,238	32,146	3,091
Cash assets, total	171,144	168,722	134,355	92,050	42,305	34,367	24,908	9,458		2,421	2,214	206
Deposits, total	1,074,426	939,509	683,611	520,167	163,443	255,898	239,053	16,844		134,916	121,265	13,650
Interbank	61,539	61,539	55,757	31,377	24,379	5,781	2,823	2,958		....	....	....
Other demand	332,859	331,268	244,841	185,994	58,847	86,426	82,342	4,084		1,591	1,531	59
Other time	680,027	546,702	383,011	302,795	80,216	163,690	153,887	9,802		133,325	119,734	13,590
Total equity capital	89,624	80,002	59,178	44,994	14,184	20,823	19,905	917		9,622	8,456	1,166
Number of banks	15,174	14,707	5,668	4,654	1,014	9,039	8,729	310		467	323	144
December 31, 1976												
Loans and investments, gross	975,321	846,515	620,610	476,610	144,000	225,904	207,085	18,819		128,806	115,297	13,508
Loans:												
Gross	681,901	595,072	442,968	340,691	102,277	152,103	135,766	16,336		86,829	77,312	9,516
Net	663,117	576,287	429,446	329,971	99,474	146,840	130,630	16,209		86,829	77,312	9,516
Investments	293,420	251,443	177,641	135,918	41,722	73,801	71,319	2,482		41,976	37,984	3,992
U.S. Treasury securities	112,112	102,515	74,576	55,727	18,849	27,938	26,884	1,054		9,597	8,576	1,020
Other	181,307	148,928	103,064	80,191	22,873	45,863	44,434	1,428		32,379	29,408	2,971
Cash assets, total	138,429	136,059	108,931	76,072	32,859	27,127	20,631	6,496		2,370	2,188	181
Deposits, total	961,983	838,329	618,868	469,377	149,491	219,460	206,134	13,325		123,653	110,998	12,654
Interbank	54,631	54,631	49,737	28,057	21,679	4,894	2,575	2,318		....	....	....
Other demand	292,599	291,463	217,657	165,023	52,633	73,806	70,565	3,240		1,135	1,102	32
Other time	614,752	492,234	351,474	276,296	75,178	140,760	132,993	7,766		122,517	109,895	12,622
Total equity capital	81,713	72,879	54,518	41,319	13,199	18,360	17,542	818		8,834	7,762	1,071
Number of banks	15,145	14,672	5,758	4,735	1,023	8,914	8,639	275		473	329	144

[1] Member banks exclude, and noninsured nonmember banks include, 8 noninsured trust companies that were members of the Federal Reserve System in 1976 and 11 in 1977.

[2] Excludes 1 national bank in the Virgin Islands and 1 in Puerto Rico, which are included in Table 19.

NOTE.—All banks in the United States. Details may not add to totals because of rounding.

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18. Member bank reserves, Federal Reserve Bank credit, and related items—end of year 1918–77 and end of month 1977

In millions of dollars

Period	Factors supplying reserve funds										
	F.R. Bank credit outstanding								Gold stock [5]	Special Drawing Rights certif. acct.	Treasury currency outstanding [6]
	U.S. Govt. securities [1]			Loans	Float [2]	All other [3]	Other F.R. assets [4]	Total			
	Total	Bought outright	Held under repurchase agreement								
1918...	239	239	....	1,766	199	294	......	2,498	2,873	......	1,795
1919...	300	300	....	2,215	201	575	......	3,292	2,707	......	1,707
1920...	287	287	....	2,687	119	262	......	3,355	2,639	......	1,709
1921...	234	234	....	1,144	40	146	......	1,563	3,373	......	1,842
1922...	436	436	....	618	78	273	......	1,405	3,642	......	1,958
1923...	134	80	54	723	27	355	......	1,238	3,957	......	2,009
1924...	540	536	4	320	52	390	......	1,302	4,212	......	2,025
1925...	375	367	8	643	63	378	......	1,459	4,112	......	1,977
1926...	315	312	3	637	45	384	......	1,381	4,205	......	1,991
1927...	617	560	57	582	63	393	......	1,655	4,092	......	2,006
1928...	228	197	31	1,056	24	500	......	1,809	3,854	......	2,012
1929...	511	488	23	632	34	405	......	1,583	3,997	......	2,022
1930...	729	686	43	251	21	372	......	1,373	4,306	......	2,027
1931...	817	775	42	638	20	378	......	1,853	4,173	......	2,035
1932...	1,855	1,851	4	235	14	41	......	2,145	4,226	......	2,204
1933...	2,437	2,435	2	98	15	137	......	2,688	4,036	......	2,303
1934...	2,430	2,430	....	7	5	21	......	2,463	8,238	......	2,511
1935...	2,431	2,430	1	5	12	38	......	2,486	10,125	......	2,476
1936...	2,430	2,430	....	3	39	28	......	2,500	11,258	......	2,532
1937...	2,564	2,564	....	10	19	19	......	2,612	12,760	......	2,637
1938...	2,564	2,564	....	4	17	16	......	2,601	14,512	......	2,798
1939...	2,484	2,484	....	7	91	11	......	2,593	17,644	......	2,963
1940...	2,184	2,184	....	3	80	8	......	2,274	21,995	......	3,087
1941...	2,254	2,254	....	3	94	10	......	2,361	22,737	......	3,247
1942...	6,189	6,189	....	6	471	14	......	6,679	22,726	......	3,648
1943...	11,543	11,543	....	5	681	10	......	12,239	21,938	......	4,094
1944...	18,846	18,846	....	80	815	4	......	19,745	20,619	......	4,131
1945...	24,262	24,262	....	249	578	2	......	25,091	20,065	......	4,339
1946...	23,350	23,350	....	163	580	1	......	24,093	20,529	......	4,562
1947...	22,559	22,559	....	85	535	1	......	23,181	22,754	......	4,562
1948...	23,333	23,333	....	223	541	1	......	24,097	24,244	......	4,589
1949...	18,885	18,885	....	78	534	2	......	19,499	24,427	......	4,598
1950...	20,778	20,725	53	67	1,368	3	......	22,216	22,706	......	4,636
1951...	23,801	23,605	196	19	1,184	5	......	25,009	22,695	......	4,709
1952...	24,697	24,034	663	156	967	4	......	25,825	23,187	......	4,812
1953...	25,916	25,318	598	28	935	2	......	26,880	22,030	......	4,894
1954...	24,932	24,888	44	143	808	1	......	25,885	21,713	......	4,985
1955...	24,785	24,391	394	108	1,585	29	......	26,507	21,690	......	5,008
1956...	24,915	24,610	305	50	1,665	70	......	26,699	21,949	......	5,066
1957...	24,238	23,719	519	55	1,424	66	......	25,784	22,781	......	5,146
1958...	26,347	26,252	95	64	1,296	49	......	27,755	20,534	......	5,234
1959...	26,648	26,607	41	458	1,590	75	......	28,771	19,456	......	5,311
1960...	27,384	26,984	400	33	1,847	74	......	29,338	17,767	......	5,398
1961...	28,881	28,722	159	130	2,300	51	......	31,362	16,889	......	5,585
1962...	30,820	30,478	342	38	2,903	110	......	33,871	15,978	......	5,567
1963...	33,593	33,582	11	63	2,600	162	......	36,418	15,513	......	5,578
1964...	37,044	36,506	538	186	2,606	94	......	39,930	15,388	......	5,405

For notes see last two pages of table.

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18.—Continued

Factors absorbing reserve funds

Currency in circulation	Treasury cash holdings [7]	Deposits, other than member bank reserves, with F.R. Banks			Other F.R. accounts [4]	Other F.R. liabilities and capital [4]	Member bank reserves			
		Treasury	Foreign	Other			With F.R. Banks	Currency and coin [8]	Required [9]	Excess [9]
4,951	288	51	96	25	118	....	1,636	....	1,585	51
5,091	385	31	73	28	208	....	1,890	....	1,822	68
5,325	218	57	5	18	298	....	1,781	....	....	....
4,403	214	96	12	15	285	....	1,753	....	1,654	99
4,530	225	11	3	26	276	....	1,934	....	....	....
4,757	213	38	4	19	275	....	1,898	....	1,884	14
4,760	211	51	19	20	258	....	2,220	....	2,161	59
4,817	203	16	8	21	272	....	2,212	....	2,256	−44
4,808	201	17	46	19	293	....	2,194	....	2,250	−56
4,716	208	18	5	21	301	....	2,487	....	2,424	63
4,686	202	23	6	21	348	....	2,389	....	2,430	−41
4,578	216	29	6	24	393	....	2,355	....	2,428	−73
4,603	211	19	6	22	375	....	2,471	....	2,375	96
5,360	222	54	79	31	354	....	1,961	....	1,994	−33
5,388	272	8	19	24	355	....	2,509	....	1,933	576
5,519	284	3	4	128	360	....	2,729	....	1,870	859
5,536	3,029	121	20	169	241	....	4,096	....	2,282	1,814
5,882	2,566	544	29	226	253	....	5,587	....	2,743	2,844
6,543	2,376	244	99	160	261	....	6,606	....	4,622	1,984
6,550	3,619	142	172	235	263	....	7,027	....	5,815	1,212
6,856	2,706	923	199	242	260	....	8,724	....	5,519	3,205
7,598	2,409	634	397	256	251	....	11,653	....	6,444	5,209
8,732	2,213	368	1,133	599	284	....	14,026	....	7,411	6,615
11,160	2,215	867	774	586	291	....	12,450	....	9,365	3,085
15,410	2,193	799	793	485	256	....	13,117	....	11,129	1,988
20,449	2,303	579	1,360	356	339	....	12,886	....	11,650	1,236
25,307	2,375	440	1,204	394	402	....	14,373	....	12,748	1,625
28,515	2,287	977	862	446	495	....	15,915	....	14,457	1,458
28,952	2,272	393	508	314	607	....	16,139	....	15,577	562
28,868	1,336	870	392	569	563	....	17,899	....	16,400	1,499
28,224	1,325	1,123	642	547	590	....	20,479	....	19,277	1,202
27,600	1,312	821	767	750	706	....	16,568	....	15,550	1,018
27,741	1,293	668	895	565	714	....	17,681	....	16,509	1,172
29,206	1,270	247	526	363	746	....	20,056	....	19,667	389
30,433	1,270	389	550	455	777	....	19,950	....	20,520	−570
30,781	761	346	423	493	839	....	20,160	....	19,397	763
30,509	796	563	490	441	907	....	18,876	....	18,618	258
31,158	767	394	402	554	925	....	19,005	....	18,903	102
31,790	775	441	322	426	901	....	19,059	....	19,089	−30
31,834	761	481	356	246	998	....	19,034	....	19,091	−57
32,193	683	358	272	391	1,122	....	18,504	....	18,574	−70
32,591	391	504	345	694	841	....	18,174	310	18,619	−135
32,869	377	485	217	533	941	....	17,081	2,544	18,988	637
33,918	422	465	279	320	1,044	....	17,387	2,823	20,114	96
35,338	380	597	247	393	1,007	....	17,454	3,262	20,071	645
37,692	361	880	171	291	1,065	....	17,049	4,099	20,677	471
39,619	612	820	229	321	1,036	....	18,086	4,151	21,663	574

For notes see last two pages of table.

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18. Member bank reserves, Federal Reserve Bank credit, and related items—end of year 1918–77 and end of month 1977—Continued

In millions of dollars

Period	Factors supplying reserve funds										
	F.R. Bank credit outstanding								Gold stock [5]	Special Drawing Rights certif. acct.	Treasury currency outstanding [6]
	U.S. Govt. securities [1]			Loans	Float [2]	All other [3]	Other F.R. assets [4]	Total			
	Total	Bought outright [10]	Held under repurchase agreement								
1965...	40,768	40,478	290	137	2,248	187	......	43,340	13,733	......	5,575
1966...	44,316	43,655	661	173	2,495	193	......	47,177	13,159	......	6,317
1967...	49,150	48,980	170	141	2,576	164	......	52,031	11,982	......	6,784
1968...	52,937	52,937	....	186	3,443	58	......	56,624	10,367	......	6,795
1969...	57,154	[10] 57,154	....	183	3,440	64	2,743	63,584	10,367	......	6,852
1970...	62,142	62,142	....	335	4,261	57	1,123	67,918	10,732	400	7,149
1971...	70,804	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972...	71,230	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973...	80,495	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974...	85,714	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975...	94,124	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976...	104,093	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977...	111,274	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1977—											
Jan...	100,924	100,924	....	47	2,482	191	3,609	107,253	11,658	1,200	10,865
Feb..	102,681	101,672	1,009	24	2,595	322	2,791	108,413	11,650	1,200	10,884
Mar..	102,772	102,278	494	271	3,286	280	2,859	109,468	11,636	1,200	10,939
Apr..	107,168	105,070	2,098	379	2,735	881	3,243	114,406	11,636	1,200	10,984
May .	104,481	103,637	844	400	3,993	108	2,856	111,838	11,629	1,200	11,026
June .	110,272	105,586	4,686	260	3,604	621	2,922	117,679	11,620	1,200	11,081
July..	106,479	103,804	2,675	788	2,543	393	3,713	113,916	11,595	1,200	11,119
Aug..	105,941	104,711	1,230	1,265	3,842	131	2,462	113,641	11,595	1,200	11,161
Sept..	112,354	109,734	2,620	1,069	2,067	482	2,873	118,845	11,595	1,200	11,206
Oct..	101,926	101,926	....	923	3,945	....	2,564	109,358	11,595	1,200	11,244
Nov..	103,937	101,767	2,170	926	4,632	248	2,119	111,862	11,595	1,200	11,308
Dec..	111,274	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331

[1] U.S. Govt. securities include Federal agency obligations held under repurchase agreement beginning Dec. 1, 1966, and Federal agency issues bought outright beginning Sept. 29, 1971.

[2] Beginning with 1960 reflects a minor change in concept; see Feb. 1961 Federal Reserve *Bulletin*, p. 164.

[3] Principally acceptances and industrial loans; authority for industrial loans expired Aug. 21, 1959.

[4] The total of F.R. Bank capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends less the sum of bank premises and other assets. Beginning Apr. 16, 1969, "Other F.R. assets" and "Other F.R. liabilities and capital" are shown separately; formerly, they were netted together and reported as "Other F.R. accounts."

[5] Before Jan. 30, 1934, included gold held in F.R. Banks and in circulation.

[6] Includes currency and coin—other than gold—issued directly by the Treasury. The largest components are fractional and dollar coins. For details see "Money in Circulation" in the *Treasury Bulletin*.

[7] Presently consists of the coin and paper currency held by the Treasury as well as Treasury gold holdings in excess of the gold that serves as security against gold certificates.

[8] Part allowed as reserves Dec. 1, 1959—Nov. 23, 1960; all allowed thereafter. From Jan. 1963 to Sept. 11, 1968, figures are estimated. Beginning Sept. 12, 1968, amount is based on close-of-business figures for reserve period 2 weeks previous to report date.

[9] These figures are estimated through 1958. Before 1929 available only on call dates (in 1920 and 1922, the call dates were Dec. 29). Beginning Sept. 12, 1968, amount is based on close-of-business figures for reserve period 2 weeks previous to report date.

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18.—Continued

Factors absorbing reserve funds

Currency in circulation	Treasury cash holdings [7]	Deposits, other than member bank reserves, with F.R. Banks			Other F.R. accounts [4]	Other F.R. liabilities and capital [4]	Member bank reserves			
		Treasury	Foreign	Other			With F.R. Banks	Currency and coin [8]	Required [9]	Excess [9, 11]
42,056	760	668	150	355	211	....	18,447	4,163	22,848	−238
44,663	1,176	416	174	588	−147	....	19,779	4,310	24,321	−232
47,226	1,344	1,123	135	653	−773	....	21,092	4,631	25,905	−182
50,961	695	703	216	747	−1,353	....	21,818	4,921	27,439	−700
53,950	596	1,312	134	807	....	1,919	22,085	5,187	28,173	−901
57,093	431	1,156	148	1,233	....	1,986	24,150	5,423	30,033	−460
61,068	460	2,020	294	999	....	2,131	27,788	5,743	32,496	1,035
66,516	345	1,855	325	840	....	2,143	25,647	6,216	32,044	[11] 98
72,497	317	2,542	251	[12] 1,419	....	2,669	27,060	6,781	35,268	−1,360
79,743	185	3,113	418	[12] 1,275	....	2,935	25,843	7,370	37,011	−3,798
86,547	483	7,285	353	1,090	....	2,968	26,052	8,036	35,197	[13] −1,103
93,717	460	10,393	352	1,357	....	3,063	25,158	8,628	35,461	−1,535
103,811	392	7,114	379	1,187	....	3,292	26,870	9,421	37,615	−1,265
91,164	502	11,397	383	642	....	3,475	23,411	8,797	35,145	−2,788
91,697	506	12,179	362	856	....	3,630	22,916	8,212	33,933	−2,659
93,383	451	7,150	349	637	....	3,457	27,814	8,477	34,008	2,416
93,960	439	13,628	305	591	....	3,528	25,773	8,892	35,529	−711
95,606	433	5,838	436	831	....	3,539	29,009	8,585	34,009	3,737
96,652	440	15,183	379	748	....	3,616	24,562	8,676	35,125	−1,762
97,048	426	8,789	469	578	....	3,606	26,912	8,932	35,495	449
97,943	440	6,115	535	679	....	3,623	28,262	8,773	34,974	2,163
97,823	434	15,740	382	853	....	3,659	23,953	8,990	35,817	−2,648
98,900	413	6,398	425	715	....	3,704	22,841	8,983	35,716	−3,823
101,856	397	2,562	416	719	....	3,675	26,345	9,094	35,500	4
103,811	392	7,114	379	1,187	....	3,292	26,870	9,421	37,615	−1,265

[10] *Includes*, beginning 1969, securities loaned—fully guaranteed by U.S. Govt. securities pledged with F.R. Banks—and *excludes* (if any) securities sold and scheduled to be bought back under matched sale–purchase transactions.

[11] Beginning with week ending Nov. 15, 1972, includes $450 million of reserve deficiencies on which F.R. Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective Nov. 9, 1972. Allowable deficiencies (beginning with first statement week of quarter) included are (in millions): 1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; and 1974—Q1, $67, and Q2, $58. The transition period ended after the second quarter of 1974.

[12] Beginning July 1973, this item includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with F.R. Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System's program of credit restraint.

As of Dec. 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at F.R. Banks that are associated with marginal reserves are no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States, and (2) Euro-dollar liabilities.

[13] Beginning with week ending Nov. 19, 1975, adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy that became effective Nov. 19, 1975.

NOTE.—For description of figures and discussion of their significance, see "Member Bank Reserves and Related Items," Section 10 of *Banking and Monetary Statistics, 1941–1970*, pp. 507–23.

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19. Changes in number of banking offices in the United States during 1977 [1]

Type of office	Nature of change	All banks	Commercial banks (incl. stock savings banks and nondeposit trust companies)						Mutual savings banks	
			Total	Member			Nonmember			
				Total	National [1]	State	Insured	Non-insured	Insured	Non-insured
BANKS	**Dec. 31, 1976**	**15,146**	**14,673**	**5,760**	**4,737**	**1,023**	**8,639**	**274**	**329**	**144**
	Changes during 1977:									
	New banks	200	200	56	39	17	98	46	...	...
	Ceased banking operations	−7	−7	−1	−1	...	...	−6	...	...
	Consolidations and absorptions:									
	Banks converted into branches	−165	−159	−86	−81	−5	−70	−3	−6	...
	Other	−2	−2	−1	−1	...	...	−1	...	...
	Interclass changes:									
	Nonmember to—									
	National	...	...	5	5	...	−5	...	...	...
	State member	...	...	5	...	5	−5	...	...	...
	State member to—									
	National	...	...	...	1	−1	...	...	...	...
	Nonmember	...	...	−26	...	−26	26	...	...	...
	National to—									
	Nonmember	...	...	−43	−43	...	43	...	...	...
	State member	...	...	...	−1	1	...	...	...	...
	Noninsured to insured	...	...	...	...	...	3	−3	...	...
	Net change	26	32	−91	−82	−9	90	33	−6	...
	Dec. 31, 1977	**15,172**	**14,705**	**5,669**	**4,655**	**1,014**	**8,729**	**[2] 307**	**323**	**144**
BRANCHES AND ADDITIONAL OFFICES	**Dec. 31, 1976 [3]**	**33,008**	**30,928**	**21,193**	**16,530**	**4,663**	**9,682**	**53**	**1,796**	**284**
	Changes during 1977:									
	De novo	2,171	1,918	1,286	1,159	127	628	4	199	54
	Banks converted	145	140	91	86	5	49	...	5	...
	Discontinued	−317	−293	−233	−165	−68	−59	−1	−22	−2
	Sale of branch	...	...	−19	−19	...	19	...	...	...

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Federal Reserve Bank of St. Louis

	Interclass changes:									
	Nonmember to—									
	National	...	...	34	34	...	−34	...	...	...
	State member	...	...	1	...	1	−1	...	...	...
	State member to—									
	National	...	...	...	15	−15	...	...	...	...
	Nonmember	...	...	−139	...	−139	139	...	...	...
	National to—									
	State member	...	...	...	−13	13	...	...	...	...
	Nonmember	...	...	−187	−187	...	187	...	...	...
	Insured mutual	...	−1	−1	−1	...	...	...	1	...
	Noninsured to insured	...	...	...	...	...	2	−2	...	...
	Facilities reclassified as branches	4	4	3	3	...	1	...	...	...
	Other	7	8	8	7	1	...	...	...	−1
	Net change	2,010	1,776	844	919	−75	931	1	183	51
	Dec. 31, 1977 [3]	35,018	32,704	22,037	17,449	4,588	10,613	54	1,979	335
BANKING FACILITIES	Dec. 31, 1976 [4]	181	181	152	141	11	29	...	...	...
	Changes during 1977:									
	Established	2	2	2	2	...	...	...	...	...
	Discontinued	−4	−4	−3	−3	...	−1	...	...	...
	Interclass changes:									
	Facilities reclassified as branches	−3	−3	−1	−1	...	−2	...	...	...
	Net change	−5	−5	−2	−2	...	−3	...	...	...
	Dec. 31, 1977 [4]	176	176	150	139	11	26	...	...	...

[1] Includes 1 national bank in Puerto Rico. Other banks or branches located in the possessions are excluded.

[2] As of Dec. 31, 1977, 12 State member noninsured trust companies are included.

[3] Excludes banking facilities.

[4] Provided at military and other Government establishments through arrangements made by the Treasury.

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Federal Reserve Bank of St. Louis

20. Number of par and nonpar banking offices, December 31, 1977

F.R. district, State, or other area	Total		Par						Nonpar (nonmember)	
			Total		Member		Nonmember			
	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices
DISTRICT										
Boston	363	2,111	363	2,111	180	1,121	183	990	...	...
New York	461	4,758	461	4,758	263	4,120	198	638	...	...
Philadelphia	374	2,276	374	2,276	236	1,442	138	834	...	...
Cleveland	761	2,773	761	2,773	460	2,201	301	572	...	...
Richmond	776	4,523	775	4,523	402	2,667	373	1,856	1	...
Atlanta	1,931	3,267	1,908	3,242	622	1,759	1,286	1,483	23	25
Chicago	2,746	3,597	2,746	3,597	923	2,251	1,823	1,346	...	...
St. Louis	1,444	1,708	1,444	1,708	419	807	1,025	901	...	...
Minneapolis	1,412	493	1,412	493	512	271	900	222	...	...
Kansas City	2,238	897	2,238	897	811	534	1,427	363	...	...
Dallas	1,537	413	1,521	403	695	153	826	250	16	10
San Francisco	511	6,334	511	6,334	146	4,911	365	1,423	...	...
Total	**14,554**	**33,150**	**14,514**	**33,115**	**5,669**	**22,237**	**8,845**	**10,878**	**40**	**35**
STATE										
Alabama	310	508	310	508	118	344	192	164	...	...
Alaska	12	106	12	106	6	83	6	23	...	...
Arizona	17	465	17	465	3	309	14	156	...	...
Arkansas	260	353	260	353	78	188	182	165	...	...
California	220	3,769	220	3,769	65	3,078	155	[1] 691	...	...
Colorado	288	64	288	64	151	42	137	22	...	...
Connecticut	72	577	72	577	23	286	49	291	...	...
Delaware	17	143	17	143	5	4	12	139	...	...
District of Columbia	16	133	16	133	15	131	1	2	...	...
Florida	674	515	674	515	292	280	382	235	...	...
Georgia	441	752	441	752	73	413	368	339	...	...
Hawaii	8	155	8	155	2	11	6	144	...	...
Idaho	24	215	24	215	10	176	14	39	...	...
Illinois	1,263	307	1,263	307	491	173	772	134	...	...
Indiana	408	995	408	995	162	543	246	452	...	...
Iowa	655	509	655	509	145	207	510	302	...	...
Kansas	616	208	616	208	178	106	438	102	...	...
Kentucky	344	606	344	606	92	337	252	269	...	...
Louisiana	254	670	215	635	60	314	155	321	39	35
Maine	43	298	43	298	20	155	23	143	...	...
Maryland	108	812	108	812	42	438	66	374	...	...
Massachusetts	147	927	147	927	79	519	68	408	...	...
Michigan	362	1,704	362	1,704	209	1,323	153	381	...	...
Minnesota	753	76	753	76	235	40	518	36	...	...
Mississippi	184	604	184	604	42	251	142	353	...	...
Missouri	713	372	713	372	174	119	539	253	...	...
Montana	157	21	157	21	101	13	56	8	...	...
Nebraska	451	177	451	177	125	127	326	50	...	...
Nevada	8	119	8	119	5	100	3	19	...	...
New Hampshire	77	125	77	125	44	95	33	30	...	...
New Jersey	188	1,498	188	1,498	119	125	69	243	...	...
New Mexico	83	216	83	216	47	131	36	85	...	...
New York	289	3,311	289	3,311	182	3,147	107	[1] 164	...	...
North Carolina	89	1,654	89	1,654	30	800	59	854	...	...
North Dakota	172	110	172	110	47	42	125	68	...	...
Ohio	487	1,827	487	1,827	331	1,525	156	302	...	...
Oklahoma	481	175	481	175	208	131	273	44	...	...
Oregon	55	495	55	495	8	325	47	170	...	...
Pennsylvania	384	2,360	384	2,360	247	1,569	137	791	...	...
Rhode Island	16	225	16	225	5	115	11	110	...	...

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20.—Continued

F.R. district, State, or other area	Total		Par						Nonpar (nonmember)	
			Total		Member		Nonmember			
	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices
STATE—Cont.										
South Carolina	88	629	87	629	26	319	61	310	1	....
South Dakota	157	137	157	137	60	97	97	40	......	....
Tennessee	347	909	347	909	85	452	262	457	......	....
Texas	1,382	176	1,382	176	643	45	739	131	......	....
Utah	71	229	71	229	22	187	49	42	......	....
Vermont	30	145	30	145	15	48	15	97	......	....
Virginia	279	1,255	279	1,255	171	954	108	301	......	....
Washington	95	766	95	766	25	636	70	130	......	....
West Virginia	226	51	226	51	135	31	91	20	......	....
Wisconsin	623	427	623	427	156	170	467	257	......	....
Wyoming	82	3	82	3	61	1	21	2	......	....
OTHER AREA										
American Samoa [2]	......	1	......	1	......	....	......	1	......	....
Guam [2]	1	13	1	13	......	5	1	8	......	....
Puerto Rico [3]	21	229	21	229	1	23	20	206	......	....
Virgin Islands [3]	6	24	6	24	......	24	6	....	......	....

[1] Includes 1 Los Angeles branch and 19 New York City branches of 3 insured nonmember Puerto Rican banks.

[2] American Samoa and Guam assigned to the San Francisco District for check-clearing and collection purposes. All member branches in Guam are branches of California and New York banks.

[3] Puerto Rico and the Virgin Islands assigned to the New York District for check-clearing and collection purposes. All member branches in Puerto Rico are branches of banks located in California, New York, and Pennsylvania. Certain branches of Canadian banks (2 in Puerto Rico and 5 in the Virgin Islands) are included above as nonmember banks; and nonmember branches in Puerto Rico include 8 other branches of Canadian banks.

NOTE.—Comprises all commercial banking offices on which checks are drawn, including 176 banking facilities. Number of banks and branches differs from that in Table 19 because this table includes banks in Guam, Puerto Rico, and the Virgin Islands but excludes banks and trust companies on which no checks are drawn.

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Federal Reserve Bank of St. Louis

21. Description of each merger, consolidation, acquisition of assets or assumption of liabilities approved by the Board of Governors during 1977[1]

CONTENTS

Applicant Bank	Other Bank(s)	Page
Central Trust Company, Reynoldsburg, Ohio	**Newark Trust Company,** Newark, Ohio	471
Chemical Bank, New York, N.Y.	**Chemical Bank Hudson Valley, N.A.,** Nyack, N.Y.	467
Commercial Bank, Delphos, Ohio	**Farmers Bank of Elida,** Elida, Ohio	467
Davenport Bank and Trust Company, Davenport, Iowa	**Donahue Savings Bank,** Donahue, Iowa	469
40 Main Street Bank, Hempstead, N.Y.	**Hempstead Bank,** Hempstead, N.Y.	469
Freeport State Bank, Freeport, Ill.	**State Bank of Freeport,** Freeport, Ill.	470
Hillsboro Bank and Savings Company, Hillsboro, Ohio	**Farmers Exchange Bank,** Lynchburg, Ohio	473
Nova Bank and Trust Company, Warrenton, Va.	**Bank of Warrenton,** Warrenton, Va.	473
Piedmont Bank, Collinsville, Va.	**Piedmont Trust Bank,** Collinsville, Va.	468
Sun Bank of Ocala, Ocala, Fla.	**Sun Bank of South Ocala,** Ocala, Fla.	472

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Federal Reserve Bank of St. Louis

21.—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 1—**The Commercial Bank,** Delphos, Ohio,	34	3	4
to merge with			
Farmers Bank of Elida, Elida, Ohio	4	1	

SUMMARY REPORT BY THE ATTORNEY GENERAL (1–6–77)

We have reviewed this proposed merger and conclude that it would not have a substantial competitive impact.

BASIS FOR APPROVAL BY FEDERAL RESERVE BANK ON BEHALF OF BOARD OF GOVERNORS UNDER DELEGATED AUTHORITY (1–13–77)

The Commercial Bank (hereinafter Applicant) proposes to merge with Farmers Bank of Elida (hereinafter Farmers Bank). While the banks' offices are only about 5 miles apart, each bank has served primarily its own small community, and no significant competition will be eliminated by the proposal. Several banking alternatives will remain in the market area, and the resulting bank would hold about 9 per cent of market area deposits. The over-all competitive effect of the proposed merger would be slightly adverse.

Financial factors as they regard Applicant are satisfactory, while consumation of the merger would solve management and financial problems existing at Farmers Bank.

The convenience and needs factor lends weight to approval of the proposal. Applicant has indicated that it will lower checking account service charges, offer indirect instalment loans, and establish Saturday banking hours at the office now occupied by Farmers Bank.

Name of bank, and type of transaction	Assets (in millions of dollars)	In operation	To be operated
No. 2—**Chemical Bank,** New York, N.Y.,	27,316	260	270
to merge with			
Chemical Bank Hudson Valley, N.A., Nyack, N.Y.	82	10	

SUMMARY REPORT BY THE ATTORNEY GENERAL (11–29–76)

The merging banks are both wholly owned subsidiaries of the same bank holding company. As such, their proposed merger is essentially a corporate reorganization and would have no effect on competition.

For notes see p. 474.

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Federal Reserve Bank of St. Louis

21. Description of each merger, consolidation, acquisition of assets or assumption of liabilities approved by the Board of Governors during 1977—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY THE BOARD OF GOVERNORS (2-11-77)

Chemical Bank and Chemical Bank Hudson Valley, N.A. (Hudson Bank), are both subsidiaries of Chemical New York Corporation, New York, New York.

Since the two banks involved in this proposal are both subsidiaries of the same bank holding company, consummation of the proposal would neither eliminate any existing or potential competition nor increase the concentration of banking resources in any relevant area. Nor does it appear that approval of the application would have any adverse effects on any other banks within the relevant banking market. Accordingly, the Board concludes that competitive considerations are consistent with approval of the application.

This application does not involve the acquisition of an additional bank by Chemical New York Corporation but a consolidation of existing subsidiaries. Therefore, the Board regards the financial and managerial resources of the institutions involved as being consistent with approval of this application. It is anticipated that the proposed merger would result in some operational economies, a more efficient use of managerial resources, and some enhancement in the services offered by the resulting bank at the offices currently operated by Hudson Bank. Accordingly, considerations relating to the convenience and needs of the communities to be served lend some weight toward approval of the application. It is the Board's judgment that consummation of the proposal would be in the public interest and that the application should be approved.

No. 3—**Piedmont Bank,** Collinsville, Va.,	(Newly organized bank; not in operation)		
to merge with			
Piedmont Trust Bank, Collinsville, Va.	101	6	6

SUMMARY REPORT BY THE ATTORNEY GENERAL
(No report received.)

BASIS FOR APPROVAL BY FEDERAL RESERVE BANK ON BEHALF OF BOARD OF GOVERNORS UNDER DELEGATED AUTHORITY (6-30-77)

The proposal is a transaction to facilitate the acquisition of Piedmont Trust Bank by Piedmont Bankgroup Incorporated, Martinsville, Virginia, a proposed bank holding company.

The proposed merger of an existing bank with a nonoperating institution (Piedmont Bank) would, in itself, have no adverse competitive effects. The financial and convenience and needs factors are consistent with approval of the application.

For notes see p. 474.

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Federal Reserve Bank of St. Louis

21.—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 4—**40 Main Street Bank,** Hempstead, N.Y.,	(Newly organized bank; not in operation)		
to merge with **Hempstead Bank,** Hempstead, N.Y.	211	28	28

Summary Report by the Attorney General (7-13-77)

The proposed merger is part of a plan through which Hempstead Bank would become a subsidiary of United Bank Corporation of New York, a bank holding company. The instant merger, however, would merely combine an existing bank with a nonoperating institution [40 Main Street Bank]; as such, and without regard to the acquisition of the surviving bank by United Bank Corporation of New York, it would have no effect on competition.

Basis for Approval by Federal Reserve Bank on Behalf of Board of Governors Under Delegated Authority (8-18-77)

The proposal is a transaction to facilitate the acquisition of Hempstead Bank by United Bank Corporation of New York, Albany, N.Y., a bank holding company.

The proposed merger would, in itself, have no adverse competitive effects. The financial and convenience and needs factors are consistent with approval of the application.

Name of bank, and type of transaction	Assets	In operation	To be operated
No. 5—**Davenport Bank and Trust Company,** Davenport, Iowa,	361	4	5
to acquire certain assets and assume certain liabilities of **Donahue Savings Bank,** Donahue, Iowa	5	1	

Summary Report by the Attorney General

(No report received. Requests for reports on the competitive factors were dispensed with, as authorized by the Bank Merger Act, to permit the Board of Governors to act immediately in order to safeguard depositors of Donahue Savings Bank.)

Basis for Approval by the Board of Governors (8-29-77)

On the basis of information before the Board, it is apparent that an emergency situation exists so as to require the Board to act immediately pursuant to the provisions of the Bank Merger Act in order to safeguard depositors of Donahue Savings Bank.

For notes see p. 474.

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Federal Reserve Bank of St. Louis

21. Description of each merger, consolidation, acquisition of assets or assumption of liabilities approved by the Board of Governors during 1977—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY THE BOARD OF GOVERNORS—Continued

Such anticompetitive effects as may be attributable to the acquisition of Donahue Savings Bank by Davenport Bank and Trust Company are clearly outweighed in the public interest by considerations relating to and involved in the emergency situation found to exist. From the record in the case, it is the Board's judgment that any disposition of the application other than approval would be inconsistent with the best interests of the depositors of Donahue Savings Bank, and the Board concludes that the proposed transaction should be approved on a basis that would not delay consummation of the proposal.

No. 6—**Freeport State Bank,** Freeport, Ill.,	(Newly organized bank; not in operation)		
to merge with **State Bank of Freeport,** Freeport, Ill.	102	1	1

SUMMARY REPORT BY THE ATTORNEY GENERAL (7–29–77)

The proposed merger is part of a plan through which State Bank of Freeport would become a subsidiary of Northwest Illinois Bancorp, Inc., a proposed bank holding company. The instant merger, however, would merely combine an existing bank with a nonoperating institution [Freeport State Bank]; as such, and without regard to the acquisition of the surviving bank by Northwest Illinois Bancorp, Inc., it would have no effect on competition.

BASIS FOR APPROVAL BY FEDERAL RESERVE BANK ON BEHALF OF BOARD OF GOVERNORS UNDER DELEGATED AUTHORITY (8–31–77)

The proposal is a transaction to facilitate the acquisition of State Bank of Freeport by Northwest Illinois Bancorp, Inc., a proposed bank holding company.

The proposed merger would, in itself, have no adverse competitive effects. The financial and convenience and needs factors are consistent with approval of the application.

For notes see p. 474.

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Federal Reserve Bank of St. Louis

21.—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 7—**The Central Trust Company,** Reynoldsburg, Ohio,	18	3	9
to merge with **The Newark Trust Company,** Newark, Ohio	71	6	

SUMMARY REPORT BY THE ATTORNEY GENERAL (7–13–77)

The merging banks are both wholly owned subsidiaries of the same bank holding company. As such, their proposed merger is essentially a corporate reorganization and would have no effect on competition.

BASIS FOR APPROVAL BY FEDERAL RESERVE BANK ON BEHALF OF BOARD OF GOVERNORS UNDER DELEGATED AUTHORITY (9–26–77)

The Central Trust Company (hereinafter Applicant) and The Newark Trust Company (hereinafter Bank) are subsidiaries of The Central Bancorporation, Inc., Cincinnati (hereinafter Bancorporation).

Applicant is headquartered in Reynoldsburg and operates 2 branches in Franklin County. Since the municipal boundaries of the village of Reynoldsburg extend into Franklin, Fairfield, and Licking Counties, any bank headquartered in Reynoldsburg is legally empowered to merge with a bank in any of these 3 counties. Bank is headquartered in Newark and operates all 6 of its offices in Licking County.

Applicant and Bank are Bancorporation's only subsidiaries operating in the Columbus banking market. Applicant and Bank together control approximately 2.2 per cent of market deposits and rank 5th among the 27 banking organizations in the market. Despite the large number of competitors, the market is highly concentrated, with the 3 largest organizations controlling 81.8 per cent of total market deposits. Since the proposal represents the reorganization of 2 banks owned by the same holding company, consummation of the proposed merger would not alter the concentration of deposits or reduce the number of competing organizations in the market. Thus, the proposed transaction would not have any adverse effects on existing or future competition.

The financial and managerial resources, and future prospects of Bancorporation and its subsidiary banks, including Applicant and Bank, are generally satisfactory. Considerations relating to banking factors are thus consistent with approval of the application.

There is no evidence to indicate that the banking needs of the Columbus banking market are not being adequately met. However, if the proposed

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Federal Reserve Bank of St. Louis

21. Description of each merger, consolidation, acquisition of assets or assumption of liabilities approved by the Board of Governors during 1977—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY FEDERAL RESERVE BANK ON BEHALF OF BOARD OF GOVERNORS UNDER DELEGATED AUTHORITY—Continued

merger is approved, all offices of the resultant bank would offer a full range of time deposits, thus providing a new source of 4- and 6-year certificates of deposit to residents of Applicant's service area. Therefore, considerations related to convenience and needs of the communities to be served are consistent with approval of the application. It has been determined that consummation of the proposal would be in the public interest.

Name of bank, and type of transaction	Assets	In operation	To be operated
No. 8—**Sun Bank of Ocala,** Ocala, Fla.,	73	2	3
to merge with			
Sun Bank of South Ocala, Ocala, Fla.	70	1	

SUMMARY REPORT BY THE ATTORNEY GENERAL
(No report received.)

BASIS FOR APPROVAL BY THE BOARD OF GOVERNORS (9–29–77)

Both banks involved in this proposal are subsidiaries of Sun Banks of Florida, Inc., Orlando, Florida.

Since the banks are both wholly owned subsidiaries of the same bank holding company and have been since 1972, the proposed transaction is essentially a corporate reorganization and would have no effect on competition; nor does it appear that approval will have any adverse effects on any other banks in the market. Therefore, the Board concludes that competitive considerations are consistent with approval of the application.

This is essentially a corporate reorganization, and the Board finds the financial condition and managerial resources of the institutions involved as being satisfactory and consistent with approval of the application.

No new services are proposed in connection with the merger. Concurrently, Sun Bank of Ocala has received approval to expand a "cash facility" into a full branch and to establish yet another branch. Accordingly, convenience and needs considerations are consistent with approval. It is the Board's judgment that consummation of the proposal would be in the public interest and that the application should be approved.

For notes see p. 474.

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Federal Reserve Bank of St. Louis

21.—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 9—**Nova Bank and Trust Company,** Warrenton, Va., *to merge with*	(Newly organized bank; not in operation)		
Bank of Warrenton, Warrenton, Va.	3	2	2

Summary Report by the Attorney General (8–31–77)

The proposed merger is part of a plan through which Bank of Warrenton would become a subsidiary of New Virginia Bancorporation, a bank holding company. The instant merger, however, would merely combine an existing bank with a nonoperating institution [Nova Bank and Trust Company]; as such, and without regard to the acquisition of the surviving bank by New Virginia Bancorporation, it would have no effect on competition.

Basis for Approval by Federal Reserve Bank on Behalf of Board of Governors Under Delegated Authority (10–26–77)

The proposal is a transaction to facilitate the acquisition of Bank of Warrenton, by New Virginia Bancorporation, Springfield, Virginia, a bank holding company.

The proposed merger would, in itself, have no adverse competitive effects. The financial and convenience and needs factors are consistent with approval of the application.

Name of bank, and type of transaction	Assets (in millions of dollars)	In operation	To be operated
No. 10—**The Hillsboro Bank and Savings Company,** Hillsboro, Ohio, *to acquire the assets and assume the liabilities of*	37	5	6
The Farmers Exchange Bank, Lynchburg, Ohio	13	1	

Summary Report by the Attorney General (10–28–77)

We have reviewed this proposed transaction and conclude that it would not have a substantial competitive impact.

For notes see p. 474.

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21. Description of each merger, consolidation, acquisition of assets or assumption of liabilities approved by the Board of Governors during 1977—Continued

Name of bank, and type of transaction [2] (in chronological order of determination)	Assets (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY THE BOARD OF GOVERNORS (12–21–77)

The Hillsboro Bank and Savings Company (hereinafter Hillsboro Bank) is the largest of 4 banks in the Hillsboro banking market, with 3 of its 4 branches operating in that market. The Farmers Exchange Bank (hereinafter Lynchburg Bank) is the 4th largest bank in the Hillsboro market. Hillsboro Bank holds approximately 31 per cent of total deposits in commercial banks in the market and upon consummation of the proposal would hold approximately 44 per cent. While the market would have fewer independent competitors, it does not appear that a significant amount of competition would be eliminated. Analysis of the market area served by Hillsboro Bank, based on commercial and commuting patterns and a survey of accounts held at Hillsboro Bank and Lynchburg Bank, indicates that Hillsboro Bank's services are oriented toward the eastern and southern portions of Highland County, whereas Lynchburg Bank primarily serves northwestern Highland County. Lynchburg Bank derives only 6.9 per cent of its total deposits and 6.7 per cent of its total loans from the service area of Hillsboro Bank. Furthermore, Hillsboro Bank derives only 1.3 per cent of its total deposits and 2.6 per cent of its total loans from the service area of Lynchburg Bank. Two of Hillsboro Bank's offices, located in the northeastern part of Highland County, derive no business at all from Lynchburg Bank's service area.

The Board finds the financial and managerial resources and future prospects of Hillsboro Bank to be satisfactory and those of Lynchburg Bank to be generally satisfactory. The financial and managerial resources and future prospects of the resulting institution would also be satisfactory, and considerations relating to financial and managerial resources are regarded as consistent with approval of the application.

Consummation of the proposed transaction should lead to the introduction of new and improved services for customers in the Lynchburg area. Lynchburg Bank, as a branch of Hillsboro Bank, would be enabled to increase its lending limit to individual customers. Hillsboro Bank has indicated that it plans to expand commercial and consumer loan activity at the Lynchburg branch. In addition, the Lynchburg office would institute the payment of maximum rates of interest allowable by law on time deposits, the payment of compound interest, and the payment of interest monthly on request. Accordingly, and in light of the convenience and needs factors discussed above, the Board regards considerations relating to the convenience and needs of the community to be served as lending some weight toward approval of the application and, in the Board's view, are sufficient to outweigh any slightly adverse competitive effects that might result from consummation of the proposal. It is the Board's judgment that the application should be approved.

[1] During 1977 the Board disapproved 1 merger application. However, under Section 18(c) of the Federal Deposit Insurance Act only those transactions approved by the Board must be described in its ANNUAL REPORT to the Congress.

[2] Each transaction was proposed to be effected under the charter of the first-named bank.

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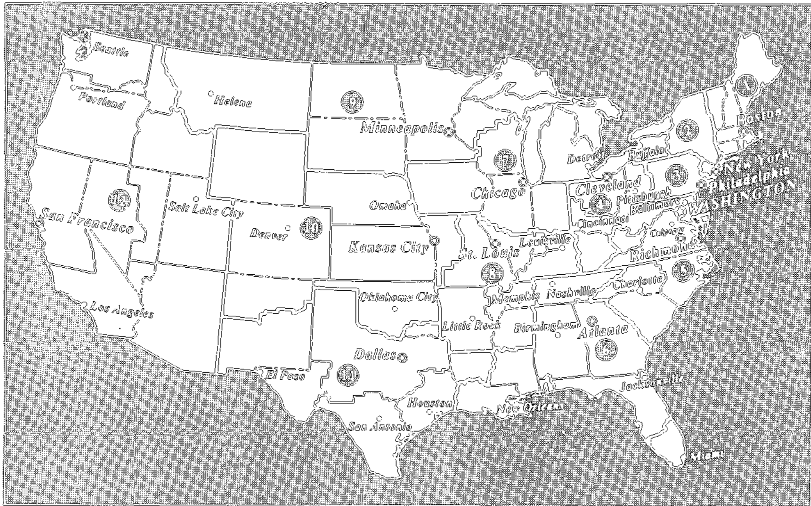
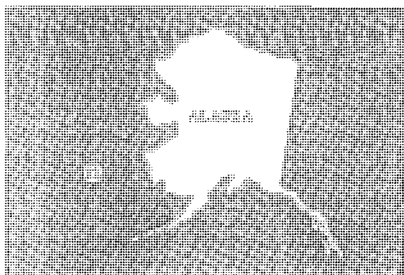
The Federal Reserve System

BOUNDARIES OF FEDERAL RESERVE DISTRICTS AND THEIR BRANCH TERRITORIES





Legend

—— Boundaries of Federal Reserve Districts

—— Boundaries of Federal Reserve Branch Territories

◎ Board of Governors of the Federal Reserve System

◉ Federal Reserve Bank Cities

Federal Reserve Branch Cities

Federal Reserve Bank Facilities

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Federal Reserve Directories and Meetings

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Board of Governors of the Federal Reserve System

December 31, 1977 — *Term expires*

ARTHUR F. BURNS, of New York, *Chairman** ....January 31, 1984
STEPHEN S. GARDNER, of Pennsylvania, *Vice Chairman** ....January 31, 1990
DAVID M. LILLY, of Minnesota ....January 31, 1978
PHILIP E. COLDWELL, of Texas ....January 31, 1980
PHILIP C. JACKSON, JR., of Alabama ....January 31, 1982
J. CHARLES PARTEE, of Virginia ....January 31, 1986
HENRY C. WALLICH, of Connecticut ....January 31, 1988

STEPHEN H. AXILROD, *Staff Director for Monetary Policy*
JOHN M. DENKLER, *Staff Director for Management*
WILLIAM H. WALLACE, *Staff Director for Federal Reserve Bank Activities*
THOMAS J. O'CONNELL, *Counsel to the Chairman*
MILTON W. HUDSON, *Asst. to the Chairman*
JOSEPH R. COYNE, *Asst. to the Board*
KENNETH A. GUENTHER, *Asst. to the Board*
JAY PAUL BRENNEMAN, *Special Asst. to the Board*
FRANK O'BRIEN, JR., *Special Asst. to the Board*
JOSEPH S. SIMS, *Special Asst. to the Board*
DONALD J. WINN, *Special Asst. to the Board*

OFFICE OF STAFF DIRECTOR FOR MONETARY POLICY

STEPHEN H. AXILROD, *Staff Director*
ARTHUR L. BROIDA, *Deputy Staff Director*
MURRAY ALTMANN, *Asst. to the Board*
PETER M. KEIR, *Asst. to the Board*
STANLEY J. SIGEL, *Asst. to the Board*
NORMAND R. V. BERNARD, *Special Asst. to the Board*

OFFICE OF STAFF DIRECTOR FOR MANAGEMENT

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ROBERT J. LAWRENCE, *Deputy Staff Director*
DONALD E. ANDERSON, *Asst. Director for Construction Management*
GORDON B. GRIMWOOD, *Asst. Director and Program Director for Contingency Planning*

OFFICE OF STAFF DIRECTOR FOR FEDERAL RESERVE BANK ACTIVITIES

William H. Wallace, *Staff Director*

OFFICE OF THE SECRETARY

THEODORE E. ALLISON, *Secretary*
GRIFFITH L. GARWOOD, *Deputy Secretary*
ROBERT E. MATTHEWS, *Asst. Secretary* †

LEGAL DIVISION

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BALDWIN B. TUTTLE, *Deputy General Counsel*
ROBERT E. MANNION, *Asst. General Counsel*
ALLEN L. RAIKEN, *Asst. General Counsel*
CHARLES R. MCNEILL, *Asst. to the General Counsel*

DIVISION OF RESEARCH AND STATISTICS

JAMES L. KICHLINE, *Director*
JOSEPH S. ZEISEL, *Deputy Director*
EDWARD C. ETTIN, *Assoc. Director*

* The designations as the Chairman and the Vice Chairman expire Jan. 31, 1978, and Feb. 12, 1980, respectively, unless the services of these members of the Board shall have terminated sooner.
† On loan from the Federal Reserve Bank of Philadelphia.

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DIVISION OF RESEARCH AND STATISTICS—Continued

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JOHN J. MINGO, *Senior Research Division Officer*
ELEANOR J. STOCKWELL, *Senior Research Division Officer*
JAMES R. WETZEL, *Senior Research Division Officer*
ROBERT A. EISENBEIS, *Assoc. Research Division Officer*
JARED J. ENZLER, *Assoc. Research Division Officer*
JOHN D. PAULUS, *Assoc. Research Division Officer*
J. CORTLAND G. PERET, *Assoc. Research Division Officer*
RICHARD H. PUCKETT, *Assoc. Research Division Officer*
HELMUT F. WENDEL, *Assoc. Research Division Officer* ‡
JAMES M. BRUNDY, *Asst. Research Division Officer*
ROBERT M. FISHER, *Asst. Research Division Officer*
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LEVON H. GARABEDIAN, *Asst. Director*

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SAMUEL PIZER, *Senior International Division Officer*

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WALTER ALTHAUSEN, *Asst. Director*
BRIAN M. CAREY, *Asst. Director*
HARRY A. GUINTER, *Asst. Director*

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CLYDE H. FARNSWORTH, JR., *Asst. Director*
JOHN F. HOOVER, *Asst. Director*
P. D. RING, *Asst. Director*

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FREDERICK C. SCHADRACK, *Deputy Director* §
FREDERICK R. DAHL, *Assoc. Director*
WILLIAM W. WILES, *Assoc. Director*
JACK M. EGERTSON, *Asst. Director*
DON E. KLINE, *Asst. Director*
THOMAS E. MEAD, *Asst. Director*
ROBERT S. PLOTKIN, *Asst. Director*
THOMAS A. SIDMAN, *Asst. Director*
SAMUEL H. TALLEY, *Asst. Director*
WILLIAM TAYLOR, *Asst. Director*

DIVISION OF CONSUMER AFFAIRS

JANET O. HART, *Director*
NATHANIEL E. BUTLER, *Assoc. Director*
JERAULD C. KLUCKMAN, *Assoc. Director*

DIVISION OF PERSONNEL

DAVID L. SHANNON, *Director*
JOHN R. WEIS, *Asst. Director*
CHARLES W. WOOD, *Asst. Director*

DIVISION OF ADMINISTRATIVE SERVICES

WALTER W. KREIMANN, *Director*
JOHN L. GRIZZARD, *Asst. Director*
JOHN D. SMITH, *Asst. Director*

OFFICE OF THE CONTROLLER

JOHN KAKALEC, *Controller*
EDWARD T. MULRENIN, *Asst. Controller*

DIVISION OF DATA PROCESSING

CHARLES L. HAMPTON, *Director*
BRUCE M. BEARDSLEY, *Assoc. Director*
UYLESS D. BLACK, *Asst. Director*
GLENN L. CUMMINS, *Asst. Director*
ROBERT J. ZEMEL, *Asst. Director*

‡ On leave of absence.
§ On loan from the Federal Reserve Bank of New York.

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Federal Reserve Bank of St. Louis

Federal Open Market Committee

December 31, 1977

MEMBERS

ARTHUR F. BURNS, *Chairman* (Board of Governors)

PAUL A. VOLCKER, *Vice Chairman* (Elected by Federal Reserve Bank of New York)

PHILIP E. COLDWELL (Board of Governors)

STEPHEN S. GARDNER (Board of Governors)

ROGER GUFFEY (Elected by Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco)

PHILIP C. JACKSON, JR. (Board of Governors)

DAVID M. LILLY (Board of Governors)

ROBERT P. MAYO (Elected by Federal Reserve Banks of Cleveland and Chicago)

FRANK E. MORRIS (Elected by Federal Reserve Banks of Boston, Philadelphia, and Richmond)

J. CHARLES PARTEE (Board of Governors)

LAWRENCE K. ROOS (Elected by Federal Reserve Banks of Atlanta, St. Louis, and Dallas)

HENRY C. WALLICH (Board of Governors)

OFFICERS

ARTHUR L. BROIDA, *Secretary*

MURRAY ALTMANN, *Deputy Secretary*

NORMAND R. V. BERNARD, *Assistant Secretary*

THOMAS J. O'CONNELL, *General Counsel*

EDWARD G. GUY, *Deputy General Counsel*

BALDWIN B. TUTTLE, *Assistant General Counsel*

STEPHEN H. AXILROD, *Economist*

ANATOL BALBACH, *Associate Economist*

RICHARD G. DAVIS, *Associate Economist*

THOMAS DAVIS, *Associate Economist*

ROBERT EISENMENGER, *Associate Economist*

EDWARD C. ETTIN, *Associate Economist*

JAMES L. KICHLINE, *Associate Economist*

JOHN E. REYNOLDS, *Associate Economist*

KARL SCHELD, *Associate Economist*

EDWIN M. TRUMAN, *Associate Economist*

JOSEPH S. ZEISEL, *Associate Economist*

ALAN R. HOLMES, *Manager, System Open Market Account*

PETER D. STERNLIGHT, *Deputy Manager for Domestic Operations*

SCOTT E. PARDEE, *Deputy Manager for Foreign Operations*

During 1977, meetings of the Federal Open Market Committee were generally held at monthly intervals. (See Record of Policy Actions taken by the Committee held in 1977 on pp. 152–325 of this REPORT.)

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Federal Advisory Council

December 31, 1977

MEMBERS

District No. 1—RICHARD D. HILL, Chairman of the Board, First National Bank of Boston, Boston, Mass.

District No. 2—WALTER B. WRISTON, Chairman of the Board, Citibank, N.A., New York, N.Y.

District No. 3—ROGER S. HILLAS, Chairman, The Provident National Bank, Philadelphia, Pa.

District No. 4—M. BROCK WEIR, President and Chief Executive Officer, Cleveland Trust Company, Cleveland, Ohio

District No. 5—JOHN H. LUMPKIN, Chairman and Chief Executive Officer, The South Carolina National Bank, Columbia, S.C.

District No. 6—FRANK A. PLUMMER, Chairman of the Board, First Alabama Bank of Montgomery, Montgomery, Ala.

District No. 7—EDWARD BYRON SMITH, Chairman of the Board, Northern Trust Co., Chicago, Ill.

District No. 8—DONALD E. LASATER, Chairman and Chief Executive Officer, Mercantile Trust Co., N.A., St. Louis, Mo.

District No. 9—RICHARD H. VAUGHAN, President, Northwest Bancorporation, Minneapolis, Minn.

District No. 10—J. W. McLEAN, Chairman of the Board, The Liberty National Bank and Trust Company of Oklahoma City, Oklahoma City, Okla.

District No. 11—BEN F. LOVE, Chairman of the Board and Chief Executive Officer, Texas Commerce Bank, N.A., Houston, Tex.

District No. 12—GILBERT F. BRADLEY, Chairman and Chief Executive Officer, Valley National Bank, Phoenix, Ariz.

OFFICERS

RICHARD D. HILL, *President*
GILBERT F. BRADLEY, *Vice President*
HERBERT V. PROCHNOW, *Secretary*
WILLIAM J. KORSVIK, *Associate Secretary*

EXECUTIVE COMMITTEE

RICHARD D. HILL, *ex officio*
GILBERT F. BRADLEY, *ex officio*
FRANK A. PLUMMER
EDWARD BYRON SMITH
M. BROCK WEIR

Meetings of the Federal Advisory Council were held on February 3–4, May 5–6, September 8–9, and November 3–4, 1977. The Board of Governors met with the Council on February 4, May 6, September 9, and November 4. The Council, which is composed of 12 representatives of the banking industry, one from each Federal Reserve district, is required by law to meet in Washington at least four times each year, and is authorized by the Federal Reserve Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

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Federal Reserve Banks and Branches

December 31, 1977

CHAIRMEN AND DEPUTY CHAIRMEN OF BOARDS OF DIRECTORS

Federal Reserve Bank of—	Chairman and Federal Reserve Agent	Deputy Chairman
Boston	Louis W. Cabot	Robert M. Solow
New York	Frank R. Milliken	Robert H. Knight
Philadelphia	John W. Eckman	Werner C. Brown
Cleveland	Horace A. Shepard	Robert E. Kirby
Richmond	E. Angus Powell	E. Craig Wall, Sr.
Atlanta	H. G. Pattillo	Clifford M. Kirtland, Jr.
Chicago	Peter B. Clark	Robert H. Strotz
St. Louis	Edward J. Schnuck	William B. Walton
Minneapolis	James P. McFarland	Stephen F. Keating
Kansas City	Harold W. Andersen	Joseph H. Williams
Dallas	Irving A. Mathews	Charles T. Beaird
San Francisco	Joseph F. Alibrandi	Cornell C. Maier

CONFERENCE OF CHAIRMEN

The Chairmen of the Federal Reserve Banks are organized into a Conference of Chairmen that meets from time to time to consider matters of common interest and to consult with and advise the Board of Governors. Such meetings, attended also by Deputy Chairmen of the Reserve Banks, were held in Washington on June 24 and December 1 and 2, 1977.

Mr. Louis W. Cabot, Chairman of the Federal Reserve Bank of Boston, who was elected Chairman of the Conference and of its Executive Committee in December 1976, served in that capacity until the close of the 1977 meetings. Dr. Peter B. Clark, Chairman of the Federal Reserve Bank of Chicago, and Mr. E. Angus Powell, Chairman of the Federal Reserve Bank of Richmond, served with Mr. Cabot as members of the Executive Committee; Dr. Clark also served as Vice Chairman of the Conference.

On December 2, 1977, Mr. Powell was elected Chairman of the Conference and of its Executive Committee to serve for the succeeding year; Mr. Joseph F. Alibrandi, Chairman of the Federal Reserve Bank of San Francisco, was elected Vice Chairman of the Conference and a member of the Executive Committee; and Mr. Harold W. Andersen, Chairman of the Federal Reserve Bank of Kansas City, was elected as the other member of the Executive Committee.

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DIRECTORS

Class A and Class B directors are elected by the member banks of the district. Class C directors are appointed by the Board of Governors of the Federal Reserve System. One term in each class of directors expires each year. Directors are chosen without discrimination as to race, creed, color, sex, or national origin.

The Class A directors are chosen as representatives of member banks and, as a matter of practice, are active officers of member banks. Class B and Class C directors represent the public and are selected with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers. Class B and C directors may not be officers, directors, or employees of any bank, nor may Class C directors be stockholders of any bank. Annually, the Board of Governors designates one Class C director of each Reserve Bank to serve as Chairman of the Bank and one to serve as Deputy Chairman.

Federal Reserve Bank branches have either five or seven directors, of whom a majority are appointed by the board of directors of the parent Federal Reserve Bank. The others are appointed by the Board of Governors of the Federal Reserve System. The Chairmen of branch Bank boards are selected from among directors appointed by the Board of Governors.

District 1—BOSTON

		Term expires Dec. 31
Class A:		
James F. English, Jr.	Chairman, The Connecticut Bank and Trust Co., Hartford, Conn.	1977
John D. Robinson	President, Firstbank, N.A., Farmington, Maine	1978
John Hunter, Jr.	President, Vermont National Bank, Brattleboro, Vermont	1979
Class B:		
Weston P. Figgins	Chairman of the Board, Wm. Filene's Sons Company, Boston, Mass.	1977
Alfred W. Van Sinderen	President, The Southern New England Telephone Company, New Haven, Conn.	1978
G. William Miller	Chairman, Textron Inc., Providence, R.I.	1979
Class C:		
Robert M. Solow	Institute Professor, Massachusetts Institute of Technology, Cambridge, Mass.	1977
Louis W. Cabot	Chairman of the Board, Cabot Corporation, Boston, Mass.	1978
Kenneth I. Guscott	President, Ken Guscott Associates, Boston, Mass.	1979

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District 2—NEW YORK

		Term expires Dec. 31
Class A:		
Raymond W. Bauer	President, United Counties Trust Company, Elizabeth, N.J.	1977
Harry J. Taw	President, First National Bank of Cortland, Cortland, N.Y.	1978
Ellmore C. Patterson	Chairman of the Board, Morgan Guaranty Trust Company of New York, New York, N.Y.	1979
Class B:		
William S. Sneath	Chairman of the Board, Union Carbide Corporation, New York, N.Y.	1977
John R. Mulhearn	President, New York Telephone Company, New York, N.Y.	1978
Maurice F. Granville	Chairman of the Board, Texaco Inc., White Plains, N.Y.	1979
Class C:		
Robert H. Knight	Partner, Shearman & Sterling, New York, N.Y.	1977
Frank R. Milliken	President, Kennecott Copper Corporation, New York, N.Y.	1978
Boris Yavitz	Dean, Graduate School of Business, Columbia University, New York, N.Y.	1979

BUFFALO BRANCH

Appointed by Federal Reserve Bank:		
Charles A. Marks	President, Alden State Bank, Alden, N.Y.	1977
Kent O. Parmington	President, The Bank of New York, Western Region, Buffalo, N.Y.	1978
M. Jane Dickman	Partner, Touche Ross & Co., Buffalo, N.Y.	1979
William B. Webber	Chairman and Chief Executive Officer, Lincoln First Bank of Rochester, Rochester, N.Y.	1979
Appointed by Board of Governors:		
Paul A. Miller	President, Rochester Institute of Technology, Rochester, N.Y.	1977
Donald R. Nesbitt	Owner, Silver Creek Farms, Albion, N.Y.	1978
Frederick D. Berkeley	Chairman of the Board and President, Graham Manufacturing Co., Inc., Batavia, N.Y.	1979

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District 3—PHILADELPHIA

		Term expires Dec. 31
Class A:		
William B. Eagleson, Jr.	Chairman of the Board and President, The Girard Bank, Bala Cynwyd, Pa.	1977
James Patchell	President and Chief Executive Officer, National Bank and Trust Company of Gloucester County, Woodbury, N.J.	1978
W. J. Smouse	President, The First National Bank in Bedford, Bedford, Pa.	1979
Class B:		
Jack K. Busby	Chairman and Chief Executive Officer, Pennsylvania Power & Light Company, Allentown, Pa.	1977
Harold A. Shaub	President and Chief Executive Officer, Campbell Soup Co., Camden, N.J.	1978
William S. Masland	President, C. H. Masland & Sons, Carlisle, Pa.	1979
Class C:		
Werner C. Brown	Chairman, Hercules Incorporated, Wilmington, Del.	1977
John W. Eckman	Chairman, Rorer Group, Inc., Fort Washington, Pa.	1978
Jean Crockett	Professor of Finance, University of Pennsylvania, Philadelphia, Pa.	1979

District 4—CLEVELAND

Class A:		
Merle E. Gilliand	Chairman of the Board and Chief Executive Officer, Pittsburgh National Bank, Pittsburgh, Pa.	1977
Richard P. Raish	President, The First National Bank, Bellevue, Ohio	1978
John W. Alford	President, The Park National Bank, Newark, Ohio	1979
Class B:		
Donald E. Noble	Chairman of the Board and Chief Executive Officer, Rubbermaid Incorporated, Wooster, Ohio	1977
John J. Dwyer	President, Oglebay Norton Co., Cleveland, Ohio	1978
Charles Y. Lazarus	Chairman, The F. & R. Lazarus Co., Columbus, Ohio	1979

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District 4—CLEVELAND—Cont.

Term expires Dec. 31

Class C:

Name	Position	Term expires Dec. 31
Horace A. Shepard	Chairman of the Board and Chief Executive Officer, TRW Inc., Cleveland, Ohio	1977
Otis A. Singletary	President, University of Kentucky, Lexington, Ky.	1978
Robert E. Kirby	Chairman and Chief Executive Officer, Westinghouse Electric Corporation, Pittsburgh, Pa.	1979

CINCINNATI BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Joe D. Blount	President, National Bank of Cynthiana, Cynthiana, Ky.	1977
Robert A. Kerr	Chairman of the Board and Chief Executive Officer, Winters National Bank and Trust Co., Dayton, Ohio	1978
Lawrence C. Hawkins	Senior Vice President, University of Cincinnati, Cincinnati, Ohio	1978
William N. Liggett	Chairman of the Board and Chief Executive Officer, The First National Bank of Cincinnati, Cincinnati, Ohio	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Lawrence H. Rogers II	President and Chief Executive Officer, Omega Communications, Inc., Cincinnati, Ohio	1977
Martin B. Friedman	President, Formica Corporation, Cincinnati, Ohio	1978
J. L. Jackson	President, Falcon Coal Company, Inc., Lexington, Ky.	1979

PITTSBURGH BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Richard D. Edwards	Vice Chairman, The Union National Bank of Pittsburgh, Pittsburgh, Pa.	1977
R. Burt Gookin	Vice Chairman and Chief Executive Officer, H. J. Heinz Company, Pittsburgh, Pa.	1978
William E. Midkiff III	Chairman of the Board, The First National Bank and Trust Company in Steubenville, Steubenville, Ohio	1978
Peter Mortensen	President, F.N.B. Corporation, Sharon, Pennsylvania	1979

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District 4—CLEVELAND—Cont.

Term expires Dec. 31

PITTSBURGH BRANCH—Continued

Appointed by Board of Governors:

Arnold R. Weber	Dean, Graduate School of Industrial Administration, Carnegie-Mellon University, Pittsburgh, Pa.	1977
William H. Knoell	President, Cyclops Corporation, Pittsburgh, Pa.	1978
G. Jackson Tankersley	President, Consolidated Natural Gas Company, Pittsburgh, Pa.	1979

District 5—RICHMOND

Class A:

James A. Hardison, Jr.	Chairman and President, The First National Bank of Anson County, Wadesboro, N.C.	1977
J. Owen Cole	Chairman of the Board and President, First National Bank of Maryland, Baltimore, Md.	1978
Frank B. Robards, Jr.	President, Rock Hill National Bank, Rock Hill, S.C.	1979

Class B:

H. Clay Hofheimer II	Chairman of the Board, Virginia Real Estate Investment Trust, Norfolk, Va.	1977
Paul E. Reichardt	Chairman of the Board and Chief Executive Officer, Washington Gas Light Company, Washington, D.C.	1978
Andrew L. Clark	President, Andy Clark Ford, Inc., Princeton, W. Va.	1979

Class C:

E. Craig Wall, Sr.	Chairman of the Board, Canal Industries, Inc., Conway, S.C.	1977
Maceo A. Sloan	Executive Vice President, North Carolina Mutual Life Insurance Company, Durham, N.C.	1978
E. Angus Powell	Partner, Midlothian Company, Midlothian, Va.	1979

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District 5—RICHMOND—Cont.

Term expires Dec. 31

BALTIMORE BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
J. Pierre Bernard	Chairman of the Board, The Annapolis Banking and Trust Company, Annapolis, Md.	1977
Steven Muller	President, The Johns Hopkins University, Baltimore, Md.	1978
Lacy I. Rice, Jr.	President, The Old National Bank of Martinsburg, Martinsburg, W. Va.	1979
A. R. Reppert	President, The Union National Bank of Clarksburg, Clarksburg, W. Va.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Catherine Byrne Doehler	Senior Vice President, Chesapeake Financial Corporation, Baltimore, Md.	1977
David W. Barton, Jr.	President, The Barton-Gillet Company, Baltimore, Md.	1978
I. E. Killian	President, Killian Enterprises, Gibson Island, Md.	1979

CHARLOTTE BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
John T. Fielder	President, J. B. Ivey and Company, Charlotte, N.C.	1977
William W. Bruner	Chairman of the Board and President, First National Bank of South Carolina, Columbia, S.C.	1978
Thomas L. Benson	President, The Conway National Bank, Conway, S.C.	1979
W. B. Apple, Jr.	President and Trust Officer, First National Bank of Reidsville, Reidsville, N.C.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Charles F. Benbow	Senior Vice President and Director, R. J. Reynolds Industries, Inc., Winston-Salem, N.C.	1977
Robert C. Edwards	President, Clemson University, Clemson, S.C.	1978
Naomi G. Albanese	Dean, School of Home Economics, University of North Carolina at Greensboro, Greensboro, N.C.	1979

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District 6—ATLANTA

		Term expires Dec. 31
Class A:		
Jack P. Keith	President, First National Bank of West Point, West Point, Ga.	1977
Sam I. Yarnell	Chairman, American National Bank and Trust Company, Chattanooga, Tenn.	1978
John T. Oliver, Jr.	President, First National Bank of Jasper, Jasper, Ala.	1979
Class B:		
Ulysses V. Goodwyn	Executive Vice President, Southern Natural Resources, Inc., Birmingham, Ala.	1977
George W. Jenkins	Chairman, Publix Super Markets, Inc., Lakeland, Fla.	1978
Jean McArthur Davis	President, McArthur Dairy, Inc., Miami, Fla.	1979
Class C:		
H. G. Pattillo	Chairman, Pattillo Construction Company, Inc., Decatur, Ga.	1977
Fred Adams, Jr.	President, Cal-Maine Foods, Inc., Jackson, Miss.	1978
Clifford M. Kirtland, Jr.	President, Cox Broadcasting Corporation, Atlanta, Ga.	1979

BIRMINGHAM BRANCH

Appointed by Federal Reserve Bank:		
D. C. Wadsworth, Jr.	President, American National Bank of Gadsden, Gadsden, Ala.	1977
Robert H. Woodrow, Jr.	Chairman of the Board and Chief Executive Officer, The First National Bank of Birmingham, Birmingham, Ala.	1978
Drury Flowers	President, First Alabama Bank of Dothan, Dothan, Ala.	1979
Martha H. Simms	Huntsville, Ala.	1979
Appointed by Board of Governors:		
Harold B. Blach, Jr.	President, J. Blach & Sons, Inc., Birmingham, Ala.	1977
Frank P. Samford, Jr.	Chairman of the Board, Liberty National Life Insurance Co., Birmingham, Ala.	1978
William H. Martin III	Executive Vice President, Martin Industries, Inc., Sheffield, Ala.	1979

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District 6—ATLANTA—Cont.

Term expires Dec. 31

JACKSONVILLE BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
C. DuBose Ausley	President and Chief Executive Officer, Capital City First National Bank, Tallahassee, Fla.	1977
John T. Cannon III	President, Barnett Bank of Cocoa, N.A., Cocoa, Fla.	1978
Richard E. Ehlis	Chairman of the Board and President, Florida National Bank at Lakeland, Lakeland, Fla.	1979
William E. Arnold, Jr.	President, William E. Arnold Company, Jacksonville, Fla.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Gert H. W. Schmidt	President, TeLeVision 12 of Jacksonville, Jacksonville, Fla.	1977
James E. Lyons	President, Lyons Industrial Corporation, Winter Haven, Fla.	1978
Copeland D. Newbern	Chairman of the Board, Newbern Groves, Inc., Tampa, Fla.	1979

MIAMI BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Harry Hood Bassett	Chairman of the Board, Southeast First National Bank of Miami, Miami, Fla.	1977
Sherrill E. Woods	President, First National Bank and Trust Company of Naples, Naples, Fla.	1978
Jane C. Cousins	President, Cousins Associates, Coral Gables, Fla.	1978
Aristides R. Sastre	President, Republic National Bank of Miami, Miami, Fla.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
David G. Robinson	President, Edison Community College, Fort Myers, Fla.	1977
Alvaro Luis Carta	President, Gulf + Western Americas Corporation, Vero Beach, Fla.	1978
Castle W. Jordan	President, Aegis Corporation, Coral Gables, Fla.	1979

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District 6—ATLANTA—Cont.

Term expires Dec. 31

NASHVILLE BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
W. M. Johnson	President, First National Bank, Sparta, Tenn.	1977
John W. Andersen	President, The First National Bank of Sullivan County, Kingsport, Tenn.	1978
Virgil H. Moore, Jr.	President, First Farmers and Merchants National Bank, Columbia, Tenn.	1979
Frank C. Thomas	Executive Vice President, Blue Diamond Coal Company, Knoxville, Tenn.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Robert C. H. Mathews	President, R. C. Mathews, Contractor, Inc., Nashville, Tenn.	1977
John C. Bolinger, Jr.	Management Consultant, Knoxville, Tenn.	1978
Cecelia Adkins	Executive Director, Sunday School Publishing Board of the National Baptist Convention, U.S.A. Inc., Nashville, Tenn.	1979

NEW ORLEANS BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
R. B. Lampton	Vice Chairman, First National Bank, Jackson, Miss.	1977
Wilmore W. Whitmore	President and Chief Executive Officer, First National Bank of Houma, Houma, La.	1978
Martin C. Miler	Chairman of the Board and President, The Hibernia National Bank, New Orleans, La.	1979
George P. Hopkins, Jr.	President, George P. Hopkins, Inc., Contractor-Engineers, Gulfport, Miss.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
George C. Cortright, Jr.	Partner, George C. Cortright Co., Rolling Fork, Miss.	1977
Edwin J. Caplan	President, Caplan's Men's Shops, Inc., Alexandria, La.	1978
Hettie D. Eaves	Executive Vice President, Avondale Shipyards, Inc., New Orleans, La.	1979

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District 7—CHICAGO

Term expires Dec. 31

Class A:

Name	Position	Term expires Dec. 31
John F. Spies	President, Iowa Trust and Savings Bank, Emmetsburg, Iowa	1977
A. Robert Abboud	Chairman of the Board, The First National Bank of Chicago, Chicago, Ill.	1978
Jay J. DeLay	President, Huron Valley National Bank, Ann Arbor, Mich.	1979

Class B:

Name	Position	Term expires Dec. 31
John T. Hackett	Executive Vice President, Cummins Engine Company, Inc., Columbus, Ind.	1977
Oscar G. Mayer	Chairman of the Executive Committee, Oscar Mayer & Co., Inc., Madison, Wis.	1978
Paul V. Farver	Vice Chairman, Rolscreen Company, Pella, Iowa	1979

Class C:

Name	Position	Term expires Dec. 31
Leo H. Schoenhofen	Retired Chairman, Marcor Inc., Chicago, Ill.	1977
Peter B. Clark	Chairman of the Board and President, The Evening News Association, Detroit, Mich.	1978
Robert H. Strotz	President, Northwestern University, Evanston, Ill.	1979

DETROIT BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Harold A. Elgas	President, Gaylord State Bank, Gaylord, Mich.	1977
Joseph B. Foster	Chairman of the Board, Ann Arbor Bank, Ann Arbor, Mich.	1978
Charles R. Montgomery	President, Michigan Consolidated Gas Company, Detroit, Mich.	1978
B. H. Paddock III	President, City National Bank of Detroit, Detroit, Mich.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
John Sagan	Vice President-Treasurer, Ford Motor Company, Dearborn, Mich.	1977
Herbert H. Dow	Director and Secretary, The Dow Chemical Company, Midland, Mich.	1978
Jordan B. Tatter	President and Chief Executive Officer, Southern Michigan Cold Storage Company, Benton Harbor, Mich.	1979

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District 8—ST. LOUIS

		Term expires Dec. 31
Class A:		
Donald N. Brandin	Chairman of the Board and President, The Boatmen's National Bank of St. Louis, St. Louis, Mo.	1977
Wm. E. Weigel	Executive Vice President and Chief Executive Officer, First National Bank & Trust Co., Centralia, Ill.	1978
Raymond C. Burroughs	President and Chief Executive Officer, The City National Bank of Murphysboro, Murphysboro, Ill.	1979
Class B:		
Ralph C. Bain	Vice President, Wabash Plastics, Inc., Evansville, Ind.	1977
Tom K. Smith, Jr.	Senior Vice President, Monsanto Company, St. Louis, Mo.	1978
Virginia M. Bailey	Owner, Eldo Properties, Little Rock, Ark.	1979
Class C:		
Edward J. Schnuck	Chairman of the Board, Schnuck Markets Inc., Bridgeton, Mo.	1977
William B. Walton	Vice Chairman of the Board, Holiday Inns, Inc., Memphis, Tenn.	1978
Armand C. Stalnaker	Chairman and President, General American Life Insurance Co., St. Louis, Mo.	1979

LITTLE ROCK BRANCH

Appointed by Federal Reserve Bank:		
Thomas E. Hays, Jr.	President and Chief Executive Officer, The First National Bank of Hope, Hope, Ark.	1977
Thomas G. Vinson	President, The Citizens Bank, Batesville, Ark.	1978
Field Wasson	President, First National Bank, Siloam Springs, Ark.	1978
B. Finley Vinson	Chairman of the Board, The First National Bank in Little Rock, Little Rock, Ark.	1979
Appointed by Board of Governors:		
Ronald W. Bailey	Executive Vice President and General Manager, Producers Rice Mill, Inc., Stuttgart, Ark.	1977
G. Larry Kelley	President, Pickens-Bond Construction Co., Little Rock, Ark.	1978
E. Ray Kemp, Jr.	Vice Chairman of the Board and Chief Administrative Officer, Dillard Department Stores, Inc., Little Rock, Ark.	1979

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District 8—ST. LOUIS—Cont.

Term expires Dec. 31

LOUISVILLE BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
J. David Grissom	Chairman and Chief Executive Officer, Citizens Fidelity Bank and Trust Company, Louisville, Ky.	1977
Tom G. Voss	President, The Seymour National Bank, Seymour, Ind.	1978
Fred B. Oney	President, The First National Bank of Carrollton, Carrollton, Ky.	1978
Howard Brenner	Vice Chairman of the Board, Tell City National Bank, Tell City, Ind.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
James C. Hendershot	Chairman of the Board and President, Reliance Universal, Inc., Louisville, Ky.	1977
James H. Davis	Chairman and Chief Executive Officer, Porter Paint Co., Louisville, Ky.	1978
James F. Thompson	Professor of Economics, Murray State University, Murray, Ky.	1979

MEMPHIS BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Charles S. Youngblood	President and Chief Executive Officer, First Columbus National Bank, Columbus, Miss.	1977
William W. Mitchell	Chairman, First Tennessee Bank N.A., Memphis, Tenn.	1978
Stallings Lipford	President, First-Citizens National Bank of Dyersburg, Dyersburg, Tenn.	1978
William M. Campbell	Chairman of the Board and Chief Executive Officer, First National Bank of Eastern Arkansas, Forrest City, Ark.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Frank A. Jones, Jr.	President, Cook Industries, Inc., Memphis, Tenn.	1977
Jeanne L. Holley	Associate Professor of Business Education and Office Administration, University of Mississippi, University, Miss.	1978
Robert E. Healy	Partner-in-Charge, Price Waterhouse & Co., Memphis, Tenn.	1979

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District 9—MINNEAPOLIS

		Term expires Dec. 31
Class A:		
William E. Ryan	President, The Citizens State Bank of Ontonagon, Ontonagon, Mich.	1977
John S. Rouzie	President, First National Bank of Bowman, Bowman, N. Dak.	1978
Nels E. Turnquist	President, National Bank of South Dakota, Sioux Falls, S. Dak.	1979
Class B:		
Donald P. Helgeson	Secretary-Treasurer, Jack Frost, Inc., St. Cloud, Minn.	1977
Russell G. Cleary	Chairman, President and Chief Executive Officer, G. Heileman Brewing Company, Inc., LaCrosse, Wis.	1978
Warren B. Jones	Secretary-Treasurer and General Manager, Two Dot Land & Livestock Co., Harlowton, Mont.	1979
Class C:		
Stephen F. Keating	Chairman of the Board, Honeywell, Inc., Minneapolis, Minn.	1977
James P. McFarland	Retired Chairman, General Mills, Inc., Minneapolis, Minn.	1978
Charles W. Poe, Jr.	President, Metropolitan Economic Development Association, Minneapolis, Minn.	1979

HELENA BRANCH

Appointed by Federal Reserve Bank:		
Donald Olsson	President, Ronan State Bank, Ronan, Mont.	1977
George H. Selover	President and General Manager, Selover Buick-Jeep, Inc., Billings, Mont.	1978
William B. Andrews	President, Northwestern Bank of Helena, Helena, Mont.	1978
Appointed by Board of Governors:		
Norris E. Hanford	Fort Benton, Mont.	1977
Patricia P. Douglas	Special Assistant to the President, University of Montana, Missoula, Mont.	1978

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District 10—KANSAS CITY

		Term expires Dec. 31
Class A:		
Craig Bachman	President, The First National Bank of Centralia, Centralia, Kans.	1977
James M. Kemper, Jr.	Chairman and President, Commerce Bancshares, Inc., Kansas City, Mo.	1978
Philip Hamm	President, First National Bank and Trust Company, El Dorado, Kans.	1979
Class B:		
Frank C. Love	Of Counsel, Crowe, Dunlevy, Thweatt, Swinford, Johnson and Burdick, Attorneys, Oklahoma City, Okla.	1977
Alan R. Sleeper	Rancher, Alden, Kans.	1978
Maurice B. Mitchell	Chancellor, University of Denver, Denver, Colo.	1979
Class C:		
Joseph H. Williams	President, The Williams Companies, Tulsa, Okla.	1977
Harold W. Andersen	President, Omaha World-Herald Company, Omaha, Nebr.	1978
Paul H. Henson	Chairman and Chief Executive Officer, United Telecommunications, Inc., Westwood, Kans.	1979

DENVER BRANCH

Appointed by Federal Reserve Bank:		
Felix Buchenroth, Jr.	President, The Jackson State Bank, Jackson, Wyo.	1977
William H. Vernon	Director and Retired Chairman and Chief Executive Officer, Santa Fe National Bank, Santa Fe, N. Mex.	1978
Delano E. Scott	President and Chairman, The Routt County National Bank of Steamboat Springs, Steamboat Springs, Colo.	1978
Appointed by Board of Governors:		
A. L. Feldman	President and Chief Executive Officer, Frontier Airlines, Inc., Denver, Colo.	1977
Edward R. Lucero	Chairman and Chief Executive Officer, Colorado Equity Capital Corporation, Denver, Colo.	1978

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District 10—KANSAS CITY—Cont.

Term expires Dec. 31

OKLAHOMA CITY BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
J. A. Mauer	Chairman, Security National Bank & Trust Co., Duncan, Okla.	1977
V. M. Thompson, Jr.	President, Utica National Bank & Trust Co., Tulsa, Okla.	1978
W. L. Stephenson, Jr.	Chairman of the Board, Central National Bank & Trust Co. of Enid, Enid, Okla.	1978

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
James G. Harlow, Jr.	President, Oklahoma Gas and Electric Co., Oklahoma City, Okla.	1977
Harley Custer	General Manager, National Livestock Association, Oklahoma City, Okla.	1978

OMAHA BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Glenn Yaussi	Vice Chairman of the Board, National Bank of Commerce Trust & Savings, Lincoln, Nebr.	1977
Roy G. Dinsdale	Chairman of the Board, Farmers National Bank of Central City, Central City, Nebr.	1977
F. Phillips Giltner	President, First National Bank of Omaha, Omaha, Nebr.	1978

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Durward B. Varner	President, University of Nebraska Foundation, Lincoln, Nebr.	1977
Edward F. Owen	President, Paxton & Vierling Steel Company, Omaha, Nebr.	1978

District 11—DALLAS

Class A:

Name	Position	Term expires Dec. 31
Frank Junell	Chairman of the Board, The Central National Bank of San Angelo, San Angelo, Tex.	1977
Robert H. Stewart III	Chairman of the Board, First International Bancshares, Inc., Dallas, Tex.	1978
Gene D. Adams	President, The First National Bank of Seymour, Seymour, Tex.	1979

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District 11—DALLAS—Cont.

Name	Position	*Term expires Dec. 31*
Class B:		
Gerald D. Hines	Owner, Gerald D. Hines Interests, Houston, Tex.	1977
Thomas W. Herrick	Cattle and Investments, Amarillo, Tex.	1978
Stewart Orton	President, Foley's Division of Federated Department Stores, Inc., Houston, Tex.	1979
Class C:		
Irving A. Mathews	Chairman of the Board and Chief Executive Officer, Frost Bros., Inc., San Antonio, Tex.	1977
Charles T. Beaird	Publisher, Shreveport Journal, Shreveport, La.	1978
Margaret S. Wilson	Chairman of the Board and Chief Executive Officer, Scarbroughs, Austin, Tex.	1979

EL PASO BRANCH

Name	Position	Term expires Dec. 31
Appointed by Federal Reserve Bank:		
Wayne Stewart	President, First National Bank in Alamogordo, Alamogordo, N. Mex.	1977
Reed H. Chittim	President, First National Bank of Lea County, Hobbs, N. Mex.	1978
Arnold B. Peinado, Jr.	Partner, AVC Development, El Paso, Tex.	1978
George V. Janzen	President, First City National Bank of El Paso, El Paso, Tex.	1979
Appointed by Board of Governors:		
Gage Holland	Owner, Gage Holland Ranch, Alpine, Tex.	1977
Josefina A. Salas-Porras	Executive Director, BI Language Services, El Paso, Tex.	1978
A. J. Losee	President, Losee & Carson, P.A., Artesia, N. Mex.	1979

HOUSTON BRANCH

Name	Position	Term expires Dec. 31
Appointed by Federal Reserve Bank:		
Seth W. Dorbandt	Chairman of the Board, First National Bank in Conroe, Conroe, Tex.	1977
Bookman Peters	President, The City National Bank of Bryan, Bryan, Tex.	1978
Nat S. Rogers	President, First City National Bank of Houston, Houston, Tex.	1978
Page K. Stubblefield	Chairman of the Board, Victoria Bank & Trust Company, Victoria, Tex.	1979

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District 11—DALLAS—Cont.

Term expires Dec. 31

HOUSTON BRANCH—Continued

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Gene M. Woodfin	Chairman of the Board and Chief Executive Officer, Marathon Manufacturing Company, Houston, Tex.	1977
Alvin I. Thomas	President, Prairie View A & M University, Prairie View, Tex.	1978
Jerome L. Howard	Chairman of the Board and Chief Executive Officer, Mortgage & Trust, Inc., Houston, Tex.	1979

SAN ANTONIO BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Leon Stone	President, The Austin National Bank, Austin, Tex.	1977
Richard W. Calvert	Chairman of the Board, National Bank of Commerce of San Antonio, San Antonio, Tex.	1978
John H. Holcomb	Owner-Manager, Progreso Haciendas Company, Progreso, Tex.	1978
Ben R. Low	Vice President, Commerce North Bank, N.A., San Antonio, Tex.	1979

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Marshall Boykin III	Senior Partner, Wood, Boykin & Wolter, Lawyers, Corpus Christi, Tex.	1977
Pete J. Morales, Jr.	President and General Manager, Morales Feed Lots, Inc., Devine, Tex.	1978
Pat Legan	Owner, Legan Properties, San Antonio, Tex.	1979

District 12—SAN FRANCISCO

Class A:

Name	Position	Term expires Dec. 31
Carl E. Schroeder	Chairman of the Board and Chief Executive Officer, The First National Bank of Orange County, Orange, Calif.	1977
Ronald S. Hanson	President and Chief Executive Officer, The First National Bank of Logan, Logan, Utah	1978
Frederick G. Larkin, Jr.	Chairman of the Board and Chief Executive Officer, Security Pacific National Bank, Los Angeles, Calif.	1979

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District 12—SAN FRANCISCO—Cont.

		Term expires Dec. 31
Class B:		
Charles R. Dahl	President and Chief Executive Officer, Crown Zellerbach Corporation, San Francisco, Calif.	1977
Malcolm T. Stamper	President, The Boeing Company, Seattle, Wash.	1978
Clair L. Peck	Chairman of the Board, C. L. Peck, Contractor, Los Angeles, Calif.	1979
Class C:		
Cornell C. Maier	President and Chief Executive Officer, Kaiser Aluminum & Chemical Corporation, Oakland, Calif.	1977
Joseph F. Alibrandi	President and Chief Executive Officer, Whittaker Corporation, Los Angeles, Calif.	1978
Dorothy Wright Nelson	Dean and Professor of Law, University of Southern California Law Center, Los Angeles, Calif.	1979

LOS ANGELES BRANCH

Appointed by Federal Reserve Bank:		
Rayburn S. Dezember	Chairman and President, American National Bank, Bakersfield, Calif.	1977
W. Gordon Ferguson	President, National Bank of Whittier, Whittier, Calif.	1978
Caroline Ahmanson	Chairman of the Board, Caroline Leonetti, Ltd., Hollywood, Calif.	1979
J. J. Pinola	Chairman and Chief Executive Officer, Western Bancorporation, Los Angeles, Calif.	1979
Appointed by Board of Governors:		
Joseph R. Vaughan	President, Knudsen Corporation, Los Angeles, Calif.	1977
Harvey A. Proctor	Chairman of the Board, Southern California Gas Company, Los Angeles, Calif.	1978
Armando M. Rodriguez	President, East Los Angeles College, Monterey Park, Calif.	1979

PORTLAND BRANCH

Appointed by Federal Reserve Bank:		
Kenneth L. Smith	General Manager, The Confederated Tribes of Warm Springs, Warm Springs, Oreg.	1977
Robert F. Wallace	Chairman of the Board, First National Bank of Oregon, Portland, Oreg.	1978
Robert A. Young	President, Northwest National Bank, Vancouver, Wash.	1978

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District 12—SAN FRANCISCO—Cont.

Term expires Dec. 31

PORTLAND BRANCH—Continued

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Loran L. Stewart	Director, Bohemia Inc., Eugene, Oreg.	1977
Jean Mater	Partner and General Manager, Mater Engineering, Corvallis, Oreg.	1978

SALT LAKE CITY BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Mary S. Jensen	Chairman, Idaho State Bank, Glenns Ferry, Idaho	1977
David P. Gardner	President, University of Utah, Salt Lake City, Utah	1978
Robert E. Bryans	Chairman of the Board, Walker Bank and Trust Company, Salt Lake City, Utah	1978

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Theodore C. Jacobsen	Partner, Jacobsen Construction Company, Inc., Salt Lake City, Utah	1977
Sam Bennion	President, V-1 Oil Company, Idaho Falls, Idaho	1978

SEATTLE BRANCH

Appointed by Federal Reserve Bank:

Name	Position	Term expires Dec. 31
Rufus C. Smith	Chairman, The First National Bank of Enumclaw, Enumclaw, Wash.	1977
Douglas S. Gamble	President and Chief Executive Officer, Pacific Gamble Robinson Company, Seattle, Wash.	1978
Harry S. Goodfellow	Chairman of the Board and Chief Executive Officer, Old National Bank of Washington, Spokane, Wash.	1978

Appointed by Board of Governors:

Name	Position	Term expires Dec. 31
Thomas T. Hirai	President and Director, Quality Growers Company, Woodinville, Wash.	1977
Lloyd E. Cooney	President and General Manager, KIRO-Radio & Television, Seattle, Wash.	1978

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PRESIDENTS AND VICE PRESIDENTS

December 31, 1976

Federal Reserve Bank or branch	President First Vice President	Vice Presidents	
Boston	Frank E. Morris	Daniel Aquilino *	R. W. Eisenmenger *
	James A. McIntosh	T. F. Hunt, Jr. *	Niels O. Larsen *
		Richard A. Walker *	Bruce W. Bean
		T. E. Cimeno, Jr.	F. K. Cummings
		Norman S. Fieleke	L. M. Hoyle, Jr.
		Jay W. Kim	D. A. Pelletier
		Richard E. Randall	Laurence H. Stone
		Walter T. Sullivan	J. M. Thayer, Jr.
		Herbert F. Wass	
New York	Paul A. Volcker	Alan R. Holmes †	Edward G. Guy *
	T. M. Timlen, Jr.	P. B. Henderson, Jr. *	F. W. Piderit, Jr. *
		Thomas C. Sloane *	Peter D. Sternlight *
		James O. Aston	Peter Bakstansky
		W. H. Braun, Jr.	E. Gerald Corrigan
		Karl L. Ege	Chester B. Feldberg
		Peter Fousek	Ronald B. Gray
		Margaret Green	Whitney R. Irwin
		Robert E. Lloyd, Jr.	Scott E. Pardee
		Edwin R. Powers	A. M. Puckett
		Geri M. Riegger	F. C. Schadrack, Jr.
		F. L. Smedley	Robert C. Thoman
		H. W. Whiteman, Jr.	H. David Willey
Buffalo		John T. Keane	
Philadelphia	David P. Eastburn	K. G. Adack *	Edward G. Boehne *
	Richard L. Smoot	Thomas K. Desch	Peter M. DiPlacido
		Richard W. Epps	James F. Gaylord
		Hiliary H. Holloway	W. Lee Hoskins
		Ira Kaminow	A. A. Kudelich
		Donald J. McAneny	G. William Metz
		L. C. Murdoch, Jr.	Bipin C. Shah
Cleveland	Willis J. Winn	John M. Davis, Jr. *	W. H. Hendricks *
	W. H. MacDonald	Donald C. Benjamin	John E. Birky
		George E. Booth, Jr.	Paul Breidenbach
		R. Joseph Ginnane	Harry W. Huning
		R. Thomas King	T. E. Ormiston, Jr.
		Lester M. Selby	Harold J. Swart
		Donald G. Vincel	
Cincinnati		R. E. Showalter *	Charles A. Cerino
Pittsburgh		Robert D. Duggan *	William R. Taggart
Richmond	Robert P. Black	Welford S. Farmer *	James Parthemos *
	George C. Rankin	John F. Rand *	R. E. Sanders, Jr. *
		Elizabeth W. Angle	L. W. Bostian, Jr.
		J. A. Broaddus, Jr.	John G. Deitrick
		George B. Evans	Roy L. Fauber
		William C. Glover	R. D. McTeer, Jr.

For notes see p. 504.

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Federal Reserve Bank of St. Louis

PRESIDENTS AND VICE PRESIDENTS—Continued

Federal Reserve Bank or branch	President First Vice President	Vice Presidents	
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		Aubrey N. Snellings	Andrew L. Tilton
		James F. Tucker	Joseph F. Viverette
Baltimore		J. R. Monhollon *	W. E. Pascoe III
		Gerald L. Wilson	
Charlotte		S. P. Fishburne *	Boyd Z. Eubanks
		Thomas E. Snider	
Culpeper [1]		A. D. Tinkelenberg	John G. Stoides
Atlanta......	Monroe Kimbrel Kyle K. Fossum	R. P. Forrestal *	Billy H. Hargett *
		Arthur H. Kantner *	B. R. Rawlings *
		Harry Brandt	W. R. Caldwell
		William N. Cox III	F. J. Craven, Jr.
		Delmar Harrison	Robert E. Heck
		William G. Pfaff	H. Terry Smith
		Pierre M. Viguerie	
Birmingham		Hiram J. Honea	
Jacksonville		Edward C. Rainey *	Charles D. East
Miami		W. M. Davis	
Nashville		Jeffrey J. Wells	
New Orleans		George C. Guynn	
Chicago.....	Robert P. Mayo Daniel M. Doyle	Ward J. Larson *	James R. Morrison *
		Karl A. Scheld *	Harry S. Schultz *
		Bruce L. Smyth *	R. D. Abrahamson
		Paul J. Bettini	George W. Cloos
		Robert P. Cornelisen	F. S. Dominick
		Franklin D. Dreyer	Rudolph W. Dybeck
		Joseph G. Kvasnicka	Richard A. Moffatt
		William T. Newport	Dorothy M. Nichols
		Louis J. Purol	William Rooney
		R. M. Scheider	Roby L. Sloan
		Adolph J. Stojetz	Carl E. Vander Wilt
		Eugene J. Wagner	Allen G. Wolkey
Detroit		William C. Conrad	Ronald Zile
St. Louis....	Lawrence K. Roos D. W. Moriarty, Jr.	Anotol B. Balbach *	J. P. Garbarini *
		F. G. Russell, Jr.*	Harold E. Uthoff *
		Ruth A. Bryant	James R. Kennedy
		Denis S. Karnosky	Warren G. Snover
		John F. Otting, Jr.	Delmer D. Weisz
		Robert W. Thomas	Charles D. Zettler
Little Rock		John F. Breen	

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Federal Reserve Bank of St. Louis

PRESIDENTS AND VICE PRESIDENTS—Continued

Federal Reserve Bank or branch	President First Vice President	Vice Presidents	
St. Louis—Cont.			
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Memphis		L. Terry Britt	
Minneapolis	Mark H. Willes Clement A. Van Nice	Thomas E. Gainor * J. A. MacDonald * L. W. Fernelius Bruce J. Hedblom Howard L. Knous Clarence W. Nelson	R. D. Graham * Melvin L. Burstein Lester G. Gable D. R. Hellweg D. R. McDonald R. W. Worcester
Helena		John D. Johnson	
Kansas City	Roger Guffey H. R. Czerwinski	W. T. Billington * Thomas E. Davis * James R. Bell Cecil B. Foley M. L. Mothersead John F. Zoellner	James R. Bowen * J. D. Hamilton * James A. Cacy G. H. Miller, Jr. Robert E. Thomas
Denver		Wayne W. Martin *	
Oklahoma City		William G. Evans	
Omaha		Robert D. Hamilton	
Dallas	Ernest T. Baughman Robert H. Boykin	G. C. Cochran III * Tony J. Salvaggio * C. J. Pickering George F. Rudy E. W. Vorlop, Jr.	Harry E. Robinson * Joseph E. Burns W. M. Pritchett Thomas R. Sullivan
El Paso		Frederic W. Reed	
Houston		J. Z. Rowe	
San Antonio		Carl H. Moore	
San Francisco	John J. Balles John B. Williams	John J. Carson * Wesley G. DeVries * Kent O. Sims * Robert C. Dietz Henry B. Jamison Michael W. Keran Louis E. Reilly W. G. Woodbury	ClaudeWoessner,Jr. Donald V. Masten * Richard T. Griffith * Warren H. Hutchins Thomas E. Judge Rix Maurer, Jr. W. Von Turk
Los Angeles		Richard C. Dunn *	James M. Davis
Portland		Angelo S. Carella	
Salt Lake City		A. Grant Holman	
Seattle		Gerald R. Kelly *	

[1] Culpeper Center not considered a branch.
* Indicates Senior Vice President.
† Indicates Executive Vice President.

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CONFERENCE OF PRESIDENTS

The Presidents of the Federal Reserve Banks are organized into a Conference of Presidents that meets from time to time to consider matters of common interest and to consult with and advise the Board of Governors. At a meeting on December 22, 1976, Mr. Willis J. Winn and Mr. John J. Balles, Presidents of the Federal Reserve Banks of Cleveland and San Francisco, were elected Chairman and Vice Chairman, respectively, for the forthcoming Conference year, ending with the December 1977 meeting.

At the December 1976 meeting, Mr. Robert J. Gorius and Ms. Adelle Foley, of the Federal Reserve Banks of Cleveland and San Francisco, were appointed Secretary and Assistant Secretary, respectively.

CONFERENCE OF FIRST VICE PRESIDENTS

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet from time to time, primarily for the consideration of operational matters. On December 22, 1976, Mr. Walter H. MacDonald, First Vice President of the Federal Reserve Bank of Cleveland, was elected as Chairman, and Mr. John B. Williams, First Vice President of the Federal Reserve Bank of San Francisco, as Vice Chairman of the Conference for the calendar year 1977. Mr. Robert J. Gorius and Ms. Adelle Foley were appointed Secretary and Assistant Secretary, respectively.

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http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Index

Page

Acceptances, bankers:
Authority to purchase and to enter into repurchase agreements 153–54, 202
Federal Reserve Bank—
Earnings 425, 444
Holdings 425, 434, 436, 438
Open market transactions during 1977 443
Repurchase agreements 434, 436, 438, 443
Assets and liabilities:
Banks, by classes 457
Board of Governors 429
Federal Reserve Banks 434–39

Balance of payments, review of 1977 56–67
Bank Examination Schools 412
Bank examiners, loans to, legislative recommendation 376–77
Bank holding companies:
Divestitures, Board policy statement 116
Foreign applications processed by Board 412
Legislative recommendations 370
Litigation 378–86
Regulation Y (*See* Regulations and rules)
Securities Acts Amendments of 1975 366
Supervision and regulation by Federal Reserve System 400–04
Bank Holding Company Act:
Amendments 398
Legislative recommendations 370, 372
Bank mergers and consolidations 408, 466–74
Bank supervision and regulation by Federal Reserve System:
Banking system, condition 413–21
In 1977 400–12
Legislative recommendations 370
Litigation 387, 388, 389, 390
Bankers acceptances (*See* Acceptances, bankers)
Banking offices:
Number, changes 462
Par and nonpar, number 464
Banking system, condition 413–21
Board of Governors:
Annual Reports to Congress 332–65
Audit of accounts 428
Banking system, condition 413–21

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Board of Governors—Continued
  Consumer affairs (*See* Consumer affairs)
  Delegation of certain authority, actions under 401, 402, 409
  Federal Reserve Reform Act relating to 397, 398
  Foreign applications processed 411, 412
  Income and expenses 428–32
  Interpretations (*See* Interpretations)
  Legislative recommendations 369–77
  Litigation 378–90
  Members and officers, list 478
  Policy actions 115–51
  Regulations and rules (*See* Regulations and rules)
  Salaries 430
Boycott practices, legislation forbidding 392
Branch banks:
  Changes in number 462
  Federal Reserve:
    Bank premises 424, 448
    Directors 483–501
    Vice Presidents in charge 502–04
  Foreign branches of member banks:
    Number and location 409–10
    Reserve requirements, amendment of Regulation M 137
Budget, Federal, and public debt 393, 394
Burns, Arthur F., statements on growth targets for
  monetary aggregates 68–112

Capital accounts:
  Banks, by classes 457
  Federal Reserve Banks 435, 437, 439
Chairmen and Deputy Chairmen of Federal Reserve Banks 482
Check clearing and collection (*See* Transfers of funds)
Clayton Act 113, 373
Commercial banks (*See also* Foreign banks):
  Assets and liabilities 457
  Banking offices, changes in number 462
  Interlocking relationships, legislative recommendation 373
  Negotiable orders of withdrawal (NOW) accounts 369
  Number, by class of bank 457
Condition statement of Federal Reserve Banks 434–39
Consumer Advisory Council 340–41
Consumer affairs:
  Annual Reports to Congress 332–65
  Board actions, review 329–32
  Complaints by consumers 359–61

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Consumer affairs—Continued
  Consumer Advisory Council 340–41
  Credit protection laws, enforcement and
    compliance 329–31, 332, 338–40, 346, 347–55, 363
  Division of Consumer Affairs 330, 332, 347
  Educational activities 330, 338, 339, 345, 347, 357
  Equal Credit Opportunity (*See* Equal Credit Opportunity)
  Fair Debt Collection Practices Act 393
  Federal Open Market Committee's domestic policy directive,
    disclosure, legislative recommendation and litigation 376, 387
  Federal Trade Commission Act 331, 358–63
  Government in the Sunshine Act 123, 186, 367, 390
  Leasing, consumer 342
  Litigation 386, 390
  Surveys 332, 334–38, 357, 358, 359
  Truth in Lending (*See* Truth in Lending)
Cost and price developments 29–33
Credit (*See also* Loans):
  Banks, unfair practices 359
  Collateral for Federal Reserve notes, legislative recommendations 375
  Consumer (*See* Consumer affairs)
  Equal Credit Opportunity (*See* Equal Credit Opportunity)
  Federal Reserve Banks, advances by 377
  Stocks (*See* Stock market)
  Truth in Lending (*See* Truth in Lending)
Credit unions, legislation enacted 352, 391, 396
Currency, Federal Reserve notes, legislative recommendations 374–75

Defense production loans 392, 426, 456
Deposits:
  Banks, by classes 457
  Federal Reserve Banks 435, 437, 439, 459, 461
  Interest rates (*See* Interest on deposits)
  Reserve requirements (*See* Reserve requirements, member banks)
Directors, Federal Reserve Banks and branches 483–501
Discount rates at Federal Reserve Banks (*See* Interest rates)
Discounts and advances by Federal Reserve Banks (*See* Loans)
Dividends, Federal Reserve Banks 424, 445, 446

Earnings of Federal Reserve Banks 423, 444, 446
Economic expansion, sources 11–22
Electronic funds transfers (*See* Transfers of funds)
Equal Credit Opportunity:
  Act 332, 346–57
  Regulation B (*See* Regulations and rules)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Examinations:
  Federal Reserve Banks 422
  International or foreign banking corporations 411–12
  Member banks 329, 338, 347, 404
  National banks 350, 405
  Nonmember banks 351
  State member banks 329, 338, 347, 404
Executive officers of member banks, loans to 407
Expenses:
  Board of Governors 428–32
  Federal Reserve Banks 423, 444, 446

Fair Credit Billing Act 338
Federal Advisory Council 481
Federal agency securities:
  Authority to purchase and to enter into repurchase agreements 153–54
  Collateral for Federal Reserve notes, legislative recommendations 375
  Federal Reserve Bank holdings and earnings 434, 436, 438, 442
  Open market transactions of Federal Reserve System during 1977 443
  Operations, revision of guidelines for 189
  Repurchase agreements 434, 436, 438, 442, 443
Federal Bank Examination Council, recommendation for 371
Federal Financing Bank 153
Federal Open Market Committee:
  Audit of System Account 423
  Continuing authorizations, review 203
  Federal Reserve Reform Act relating to 397
  Foreign currencies, review of operations 326
  Government in the Sunshine Act, statement of policy on 186
  Meetings 152, 480
  Members and officers:
    List 480
    Litigation 389
  Policy actions:
    Disclosure, legislative recommendation and litigation 376, 387
    In 1977 152–325
  Rules Regarding Availability of Information, amendment 189
Federal Reserve Act:
  Federal Reserve Banks' direct purchase authority, renewal 397
  Legislative recommendations 370, 372, 374, 377
Federal Reserve Agents 482
Federal Reserve Banks:
  Advances by 377
  Assessment for expenses of Board of Governors 430

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Federal Reserve Banks—Continued
  Bank premises 424, 434, 436, 438, 448
  Branches (*See* Branch banks)
  Capital accounts 435, 437, 439
  Chairmen and Deputy Chairmen 482
  Condition statement 434–39
  Delegation by Board of certain authority to 401, 402, 409
  Directors 483–501
  Discount rates (*See* Interest rates)
  Dividends 424, 445, 446
  Earnings and expenses 423, 444, 446
  Examination 422
  Federal Reserve Reform Act relating to 397, 398
  Foreign accounts 426
  Officers and employees, number and salaries 451
  Operations, volume and cost 427, 449, 450
  Payments mechanism developments 422
  Presidents and Vice Presidents 502–04
  Profit and loss 445
  U.S. Govt. securities (*See* U.S. Govt. securities)
Federal Reserve notes:
  Condition statement data 435–39
  Cost of printing, issue, and redemption 430
  Interest paid to Treasury 445, 446
  Legislative recommendations 374–75
  Litigation 389–90
Federal Reserve Reform Act 397
Federal Reserve System (*See also* Board of Governors):
  Bank and bank holding company supervision and regulation by 400–12
  Consumer affairs (*See* Consumer affairs)
  Foreign currency operations (*See* Foreign currency operations)
  Map of Federal Reserve districts 475
  Membership 407
  Payments mechanism developments 422
  Schools 412
  Securities Acts Amendments of 1975 366
  Transfers of funds (*See* Transfers of funds)
Federal Trade Commission Act 331, 358–63
Financial Institutions Supervisory Act 370, 386–87
Financial markets and monetary policy 34–55
Foreign accounts of Federal Reserve Banks 426
Foreign applications processed by Board 411, 412
Foreign banking or international corporations, examination
  and operation 411
Foreign banks 371

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Foreign branches of member banks 137, 409–10
Foreign currency operations:
  Authorization and directive 153, 156–59, 203, 325
  Exchange Stabilization Fund, agreement 174
  Federal Reserve earnings on foreign currencies 444
  Review 326
  Sterling, agreement on official balances 172
Freedom of Information Act 386, 387, 388, 390
Funds transfers (*See* Transfers of funds)

Gold, tables showing gold certificate accounts of Reserve Banks
  and gold stock 434, 436, 437, 438, 439, 458, 460
Government in the Sunshine Act 123, 186, 367, 368, 390

Home Mortgage Disclosure Act of 1975 363–65
Housing (*See* Real estate)

Individual retirement accounts (IRA's) 124
Insured commercial banks:
  Assets and liabilities 457
  Banking offices, changes in number 462
Interest on deposits (*See also* Interest rates):
  Legislative recommendations 369, 370
  Rates, extension of flexible authority to set 391, 397
  Time and savings deposits:
    Early withdrawal of time deposits, amendment of Regulation Q
      relating to interest penalties 123, 133, 136
    Loans secured by, amendment of Regulation Q 138
    Negotiable orders of withdrawal (NOW) accounts, legislative
      recommendation 369
    Pooled time deposits of $100,000 or more, proposed amendment
      of Regulation Q not adopted 125
    Retirement accounts, amendment of Regulation Q to establish
      new category of time deposit accounts 124
    Supervisory powers, legislative recommendations 370
    Table on maximum rates 454
  Treasury tax and loan deposits 139, 396
Interest rates (*See also* Interest on deposits):
  Consumer loan data, litigation 386
  Defense production loans 456
  Federal Reserve Banks:
    Advances by, legislative recommendation 377
    Changes 141–51
    Table on rates 451
  Variable-rate clause in credit contract, amendment of Regulation Z ... 127
Interlocking bank relationships 115, 373

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

International developments:
  Legislation enacted 394
  Review 56–67
International Monetary Fund, legislation enacted 396
Interpretations, Board of Governors 331, 355–57, 363
Investments:
  Banks, by classes 457
  Federal Reserve Banks 434, 436, 438

Keogh plan retirement accounts 124

Labor market developments 23–28
Leasing, consumer 342
Legislation:
  Bank examiners, legislative recommendation on loans 376–77
  Bank Holding Company Act 370, 372, 398
  Civil Rights Act of 1968 389
  Clayton Act 113, 373
  Consumer Leasing Act of 1976 342
  Defense Production Act, extension 392
  Depository institutions amendments 391
  Discounts for cash customers, amendment of Regulation Z to implement 132
  Equal Credit Opportunity Act 332, 346–57
  Export Administration Act amendments 392
  Export-Import Bank Act amendments 395
  Fair Credit Billing Act 338
  Fair Debt Collection Practices Act 393
  Fair Labor Standards Act amendments 396
  Federal budget deficits, congressional resolutions, and extension of debt ceiling 393, 394
  Federal Open Market Committee's domestic policy directive, disclosure, legislative recommendation and litigation 376, 387
  Federal Reserve Act (*See* Federal Reserve Act)
  Federal Reserve Banks:
    Advances by, Board recommendations 377
    Direct purchase authority, renewal 397
  Federal Reserve notes, legislative recommendations 374–75
  Federal Reserve Reform Act 397
  Federal Trade Commission Act 331, 358–63
  Financial Institutions Supervisory Act 370, 386–87
  Flood Disaster Protection Act of 1973 126
  Foreign bank regulation, legislative recommendations 371
  Freedom of Information Act 386, 387, 388, 390
  Government in the Sunshine Act 123, 186, 367, 390

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Legislation—Continued
Home Mortgage Disclosure Act of 1975 363–65
Housing and Community Development Act 394
Interlocking relationships, legislative recommendation 373
International Development Assistance Act 394
Member banks, legislative recommendation on affiliates 372
Negotiable orders of withdrawal (NOW) accounts, legislative recommendation 369
Securities Acts Amendments of 1975 366
Securities Exchange Act amendment 398
Small Business Act and Small Business Investment Act amendments .. 393
Social Security Act amendments 399
Supervisory powers of Board, legislative recommendation on strengthening 370
Tax Reduction and Simplification Act 391
Treasury tax and loan deposits, interest on 139, 396
Truth in Lending Act (*See* Truth in Lending)
Unemployment compensation program, extension 391
Wage and Price Stability Act Council, amendments 394
Litigation:
Bank holding companies, antitrust action and review of Board's actions 378–86
Challenges to Board procedures and regulations 386–90
Government in the Sunshine Act 368, 390
Loans (*See also* Credit):
Banks:
By classes 457
Examiners, legislative recommendation 376–77
Executive officers of member banks 407
Legislative recommendations 370
Consumer, litigation 386
Defense production 392, 426, 456
Fair Debt Collection Practices Act 393
Federal Reserve Banks:
Advances by, legislative recommendation 377
Holdings and earnings 425, 444
Interest rates 451
Volume 434, 436, 438, 449, 458, 460
Real estate (*See* Real estate)
Secured by depositor's time or savings deposit, amendment of Regulation Q 138
Stocks (*See* Stock market)

Margin requirements:
"Straddle" transaction, calculating, amendment of Regulation T 128
Table 455

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Member banks (*See also* National banks):
Affiliates, legislative recommendations 372
Assets, liabilities, and capital accounts 457
Banking offices, changes in number 462
Borrowing from Reserve Banks 377
Branches (*See* Branch banks)
Examination 329, 338, 347, 404
Executive officers, loans to 407
Foreign applications processed 411, 412
Foreign branches, number and location 409–10
Interest on deposits (*See* Interest on deposits)
Interlocking relationships, amendment of Regulation L and
legislative recommendation 115, 373
Negotiable orders of withdrawal (NOW) accounts 369
Number 407, 457
Reserve requirements (*See* Reserve requirements, member banks)
Reserves and related items 458–61
State member (*See* State member banks)
Transfers of funds (*See* Transfers of funds)
Mergers and consolidations 408, 466–74
Monetary aggregates, official statements on growth targets 68–112
Monetary policy:
Financial markets relative to 34–55
Review of 1977 3–67
Mortgages (*See also* Real estate):
Home Mortgage Disclosure Act of 1975 363–65
Housing and Community Development Act 394
Mutual savings banks 457, 462

National banks (*See also* Member banks):
Assets and liabilities 457
Banking offices, changes in number 462
Examination 350, 405
Foreign branches:
Number 409–10
Reserve requirements, amendment of Regulation M 137
Number 407, 457
Negotiable orders of withdrawal (NOW) accounts 369
Nonmember banks:
Assets and liabilities 457
Banking offices, changes in number 462
Examination 351
Number 457

Par and nonpar banking offices, number 464
Payments mechanism developments 422

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Policy actions:
  Board of Governors:
    Bank holding companies, statement on divestitures 116
    Discount rates at Federal Reserve Banks 141–51
    Regulations and rules (*See* Regulations and rules)
  Federal Open Market Committee:
    Authority to effect transactions in System Open Market Account:
      Domestic operations 153–56, 160, 176, 191, 202, 205, 220, 231, 242, 257, 268, 280, 282, 298, 300, 312
      Foreign currency operations 153, 156–59, 325
      Review 203
    Exchange Stabilization Fund, agreement 174
    Federal agency issues, revision of guidelines for operations 189
    Government in the Sunshine Act, statement of policy on 186
    Rules Regarding Availability of Information, amendment 189
    Sterling, agreement on official balances 172
Presidents and Vice Presidents of Federal Reserve Banks:
  Conference of Presidents and Conference of First Vice Presidents 505
  List 502–04
  Salaries of Presidents 451
Prices:
  Developments, and factors affecting 29–33
  Legislation enacted 394
Profit and loss, Federal Reserve Banks 445

Real estate (*See also* Mortgages):
  Legislative recommendation 376–77
  Litigation 389
  Loans in identified flood-hazard areas 126
Record of policy actions (*See* Policy actions)
Regulations and rules, Board of Governors:
  AA, Unfair or Deceptive Acts or Practices 359
  B, Equal Credit Opportunity:
    Amendments and interpretations 346, 355–57
    Consumer complaints 359–60
    Enforcement 347–55
    Pamphlet 332, 357
  C, Home Mortgage Disclosure:
    Consumer complaints 360
    Interpretations 363
  D, Reserves of Member Banks:
    Borrowings from member bank with head office outside States of United States and District of Columbia, amendment 139
    Treasury tax and loan accounts, investment of funds deposited in, amendment 139

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Regulations and rules—Continued
H, Membership of State Banking Institutions in the Federal Reserve System:
Clearing agencies for stock market transactions, amendment 135
Municipal securities dealers, amendment requiring filing of information 133
Real estate loans in identified flood-hazard areas, technical amendments 126
J, Collection of Checks and Other Items by Federal Reserve Banks:
Wire transfers of funds between member banks, amendment and implementation 131, 422
L, Interlocking Bank Relationships Under the Clayton Act:
Member bank and minority or women's bank, amendment 115
M, Foreign Activities of National Banks:
Reserve requirements, amendment 137
Q, Interest on Deposits:
Early withdrawal of time deposits:
Disaster area, suspension of penalties for 133
Penalty not imposed under certain conditions, amendments ...123, 136
Loans secured by depositor's time or savings deposit, amendment .. 138
Pooled time deposits of $100,000 or more, proposed amendment not adopted 125
Retirement accounts, new category of time deposit accounts, amendment 124
Treasury tax and loan accounts, investment of funds deposited in, amendment 139
Rules Regarding Availability of Information, amendment 189
Rules Regarding Public Observation of Meetings, adoption 123
T, Credit by Brokers and Dealers:
Margin requirement on "straddle" transaction, calculating, amendment 128
Y, Bank Holding Companies:
Board decisions concerning permissible activities:
Futures commission merchant, acting as 134
Investment company, operation 129
Money orders and other consumer-type payment instruments, issuance 121
Municipal securities dealer activities 133
Savings and loan association, operation 120
Clearing agencies for stock market transactions, amendment 135
Z, Truth in Lending:
Compliance 338–40
Consumer complaints 359–60
Disclosures, amendments 127, 343
Discounts for cash customers, amendment 132, 342
Simplification, amendments and interpretations ...329, 331, 333, 342–45

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Page

Repurchase agreements:
  Authority to enter into 153–54
  Bankers acceptances 153–54, 434, 436, 438, 443
  Federal agency securities 153–54, 434, 436, 438, 442, 443
  U.S. Govt. securities 153–54, 434, 436, 438, 442, 443, 458, 460
Reserve requirements, member banks:
  Changes, amendment of Regulation D (*See* Regulations and rules)
  Foreign branches, amendment of Regulation M 137
  Legislative recommendations 369, 370
  Table 452
Reserves, member banks:
  Reserve requirements (*See* Reserve requirements, member banks)
  Reserves and related items 458–61

Salaries:
  Board of Governors 430
  Federal Reserve Banks 451
Savings and loan associations 120, 351, 396
Securities (*See specific types*):
  State member banks 133, 135, 366
  Stocks (*See* Stock market)
Securities Acts Amendments of 1975 366
Securities Exchange Act amendment 398
Special Drawing Rights 434, 436, 438, 458, 460
State member banks (*See also* Member banks):
  Assets and liabilities 457
  Banking offices, changes in number 462
  Consumer affairs (*See* Consumer affairs)
  Control, changes, reporting requirements 406
  Examination 329, 338, 347, 404
  Foreign branches, number 409–10
  Mergers and consolidations 408, 466–74
  Number 407, 457
  Real estate loans (*See* Real estate)
  Securities 133, 135, 366
Stock market:
  Margin requirement on "straddle" transaction, calculating 128
  Securities Acts Amendments of 1975 366
  Transactions, amendment of Regulations H and Y 135
System Open Market Account:
  Audit 423
  Authority to effect transactions in—
    Domestic operations 153–56, 160, 176, 191, 202, 205, 220, 231, 242, 257, 268, 280, 282, 298, 300, 312
    Foreign currency operations 153, 156–59, 325
    Review 203

Digitized for FRASER
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Federal Reserve Bank of St. Louis

Page

System Open Market Account—Continued
Exchange Stabilization Fund, agreement 174
Foreign currencies, review of operations 326
Sterling, agreement on official balances 172

Taxation, legislation enacted 391
Training activities 330, 338, 339, 347, 357, 412
Transfers of funds:
Payments mechanism developments 422
Volume and cost of Reserve Bank operations 427, 449, 450
Wire transfers between member banks, amendment of Regulation J .. 131
Treasury Department tax and loan accounts:
Investment of funds deposited in, amendment of Regulations D and Q 139
Legislation enacted 396
Truth in Lending (*See also* Consumer affairs):
Act:
Enforcement and compliance 329–31, 332, 338–40
Simplification 329, 331, 332, 333, 375
State exemptions 345
Annual Report to Congress 332–46
Fair Credit Billing Act 338
Regulation Z (*See* Regulations and rules)

U.S. balance of payments, review of 1977 56–67
U.S. Govt. securities:
Authority to purchase and to enter into repurchase agreements 153–54
Bank holdings, by class of bank 457
Federal agency securities (*See* Federal agency securities)
Federal Reserve Bank—
Authority to buy directly from United States 154, 280, 298, 397
Earnings 423–24, 425, 444
Holdings 425, 434, 436, 438, 440, 458, 460
Lending 204
Open market operations 152–325, 443
Repurchase agreements 434, 436, 438, 442, 443, 458, 460
Special certificates purchased directly from United States 442
U.S. Govt. agency securities (*See* Federal agency securities)

V loans 392, 426, 456

Wire transfers of funds (*See* Transfers of funds)

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Federal Reserve Bank of St. Louis