72nd Annual Report 1985

Board of Governors of the Federal Reserve System

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Letter of Transmittal

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., June 19, 1986

THE SPEAKER OF
THE HOUSE OF REPRESENTATIVES

Pursuant to the requirements of section 10 of the Federal Reserve Act, I am pleased to submit the Seventy-Second Annual Report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 1985.

Sincerely,

Paul A. Volcker, *Chairman*

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Contents

Part 1 Monetary Policy and the U.S. Economy in 1985

3 INTRODUCTION

5 THE ECONOMY IN 1985
5 Prices
8 Household sector
8 Business sector
9 Government sector
10 Foreign sector
10 Labor markets

12 MONETARY POLICY AND FINANCIAL MARKETS
12 Monetary aggregates
17 Aggregate credit flows

20 INTERNATIONAL DEVELOPMENTS
22 U.S. international transactions
24 Foreign currency operations

27 MONETARY POLICY REPORTS TO CONGRESS
27 Report on February 20, 1985
42 Report on July 16, 1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Part 2 Records, Operations, and Organization

63 RECORD OF POLICY ACTIONS OF THE BOARD OF GOVERNORS
63 Regulation B (Equal Credit Opportunity)
64 Regulation D (Reserve Requirements of Depository Institutions)
64 Regulation G (Securities Credit by Persons Other than Banks, Brokers, or Dealers), Regulation T (Credit by Brokers and Dealers), and Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks)
65 Regulation G (Securities Credit by Persons Other than Banks, Brokers, or Dealers) and Regulation T (Credit by Brokers and Dealers)
65 Regulation J (Collection of Checks and Other Items and Wire Transfers of Funds)
66 Regulation K (International Banking Operations)
66 Regulation T (Credit by Brokers and Dealers)
66 Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks)
67 Regulation AA (Unfair or Deceptive Acts or Practices)
67 Policy statements and other actions
69 1985 discount rates

74 RECORD OF POLICY ACTIONS OF THE FEDERAL OPEN MARKET COMMITTEE
74 Authorization for domestic open market operations
76 Domestic policy directive
77 Authorization for foreign currency operations
79 Foreign currency directive
80 Meeting held on February 12–13, 1985
90 Meeting held on March 26, 1985
97 Meeting held on May 21, 1985
104 Meeting held on July 9–10, 1985
115 Meeting held on August 20, 1985
123 Meeting held on October 1, 1985
130 Meeting held on November 4–5, 1985
137 Meeting held on December 16–17, 1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

145 CONSUMER AND COMMUNITY AFFAIRS
145 Regulatory actions
149 Community affairs
150 Compliance with consumer regulations
152 Economic impact of Regulation E
153 Consumer complaints
155 Unregulated practices
155 Community Reinvestment Act
156 Consumer Advisory Council
157 Legislative recommendations

158 LEGISLATIVE RECOMMENDATIONS
158 Bank holding company legislation
159 Increasing the number of Class C directors
159 Federal Reserve Bank branches
159 Return check notification
160 Interstate banking
160 Emergency acquisition authority

162 LITIGATION
162 Bank holding companies—antitrust action
162 Bank Holding Company Act—review of Board actions
165 Other litigation involving challenges to Board procedures and regulations

168 BANKING SUPERVISION AND REGULATION
168 Supervision for safety and soundness
172 Program to strengthen supervision of banks and bank holding companies
173 Other supervisory guidelines
177 Regulation of the U.S. banking structure
182 Enforcement of other laws and regulations
185 Federal Reserve membership

186 REGULATORY SIMPLIFICATION
186 Periodic review
187 New regulatory actions

189 FEDERAL RESERVE BANKS
189 Developments in the pricing of Federal Reserve services and in the payment mechanism
192 Examination
192 Income and expenses
194 Federal Reserve Bank premises
194 Holdings of securities and loans
194 Volume of operations

195 BOARD OF GOVERNORS
195 Financial statements

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

201 STATISTICAL TABLES
202 1. Detailed statement of condition of all Federal Reserve Banks combined, December 31, 1985
204 2. Statement of condition of each Federal Reserve Bank, December 31, 1985 and 1984
208 3. Federal Reserve open market transactions, 1985
210 4. Federal Reserve Bank holdings of U.S. government and federal agency securities, December 31, 1983-85
211 5. Number and salaries of officers and employees of Federal Reserve Banks, December 31, 1985
212 6. Bank premises of Federal Reserve Banks and Branches, December 31, 1985
213 7. Income and Expenses of the Federal Reserve System, 1981-85
214 8. Income and expenses of Federal Reserve Banks, 1985
218 9. Income and expenses of Federal Reserve Banks, 1914-85
222 10. Revenue and expense of priced services at Federal Reserve Banks, 1985 and 1984
224 11. Operations in principal departments of Federal Reserve Banks, 1982-85
224 12. Federal Reserve Bank interest rates, December 31, 1985
225 13. Reserve requirements of depository institutions
227 14. Maximum interest rates payable on time and savings deposits at federally insured institutions, December 31, 1985
228 15. Margin requirements for Regulations T, U, G, and X
229 16. Principal assets and liabilities, and number of insured commercial banks, by class of bank, June 30, 1985 and 1984
230 17. Reserves of depository institutions, Federal Reserve Bank credit, and related items—year-end 1918-85, and month-end 1985
234 18. Changes in number of banking offices in the United States, 1985
235 19. Mergers, consolidations, and acquisitions of assets or assumptions of liabilities approved by the Board of Governors, 1985

246 MAP OF FEDERAL RESERVE SYSTEM—DISTRICTS

247 FEDERAL RESERVE DIRECTORIES AND MEETINGS
248 Board of Governors of the Federal Reserve System
250 Federal Open Market Committee
251 Federal Advisory Council
252 Consumer Advisory Council
253 Thrift Institutions Advisory Council
254 Federal Reserve Banks, Branches, and Offices

275 INDEX

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Part 1

Monetary Policy and the U.S. Economy in 1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Introduction

Nineteen eighty-five was a year of further progress for the national economy. Although growth in economic activity was slower than it had been in the earlier phase of the expansion, increases in output were large enough to reduce the unemployment rate to its lowest level since 1980. Moreover, even as the economic upswing moved into its fourth year, inflationary pressures remained in check. Prices generally rose less than in 1984, and wage gains were restrained.

Continued economic growth in 1985 was supported by a generally accommodative monetary policy. The demand for narrow money was strong, partly in lagged response to earlier declines in interest rates and partly perhaps in response to more conservative cash management practices. M1 expanded relatively rapidly throughout the year, growing about 12 percent, and its velocity exhibited an unusual and large drop of nearly 6 percent; growth in M1 exceeded both the original target range set in February and the wider, rebased range for the second half set in July. However, the broader monetary aggregates behaved more normally and ended the year within their target ranges: M2 expanded about 8½ percent compared with its range of 6 to 9 percent, and M3 grew 7¾ percent compared with its range of 6 to 9½ percent.

In credit markets, short-term interest rates declined only a little over 1985, while long-term rates dropped 2 percentage points or more, partly reflecting an improved outlook for inflation and expectations of greater fiscal restraint. The Federal Reserve discount rate was reduced once, by one-half percentage point. Stock prices rose substantially during the year. Meanwhile, debt growth was strong; expansion of domestic nonfinancial debt for the year amounted to 14 percent, above the monitoring range of 9 to 12 percent set by the Federal Open Market Committee. The rapidity of debt creation resulted, in part, from borrowings to finance retirements of corporate stock associated with mergers, buyouts, and share repurchases and from the acceleration of state and local debt issuance in response to proposed tax law changes.

While output of the U.S. economy expanded only moderately in 1985, the domestic sectors increased their purchases of goods and services rapidly. The difference was an increasing volume of imports and decline in the volume of exports. Thus, not all segments of the economy shared equally in the expansion. Key sectors such as manufacturing, mining, and agriculture continued to face strong competition from foreign producers. Sluggish growth abroad also limited export markets for U.S. producers. In financial markets, a number of institutions had to cope with loan problems associated with the economic pressures and large debt burdens of certain borrowers, including less developed countries as well as energy and agricultural borrowers in the United States.

Adjustments are in process that

NOTE. This discussion of economic and financial developments in 1985 is adapted from the *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978* (Board of Governors, February 1986).

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

should help correct the imbalances that have emerged in recent years. Passage of the Balanced Budget and Emergency Deficit Control Act of 1985 has had salutary effects on expectations in financial markets. As budgetary deficits are reduced, increasing amounts of domestic saving can be channeled into investment in the plant and equipment needed to improve productivity and sustain economic growth over the long term. The decline in the foreign exchange value of the dollar should help create an environment in which U.S. producers can compete more effectively in world markets. The efforts of many banks and other financial intermediaries to bolster capital and reserves, together with lower interest rates, should help financial institutions to strengthen their ability to cope with financial strain. Questions remain, however, about other factors affecting the U.S. economy, including the strength of economic expansion abroad, the influence of a declining dollar on inflation here, and the effect of reduced oil prices on the financial health of domestic energy producers and of a number of oil-exporting developing countries.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Economy in 1985

The economy completed a third consecutive year of expansion in 1985, with the real gross national product rising about 2 percent over the year. This rise was sufficient to create 3 million new payroll jobs, and the unemployment rate edged down.

An important achievement of the current recovery has been the sustained expansion of economic activity without any relinquishing of the progress achieved toward the goal of price stability. Most broad measures of price increase indicate that inflation slowed to about a 3½ to 3¾ percent rate in 1985, somewhat less than the pace registered over the previous two years. The containment of inflation has been aided by the high exchange value of the dollar and excess world supplies of many basic materials, which have left prices unchanged or lower for a wide range of imported goods, industrial commodities, agricultural products, and petroleum. More fundamentally, wage increases in the aggregate have been restrained, limiting upward pressure on costs.

Although output and employment continued to grow in 1985, the rate of expansion was slower than some had anticipated and thus raised concerns about the sustainability of the recovery. Furthermore, the pattern of developments in the past year had some disturbing aspects: domestic and foreign demands continued to be diverted away from goods and services produced in the United States, draining income from U.S. households and businesses and exacerbating an inventory correction by U.S. firms as their sales lagged; meanwhile, consumers continued to increase their spending at a substantial clip, but they did so only by borrowing at a pace that pushed household debt burdens to still higher levels.

While the nation as a whole experienced continued growth, the serious sectoral imbalances that had emerged earlier in the recovery became more apparent when gains in activity moderated. Industrial output grew slowly in 1985, and manufacturing and mining employment actually declined during much of the year. The agricultural sector remained under acute pressure; shrinking export markets and abundant harvests pushed prices sharply lower, and as a result, farmers faced mounting difficulties in servicing the large volume of debt they accumulated in the 1970s.

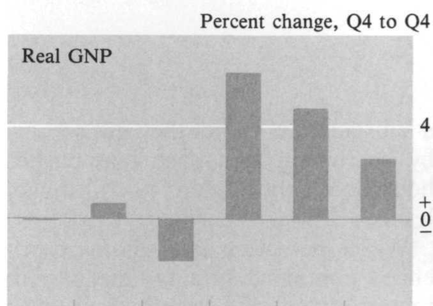
To a considerable extent, these imbalances and stresses are related to fundamental disequilibria in the nation's finances: the continuing huge federal budget deficit and the deterioration in the U.S. current account. During the past year, however, policymakers took important steps to address these problems. The Balanced Budget and Emergency Deficit Control Act established a mechanism for deficit reduction, and the financial authorities of the G-5 nations agreed that steps should be taken that would bring about exchange rates that would better reflect underlying economic relationships.

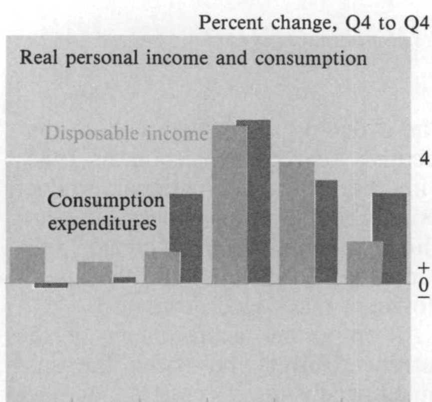
Prices

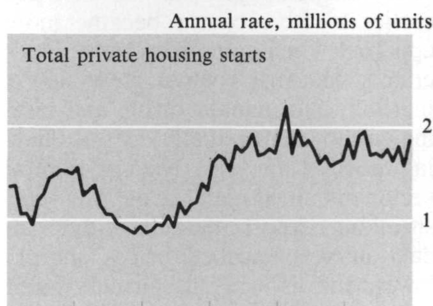
The consumer price index advanced 3¾ percent over 1985, compared with the 4 percent increase of the previous year. The GNP fixed-weight price in-

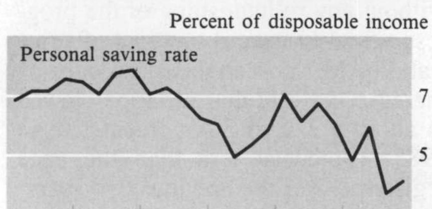
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

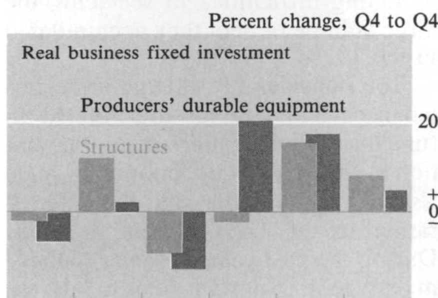
Indicators of Economic Performance

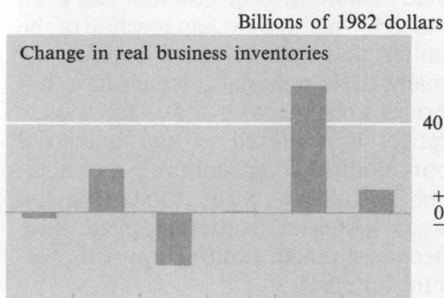


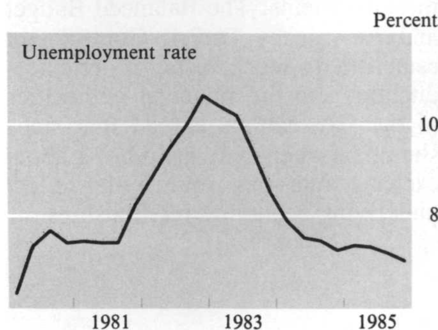


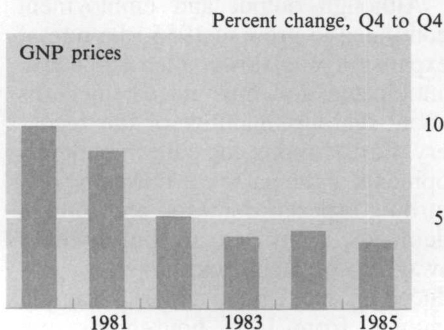












All data are seasonally adjusted, and those that involve dollar amounts are in 1982 dollars. The unemployment data are from the U.S. Department of Labor; the other data are from the U.S. Department of Commerce.

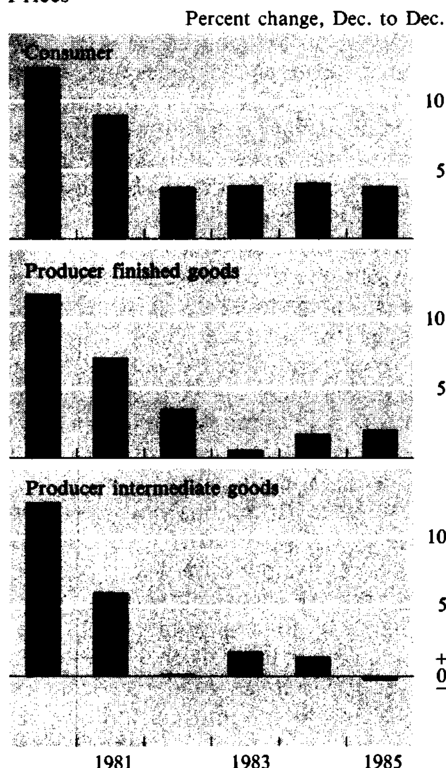
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

dex, which includes production for businesses, government, and export, as well as for consumers, increased 3 1/2 percent, about 1/2 percentage point less than the average increase over the preceding two years. Producer prices of finished goods advanced 1 3/4 percent last year, and prices of intermediate materials were essentially flat.

Progress toward price stability has been sustained by several factors, the most important of which have been subdued inflation expectations, moderate increases in wages, and the influence of the high value of the dollar on the prices of imports and goods that compete with imports. In addition, developments in the food and energy markets continued to restrain overall inflation in 1985. Energy prices showed little change last year; however, a substantial margin of unutilized productive capacity, continued conservation efforts, and the debt-servicing problems of several important oil producers all contributed to a surplus of oil and a sharp break in oil prices on world markets at the end of the year. Crop prices at the farm remained depressed by diminished export demand and high levels of production. Lower prices for crude foods and small increases in processing costs held the increase in retail food prices to 2 3/4 percent last year.

Prices for many basic industrial commodities fell during 1985. Weak expansion of industrial production in the United States and in other major industrial countries limited the growth in demand for raw and semiprocessed materials. Furthermore, the high prices for many raw commodities that prevailed in the 1970s and early 1980s induced a rapid expansion of capacity, particularly in developing countries. With productive capacity in place and with many of these countries facing massive debt-servicing requirements,

Prices



The data are from the U.S. Department of Labor.

supplies of commodities on world markets have remained plentiful.

On balance, price increases outside of the food and energy area held steady in 1985. Consumer prices other than those for food and energy increased about 4 1/2 percent, a bit less than in 1984. The prices of retail goods excluding food and energy were held to a gain of 2 percent last year, at least in part because of small increases or declines in markets where import competition is substantial. Price increases for nonenergy services remained at about a 5 3/4 percent annual rate last year. Capital equipment prices rose 2 3/4 percent, somewhat more than in 1984.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Household Sector

Spending in the household sector remained strong in 1985, despite a sharp slowing in the growth of income. As wage and salary gains slowed, interest income weakened, and farm income plummeted, real disposable income rose only about 1¼ percent, much less than the 4 percent increase of the previous year. Meanwhile, real personal consumption expenditures, buoyed by continued high levels of borrowing, advanced 3 percent—only a little less than in 1984. As a result, the personal saving rate fell to an average of about 4½ percent in 1985, well below historical norms.

The strength in household spending in 1985 reflected further gains in outlays for consumer durables, especially purchases of new automobiles. Sales of new cars totaled more than 11 million units, the strongest selling pace since 1978. Sales of domestic autos picked up to 8¼ million units in response to the general downtrend in interest rates, several rounds of price and financing concessions offered by manufacturers, and increased availability of some models that had been in short supply in 1984. Sales of foreign cars climbed to a record level of more than 2¾ million units for the year; a greater volume of exports to the United States was permitted under the Japanese voluntary restraint program for 1985-86, and this accounted for most of the pickup.

Activity in the housing sector was flat in 1985. The number of new homes started during the year remained at about the 1¾ million unit level of the preceding two years. Construction of single-family housing showed no new strength despite favorable demographic trends and a decline in mortgage rates to their lowest level in six years. A tightening of qualification standards by lenders and mortgage insurers and higher mortgage insurance premiums may have offset some of the effect of lower mortgage rates. Construction of multifamily housing remained at the relatively high level of the two previous years, notwithstanding high and rising vacancy rates for rental units. Rental housing construction was supported by heavy issuance of debt by state and local authorities, partly in anticipation of constraints that would be imposed on such debt by proposed tax reform legislation.

Business Sector

Economic conditions in the business sector were mixed in 1985. After-tax economic profits of nonfinancial corporations as a group increased sharply for a third consecutive year, to the highest percent of GNP since the late 1960s. Many firms in manufacturing and mining industries, however, encountered significant difficulties brought about by the high value of the dollar. In addition to the influence of the exchange rate, pressure on prices and profits in the agricultural and energy sectors was exacerbated by ample supplies in world markets.

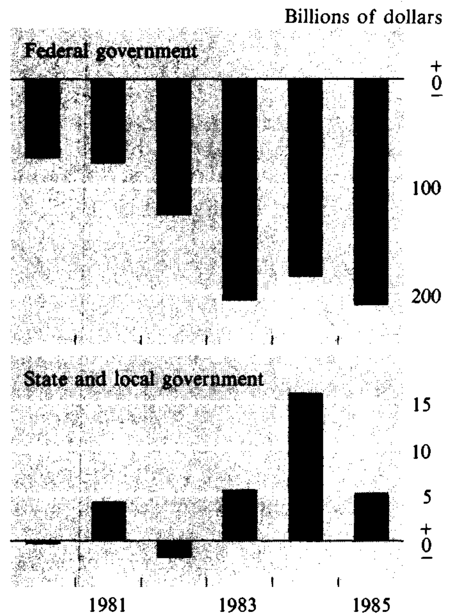
Business spending for equipment and structures rose 6¼ percent in real terms in 1985, supported by falling interest rates, declining relative prices for capital equipment, and continued efforts to modernize facilities in order to meet intensified competition. Nevertheless, the growth in business fixed investment was well below the extraordinary pace of the preceding two years. Furthermore, the slowdown in capital outlays was widespread and occurred in many categories of high-technology equipment, heavy industrial machinery, and structures. Some

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

deceleration of investment spending can be expected as an expansion progresses and the growth of sales subsides to more sustainable rates. However, declining capacity utilization further slowed the pace of investment in 1985 in the industrial sector, and rising vacancy rates for office buildings contributed to slower growth in expenditures for nonresidential structures.

Businesses accumulated inventories at a much reduced pace in 1985, particularly in the manufacturing sector. In real terms, nonfarm business inventories rose $10½ billion, after the large investment of $56 billion in 1984. In the manufacturing sector, sluggish orders and stable or falling prices induced a cautious approach to inventory accumulation; factory inventories declined over the second half of 1985 and were little changed on balance for the year as a whole. Stocks in the trade sector increased over the year, boosted by a large rise in auto inventories in the fourth quarter. Excluding autos, inventories at retail establishments increased about in line with the moderate rise in sales.

Government Surpluses and Deficits



The data on the federal government deficit are for fiscal years and are on a budget basis; they are from the U.S. Department of the Treasury.

The data on state and local governments are for operating budgets. They are on a national income accounts basis, and they come from the U.S. Department of Commerce.

Government Sector

The federal budget deficit rose to $212 billion in fiscal year 1985. Although the economic expansion continued to boost receipts, outlays rose even faster, with large increases in agricultural support payments, interest payments, and defense purchases. The deficit remained at a historically high 5 percent of GNP, absorbing a large share of the net saving available to the domestic economy.

Purchases of goods and services by the federal government, which add directly to GNP and constitute one-third of total federal expenditures, posted another strong advance in 1985. Excluding changes in farm inventories held by the Commodity Credit Corporation (CCC), federal purchases were up 3¼ percent over the year, after adjustment for inflation. Defense outlays, which increased 6 percent over the year, continued to provide a major boost to federal purchases. CCC purchases rose sharply as low market prices encouraged farmers to shift massive inventories of grain to the federal government.

State and local governments increased their purchases of goods and services 2½ percent in 1985, a somewhat smaller rise than in the preceding year. Most of the growth in expenditures last year reflected strong increases in construction outlays as states and localities continued their ef-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

forts to improve and expand basic public facilities. With the rise in expenditures exceeding the growth in receipts, the fiscal position of state and local governments weakened throughout the year; aggregate operating and capital account surpluses, which had risen to substantial levels in 1984, were virtually eliminated by the end of 1985.

Foreign Sector

After registering particularly sharp gains toward the end of 1984 and in the first two months of 1985, the dollar generally fell in international currency trading throughout the remainder of last year. By the end of 1985 the trade-weighted foreign exchange value of the dollar had fallen nearly 25 percent from its peak in February, retracing about half of the appreciation that had occurred since the end of 1980. The decline in the dollar in 1985 occurred against the backdrop of a narrowing of the differential between inflation-adjusted long-term interest rates in the United States and those in other industrial countries, which at least in part reflected the slowing of economic growth in the United States relative to growth abroad.

With the dollar still relatively strong, the external position of the United States continued to deteriorate last year. The widening gap between imports and exports boosted the current account deficit to $118 billion, compared with $107 billion in 1984.

The volume of merchandise exports declined in 1985. With U.S. prices relatively high and world supplies abundant, agricultural exports fell abruptly. Exports of nonagricultural goods were essentially unchanged as the continuing effects of the dollar's earlier appreciation, combined with relatively moderate growth in other industrial countries, on average, limited the expansion of markets for U.S. products. Furthermore, economic growth in developing nations recovered only a bit, as many countries continued to face difficult debt-servicing problems externally and strong inflationary pressures at home.

Merchandise imports continued to rise in 1985, increasing about 3½ percent in real terms over the 1984 level. Imports of consumer goods rose strongly while imports of capital equipment and industrial materials posted smaller increases, and oil imports declined. Although prices of imported goods fell for the year as a whole, some firming in the prices of manufactured imports became apparent toward the end of the year, reflecting the effects of the decline in the value of the dollar.

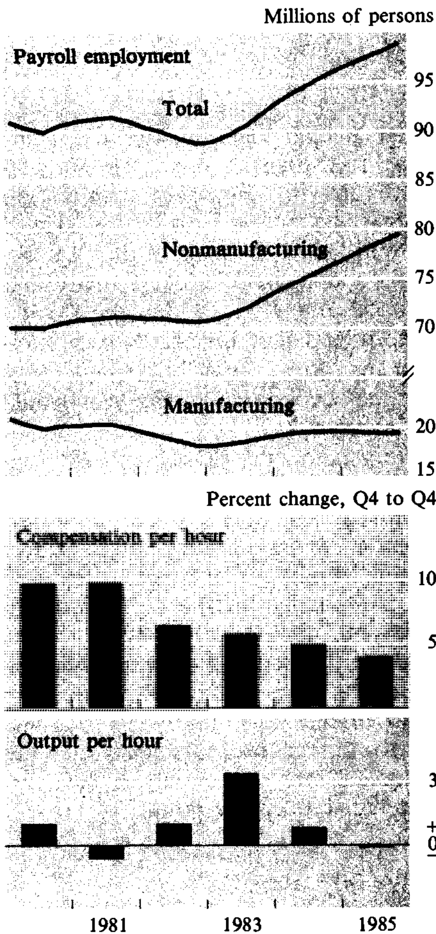
Labor Markets

With the economy continuing to expand, developments in labor markets remained generally favorable in 1985. Gains in employment exceeded the growth of the labor force, causing the unemployment rate to drift down over the year. Labor force participation maintained its upward trend; women continued to enter the workforce in large numbers, in part responding to expanding job opportunities. Over all, the number of persons employed relative to the population rose to a record level.

Nonfarm payrolls expanded 3 million in 1985, somewhat below the unprecedented hiring rate during the first two years of the recovery. Although growth in aggregate employment continued, the composition of the gains reflected the unevenness of the current

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Labor Market Conditions



Payroll employment covers the total nonfarm sector; hourly compensation and output cover the nonfarm business sector. All data are from the U.S. Department of Labor.

expansion. Employment in the trade and service sectors accounted for more than two-thirds of the growth in payrolls last year. Government employment rose nearly one-half million, primarily because of increased payrolls of state and local governments. By contrast, the weak expansion of output in manufacturing resulted in some trimming of employment over the first three quarters of the year. Although an upturn in manufacturing jobs began in the fall, employment in that sector was down about 180,000 over the year.

Wage increases remained restrained in most segments of the labor market in 1985, despite a further reduction in the unemployment rate. Hourly compensation in the private sector, as measured by the employment cost index, rose about 4 percent, 1 percentage point less than in 1984. Nearly all of the deceleration of compensation per hour last year reflected a slowing in the growth of fringe benefits; wage rates increased at about the 1984 pace. To a large extent, the recent slowing in the growth of benefits has resulted from lower health care expenses for employers, as cost-sharing arrangements shifted greater responsibilities to employees and programs to contain hospital costs became more widespread.

Meanwhile, labor productivity was nearly unchanged in 1985, after increasing substantially earlier in the recovery. When viewed over a longer period, the underlying trend in productivity in recent years appears to have improved a little from the very low pace of the 1970s, but it has remained well below the pace earlier in the postwar period. Management and workers have responded to a more competitive environment by modernizing plant and equipment, improving operational efficiency, and making work rules more flexible. Unit labor costs in the nonfarm business sector rose 4 percent in 1985, a larger increase than during the previous two years but well under the growth of the early 1980s.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Monetary Policy and Financial Markets

At its meeting in February 1985 the Federal Open Market Committee established ranges for growth of money and credit during the year, measured from the fourth quarter of 1984 to the fourth quarter of 1985, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3. The associated monitoring range for the debt of domestic nonfinancial sectors was set at 9 to 12 percent. These growth ranges were designed to be consistent with further sustainable economic growth and progress toward reasonable price stability over time.

In July the Committee reaffirmed the ranges for M2, M3, and debt but established a new M1 growth range of 3 to 8 percent, measured at an annual rate, from the second to the fourth quarter of the year. Over the first half of the year, M1 had grown well above the upper end of its range, and velocity had registered an unusually steep decline. These developments apparently reflected substantial additions to money balances, especially interest-earning transaction balances, that were spurred by the sharp drop in interest rates since mid-1984. The M1 objective for the second half of the year anticipated a considerable slowing of money growth, on the assumption that historically more normal behavior in the velocity of M1 would reemerge. The Committee signaled continued uncertainty about the behavior of the aggregate, however, by widening the M1 range 2 percentage points.

The unusual behavior of M1 in fact persisted over the second half of the year: growth in the aggregate did not slow, and its velocity registered an even steeper decline. At the same time, the broader monetary aggregates were growing generally within their ranges, economic growth had slowed to well below the pace of the year before, and upward price pressures remained muted. In the fall the FOMC determined that under these circumstances, growth in M1 above its range for the second half of the year would be acceptable.

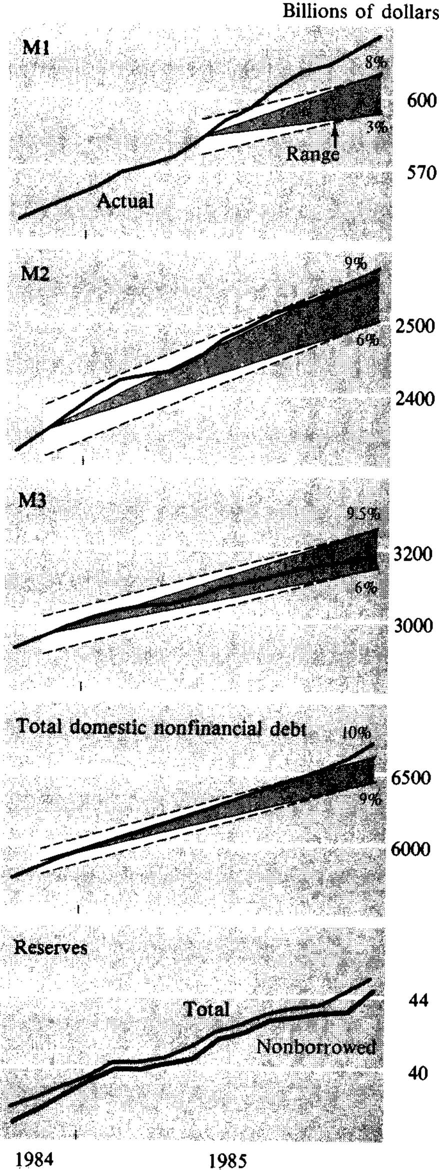
In general, the FOMC in 1985 emphasized the need to evaluate growth in all the aggregates in light of developments in the economy and in prices, and of conditions in financial and foreign exchange markets. Throughout the year, monetary policy remained generally accommodative to emerging demands for money. Pressures on bank reserve positions were varied in a narrow range over the year, and the discount rate was reduced once, by one-half percentage point.

Monetary Aggregates

M1 increased at an annual rate of 12.8 percent from the second to the fourth quarter of 1985, compared with its range of 3 to 8 percent for this period; growth for the year as a whole came to 11.9 percent. Much of the unusually strong growth in M1 and the accompanying decline in velocity seemed to be attributable to lower interest rates, though expansion in the aggregate was stronger, particularly in the second half of the year, than historical evidence on its relationship to income and interest rates would have suggested. M1 may have become more sensitive to changes in market rates in recent years owing to the deregulation

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Monetary Aggregates, Nonfinancial Sector Debt, and Reserves



The ranges adopted by the FOMC for the monetary aggregates and for total debt of the domestic nonfinancial sector were for the period from 1984:4 to 1985:4, except for M1, which was for 1985:2 to 1985:4.

The reserve aggregates have been adjusted to remove discontinuities associated with changes in reserve requirements. Nonborrowed reserves include extended credit. The shaded area is adjustment and seasonal borrowing.

of certain transaction accounts. By reducing the opportunity cost of holding transaction balances, the creation of NOW and Super NOW accounts has made M1 a much more attractive savings vehicle for households. Moreover, with the rates on NOW accounts fixed and those on Super NOWs being adjusted sluggishly to changing conditions, falling interest rates have led to relatively substantial reductions in incentives to economize on M1 balances, with accompanying declines in velocity. However, as both money holders and depository institutions adapt to the elimination of important regulatory constraints, considerable uncertainty unavoidably persists regarding the response of M1 to variations in interest rates or income.

In 1985 the interaction of lower market interest rates with deregulated transaction deposit rates seemed to induce especially heavy inflows to interest-bearing checkable accounts. Spreads between offering rates on these deposits and interest rates on time deposits and market instruments, narrow by the standards of recent decades, apparently diminished the incentives to keep savings in longer-term instruments as well as to separate savings from transaction balances. Demand deposits also contributed to the increase in M1 last year, registering unusually rapid growth, especially in the second half. Business demand balances paced the rise, likely reflecting not only the cumulative effect of lower interest rates on incentives to economize on demand deposits and on compensating balance requirements, but also generally more cautious cash management practices, adopted possibly in part because banks and corporations sought to reduce risk in response to financial problems that had developed in certain areas of the market.

M2 grew 8.6 percent in 1985, a rate

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Reserves, Money Stock, and Debt Aggregates

Annual rate of change based on seasonally adjusted data unless otherwise noted, in percent[1]

Item	1983	1984	1985	1984	1985			
				Q4	Q1	Q2	Q3	Q4
Depository institution reserves[2]								
Total	6.5	6.6	15.3	3.8	17.4	12.2	16.4	12.1
Nonborrowed	5.9	4.0	26.8	36.3	57.3	14.1	18.2	9.9
Required	6.3	6.1	15.1	3.0	16.9	12.3	17.1	11.1
Monetary base[3]	9.3	7.1	8.8	4.6	8.8	7.5	9.7	8.1
Concepts of money[4]								
M1	10.4	5.4	11.9	4.5	10.1	10.5	14.5	10.6
Currency and travelers checks	10.3	7.2	7.5	5.1	6.8	6.7	8.3	7.4
Demand deposits	2.7	1.5	8.6	1.1	5.5	7.8	12.4	7.7
Other checkable deposits	28.8	10.8	22.2	10.0	21.1	18.7	23.9	18.8
M2	12.2	8.0	8.6	9.7	11.6	6.3	9.5	6.0
Non-M1 component	12.8	8.8	7.6	11.3	12.1	5.0	8.0	4.6
MMDAs (n.s.a.), savings, and small-denomination time deposits	18.0	8.0	7.1	9.5	11.8	6.1	6.3	3.3
General-purpose and broker/dealer money market mutual fund assets (n.s.a.)	−26.3	17.0	9.3	28.3	32.7	−.7	4.1	.9
Overnight RPs and Eurodollars (n.s.a.)	31.7	4.7	18.5	−7.7	47.6	−17.8	18.7	23.6
M3	9.9	10.5	7.7	10.5	10.2	5.5	7.6	6.5
Non-M2 component	1.0	21.2	3.9	13.4	4.4	2.6	.2	8.2
Large-denomination time deposits	−2.1	26.0	5.7	15.9	7.8	6.4	−2.7	10.8
Institution-only money market mutual fund assets (n.s.a.)	−16.6	33.6	11.1	97.4	31.2	7.7	1.3	3.1
Large denomination term RPs (n.s.a.)	39.1	36.7	4.4	11.9	−42.1	−3.4	−7.6	39.2
Term Eurodollars (n.s.a.)	8.2	−8.4	3.7	−22.6	2.9	−9.2	−4.0	−4.5
Domestic nonfinancial sector debt	11.2	14.3	13.9	14.1	13.7	12.1	12.9	14.4
Federal	21.5	15.8	15.2	16.2	15.3	12.5	14.6	15.0
Nonfederal	8.5	13.8	13.6	13.5	13.2	12.0	12.3	14.2

1. Changes are calculated from the average amounts outstanding in each quarter. Annual changes are measured from Q4 to Q4.

2. Data on reserves and the monetary base incorporate adjustments for discontinuities associated with the implementation of the Monetary Control Act and other regulatory changes to reserve requirements.

3. The monetary base consists of total reserves plus required clearing balances and adjustments to compensate for float at Federal Reserve Banks plus the currency component of the money stock less the amount of vault cash holdings of thrift institutions that is included in the currency component of the money stock plus, for institutions not having required reserve balances, the excess of current vault cash over the amount applied to satisfy current reserve requirements.

4. M1 consists of currency in circulation; travelers checks of nonbank issuers; demand deposits at all commercial banks other than those due to domestic banks, the U.S. government, and foreign banks and official institutions, less cash items in the process of collection and Federal Reserve float; and other checkable deposits, which consist of negotiable orders of withdrawal and automatic transfer service accounts at depository institutions, credit union share draft accounts, and demand deposits at thrift institutions. M2 is M1 plus money market deposit accounts (MMDAs); savings and small-denomination time deposits at all depository institutions (including retail repurchase agreements), from which have been subtracted all individual retirement accounts (IRAs) and Keogh accounts at commercial banks and thrift institutions; taxable and tax-exempt general-purpose and broker/dealer money market mutual funds, excluding IRAs and Keogh accounts; overnight and continuing-contract RPs issued by commercial banks; and overnight Eurodollars issued to U.S. residents by foreign branches of U.S. banks worldwide. M3 is M2 plus large-denomination time deposits at all depository institutions; assets of institution-only money market mutual funds; large-denomination term RPs issued by commercial banks and thrift institutions; and term Eurodollars held by U.S. residents in Canada and the United Kingdom and at foreign branches of U.S. banks elsewhere.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in the upper part of its range, as its nontransaction (non-M1) component increased 7.6 percent. The shift toward more liquid assets evident in the rapid rise of M1 also affected the distribution of deposits within the nontransaction portion of M2. Small time deposits declined, while some very liquid components, such as money market deposit accounts, showed very large increases; even savings deposits rose (by 4¼ percent) after several years of decline. However, growth of M2 appears to have been restrained by some redirection of household portfolios toward such non-M2 instruments as shares in stock and bond mutual funds.

M3 growth slowed to 7¾ percent last year—close to the midpoint of its range—reflecting in part a slower pace of credit expansion at depository institutions and consequently a reduced need to raise funds through issuance of managed liabilities. Thrift institutions, in particular, greatly reduced their net acquisition of assets, partly in response to new regulations by the Federal Home Loan Bank Board that raised capital requirements for rapidly growing institutions. The growth of large time deposits issued by thrift institutions slowed to less than 7 percent in 1985 from the nearly 50 percent pace recorded in the preceding year.

In implementing monetary policy during 1985 the Federal Reserve basically accommodated the strong demands for reserves by depository institutions. In the early part of the year—when M1 expansion was very rapid, and M2 and M3 growth was also strong—interest rates rose somewhat. However, these increases were more than reversed later in the first half, a movement influenced in part by a cut in the discount rate from 8 to 7½ percent in May, as economic activity appeared more sluggish, partly reflecting the drag from the relatively high value of the dollar on exchange markets. Growth of the broader aggregates had slowed appreciably after the early part of the year, though M1 remained well above its range. On balance, over the first six months of the year most market interest rates fell about 1 percentage point, leaving them about 3 to 4 percentage points below their mid-1984 levels. The dollar, which had risen sharply on exchange markets through February, declined thereafter and by midyear was 9 percent below its February peak on a trade-weighted basis, leaving it just under its level at the end of 1984.

When the FOMC at its July meeting reaffirmed its ranges for M2, M3, and debt and widened and rebased the M1 range, the members anticipated that these ranges would be consistent with continued subdued inflation and some pickup in economic growth from the sluggish pace of the first half. As the summer progressed, however, it became clear that the demand for M1 remained strong. After slowing somewhat in July, M1 spurted again in August and continued to rise at a double-digit annual rate in September. M2 growth also was stronger during the summer, climbing above its range.

In the summer also, market interest rates reversed a portion of their earlier declines. With both M1 and M2 growing relatively rapidly, economic activity apparently picking up, and the dollar having declined further, the Federal Reserve for a time was a bit more cautious in providing reserves. But beginning around mid-autumn, the Federal Reserve was seeking a slight easing in bank reserve conditions, as incoming data suggested that increases in economic activity would continue to be relatively moderate, and upward price pressures remained subdued. Meanwhile, M1 growth was

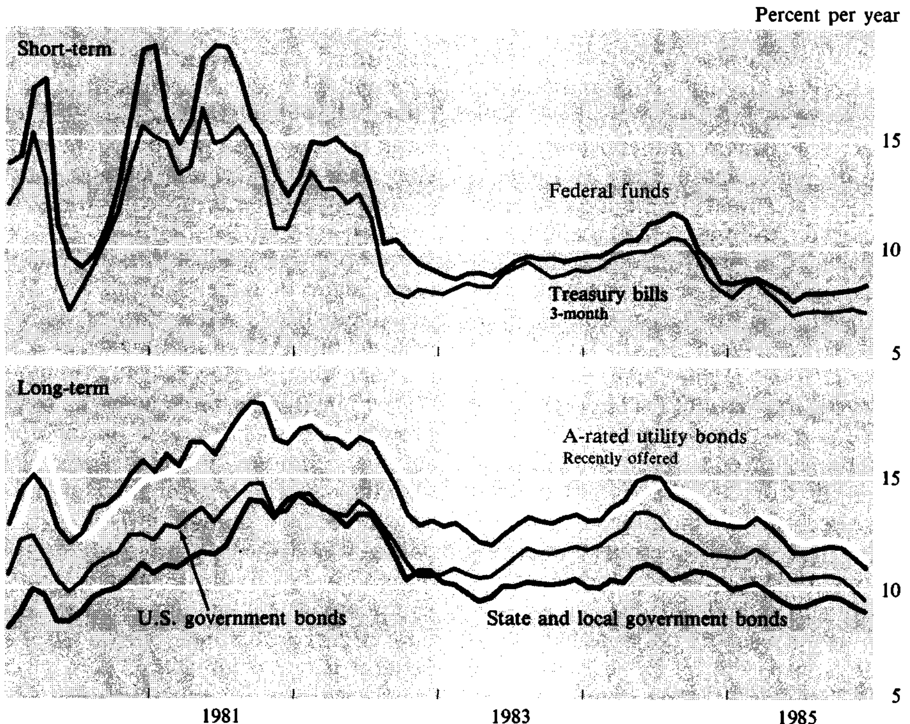
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

continuing strong on balance, but growth in the broader aggregates was slowing.

On balance, over the second half of the year most short-term rates were little changed; they ended the year just slightly above their midyear lows and about 1 percentage point below their levels when 1985 began. However, on exchange markets the dollar declined more than 15 percent over the second half, impelled largely by the G-5 announcement in September indicating the desirability of some appreciation of other currencies relative to the dollar and by the ensuing coordinated intervention by the United States and other key industrial countries.

In long-term debt markets, interest rates generally fell 1 percentage point or more on balance over the second half, with most of the decline occurring during a fourth-quarter rally that accelerated as the year drew to a close. The downward movement in long-term rates and the simultaneous explosion in stock market prices were fueled in part by legislation to mandate reductions in the federal deficit and pare the government's demands on credit mar-

Interest Rates



All the data are monthly averages. Their descriptions and sources are as follows: Federal funds, from the Federal Reserve; three-month Treasury bills, market rate on three-month issues, on a discounted basis, from the U.S. Department of the Treasury; conventional mortgages, weighted averages of 30-year, fixed-rate, level-payment mortgages at savings and loan associations, from the Federal Home Loan Mortgage Corporation; A-rated utility bonds, weighted averages of recently offered, 30-year investment-grade bonds adjusted to an A-rated basis by the Federal Reserve; U.S. government bonds, market yields adjusted to 30-year constant maturity by the U.S. Treasury; state and local government bonds, index based on 25 issues of 30-year revenue bonds of mixed quality, from the *Bond Buyer*.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

kets. Declining world oil prices and the continued softness in markets for other commodities, which promoted expectations of lower inflation among market participants, also contributed to the rally.

Aggregate Credit Flows

Expansion in the debt of domestic nonfinancial sectors in 1985 moderated only a little from its elevated 1984 pace and, at 14 percent, exceeded its monitoring range of 9 to 12 percent. Last year was the fourth consecutive year in which debt expanded more rapidly than GNP, after more than 20 years in which the ratio of debt to GNP had been generally stable. One factor boosting debt growth relative to spending was the extraordinary pace of corporate borrowing to retire equity in mergers, buyouts, and stock repurchases. In addition, borrowing surged late last year in the tax-exempt market, where issuance was accelerated into 1985 in anticipation of possible changes in the tax law. Even after allowance for these two factors, which together may have accounted for roughly 2 percentage points of the 1985 growth in debt, the expansion of the debt of domestic nonfinancial sectors remained very strong. Another important element in the continued rapid growth of debt and the rise in its ratio to GNP has been the huge federal deficits. Although the growth of federal debt has slowed since 1982, it continued to exceed 15 percent last year.

Corporations reduced their demands on credit markets in 1985 as strengthening profits and weaker capital expenditures narrowed the sector's financing gap. Nevertheless, business borrowing to finance stock retirements remained high—perhaps $80 billion in each of the last two years. Spurred by the drop in long-term rates to six-year lows, corporate credit demands focused on the bond markets. Record amounts of securities were offered publicly by nonfinancial firms in both the domestic and the Eurobond markets last year. On the other hand, short-term borrowing slowed, with bank loans to businesses relatively low.

Tax-exempt borrowing was extraordinarily strong almost all of last year, and the surge in bond offerings late in the year lifted 1985 volume to a record high. While more favorable interest rates stimulated borrowing generally, the efforts to finance in advance of the possible restrictions that were scheduled to take effect after year-end boosted advance refunding and private-purpose issues in particular.

Households continued to borrow heavily in 1985. Consumer installment debt climbed sharply again in 1985, at a pace near the 20 percent rate recorded in 1984. But the growth of home mortgage borrowing, while near its 1983-84 average, was probably restrained somewhat by the tightening of lending standards that accompanied the rise of mortgage loan delinquency rates to record levels.

Growth in the financial assets of households more than kept pace with the rapid rise in debt over the past two years. In particular, the sizable gains in the stock and bond markets in 1985 raised household wealth substantially. Indications of debt-servicing difficulties in the household sector have mounted, however. Delinquency rates on consumer installment loans have been on the rise since mid-1984 and have reached relatively high levels for some categories such as bank credit cards. Moreover, mortgage loan delinquencies remain at the historically high levels that have prevailed since

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the 1981-82 recession, associated with the influence of lingering high rates of unemployment in some communities, slow income growth, and weak housing prices in certain areas of the country. At the same time, surveys of households continue to show favorable readings on attitudes concerning financial positions, which suggests that these financial strains are currently limited to a small part of the population.

Strains in financial markets were evident at times in 1985 but did not cause major disruptions in overall market conditions. Financial market concern over credit quality was not severe enough to be reflected in a broad-based widening of spreads between yields on corporate and Treasury debt, or between yields on private-sector securities of different risk classes. Nevertheless, the agricultural sector of the economy continued to experience serious financial distress and there were occasional pressures on some segments of the financial community.

In Ohio early in the year, and later in Maryland, privately insured savings and loan associations were closed or limited to small withdrawals after runs by depositors in both states. The problem in Ohio was triggered by news of losses at one large thrift institution. Problems developed in Maryland when heightened anxieties in the aftermath of the Ohio crisis combined with news of difficulties at a local savings and loan. As the problems emerged, the Federal Reserve advanced funds at the discount window to bolster the liquidity of the affected institutions. The loans—whose expansive effect on reserves was offset through open market operations—have been repaid in Ohio, where the troubled institutions have been restructured and reopened, but they remain outstanding at a number of Maryland thrift institutions.

The thrift industry as a whole experienced some improvement in earnings and capital positions last year, although many institutions remained heavily burdened with assets of low quality or low yield. Lower interest rates lifted their profits from the depressed levels of 1984 by reducing the cost of funds and generating capital gains on sales of assets.

The profitability of commercial banks also increased in 1985, breaking the downtrend of recent years. Asset quality remained a concern for some institutions, however, and was a major factor in the sharp increase in the number of bank failures. Banks again increased the rates at which they charged off bad loans and added to loan-loss reserves, responding to continued financial strains in such sectors as agriculture, energy, and real estate. Higher profits along with the rallies in the stock and bond markets helped many banks improve their capital positions in 1985, which facilitated their efforts to comply with more stringent capital adequacy guidelines. As part of its efforts to ensure the continued safety and soundness of the financial system, the Federal Reserve also initiated a program to strengthen supervision of commercial banking operations.

Agricultural finances drew special attention last year. Farm income remained depressed, and falling prices for agricultural products left many farmers unable to meet their debt-servicing requirements. Moreover, declining land prices eroded the value of collateral behind many agricultural loans. Consequently, failures of banks with relatively high proportions of agricultural loans in their portfolios rose to 68 in 1985, from 32 in 1984 and an average of only 6 in each of the preceding three years. The Farm Credit System, which holds about one-third

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of U.S. farm debt, suffered mounting losses and requested federal aid. Farm Credit securities, which had been priced very close to Treasury issues of comparable maturity, yielded as much as 100 basis points more than Treasury debt at one point in the fall. Rate spreads narrowed in December, after passage of legislation enabling the Farm Credit System to mobilize its resources more readily and providing for the possibility of a backup source of assistance once internal sources of funds are exhausted.

To ease possible constraints on the availability of credit at agricultural banks over the 1985 growing season, the Federal Reserve in March liberalized its regular seasonal borrowing program and initiated a temporary special seasonal program aimed at making liquidity available to agricultural banks that might experience strong loan demand. Although total seasonal borrowing fell short of the unusually high level in 1984, evidence suggests that these actions increased access to seasonal credit, boosting borrowing somewhat above what would otherwise have been expected given money market conditions and overall slack loan demand by farmers. In early 1986 the Federal Reserve renewed the temporary seasonal program to assure that agricultural banks would not face liquidity constraints in accommodating the needs of their farm borrowers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

International Developments

The year 1985 was marked by a substantial depreciation of the dollar on foreign exchange markets. After soaring to new highs in January and February, the dollar declined sharply through the remainder of the year, though by year-end it was still nearly 40 percent above its fourth-quarter 1980 level on a trade-weighted average basis against major foreign currencies.

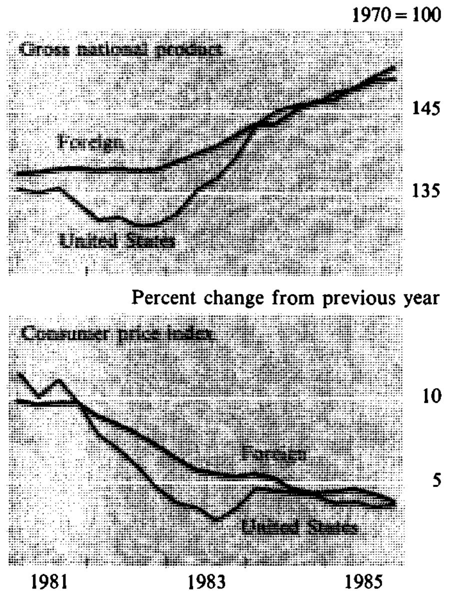
Although economic activity in major industrial countries grew at a stronger pace than in the United States, and growth in developing countries recovered somewhat, the United States had record trade and current account deficits, reflecting the lagged effects of the dollar's earlier appreciation. By the fourth quarter, however, signs of an upturn in U.S. import prices emerged, showing the first effects of the dollar's depreciation during 1985 and pointing toward a reduction of the external deficits expected to begin during the course of 1986.

Real economic activity abroad continued to expand at a moderate rate, but relative strength shifted significantly across the major industrial countries. In Japan, where growth during the recovery had been strongest among the major foreign industrial countries, real GNP slowed somewhat from its pace in 1984. In contrast, economic activity in Germany recovered in the second quarter, from a decline earlier in the year that had resulted in part from a particularly severe winter, and then strengthened further during the rest of the year. The ending in March of a prolonged miners' strike in the United Kingdom contributed importantly to U.K. economic growth that was faster than in the previous year.

Despite moderate economic growth, unemployment rates abroad stayed close to the historically high levels of recent years. In Germany and the United Kingdom, unemployment rates remained about unchanged throughout the year, while in Japan the rate edged up slightly during the second half of 1985. In Canada, and to a lesser extent in France, some reduction in the rate of unemployment did occur.

The rate of inflation in the major foreign industrial countries on balance fell further in 1985. In several coun-

GNP and Prices



Foreign data are multilaterally weighted averages for 10 industrial countries, using 1972–76 total trade weights.

Data for the United States are from the U.S. Departments of Commerce and Labor.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tries rates dropped to levels not experienced in more than a decade. The moderate pace of the recovery, the appreciation against the dollar of the currencies of most of these countries, weakness in world oil and other commodity prices, and continued slack in labor markets, particularly in the European economies, were all factors contributing to the deceleration of price increases.

Money growth abroad remained generally moderate. With a few exceptions, growth of specific aggregates was within announced targets, which most often were equal to or slightly below targets set for the previous year. Fiscal policy measures led to government deficits that, as a fraction of GNP, were about unchanged or further reduced in the major foreign industrial countries.

Significantly larger current account surpluses in several foreign industrial countries corresponded in the aggregate to the greater U.S. current account deficit. The largest gain was in Japan, where the surplus rose from $35 billion in 1984 to about $50 billion. The German current account surplus more than doubled from its level of $6 billion in 1984, and that of the United Kingdom also increased substantially.

The continued current account deficit of non-OPEC developing countries widened somewhat in 1985 as compared with 1984 but remained considerably below the large imbalances of the 1980–82 period. The widening of the current account deficit last year reflected mainly a decline in export revenues, much of which can be traced to an economic slowdown in industrial countries and a substantial decline in primary commodity prices from their 1984 level. With exchange rates often linked to the U.S. dollar, most major countries of Latin America and East Asia permitted some deterioration of their international trade competitiveness early in the year but, following the downward trend of the dollar after February, showed a dramatic net improvement in their export competitiveness over the year as a whole.

Growth in developing countries remained moderate in 1985. Inflation remained a problem in several countries, with rates of inflation rising in Brazil and Yugoslavia and remaining high in Mexico. In contrast, Argentina instituted a monetary reform in mid-1985, which facilitated a dramatic reduction in its inflation rate.

The problems associated with the large volume of external debt of developing countries remained one of the most important issues in international finance in 1985. Despite a significant decline in interest rates in 1985, a number of developing countries with large external debts found it difficult to implement consistently the economic adjustment programs begun in 1982–83 because levels of economic activity and living standards remained low compared with those of the late 1970s. Partly in response to these continuing strains, U.S. Treasury Secretary Baker proposed a strengthening of the overall debt strategy at the annual meetings of the International Monetary Fund and World Bank held in Seoul in October 1985. The initiative retains the case-by-case approach to the debt problems of individual countries that has been followed since 1982. Under the plan, commercial banks and multilateral development banks, especially the World Bank, would provide significant additional external financing in the 1986–88 period. This additional financing would facilitate and encourage new efforts by the participating developing countries

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to implement structural reforms in their economies that would lead to higher sustainable growth rates. Since the emphasis would be on increased medium-term structural reforms, the World Bank would have a larger role to play than it had previously in the management of the debt problem of developing countries. The International Monetary Fund would continue its role in the formulation and implementation of sound macroeconomic policies.

In early 1986, Argentina, Mexico, and several smaller countries were working closely with the IMF and the World Bank to formulate programs that might attract the increased financing envisaged by the Baker initiative. For Mexico the sharp drop in oil prices that occurred during the first two months of 1986 has made it more difficult to formulate policies in the longer-term context.

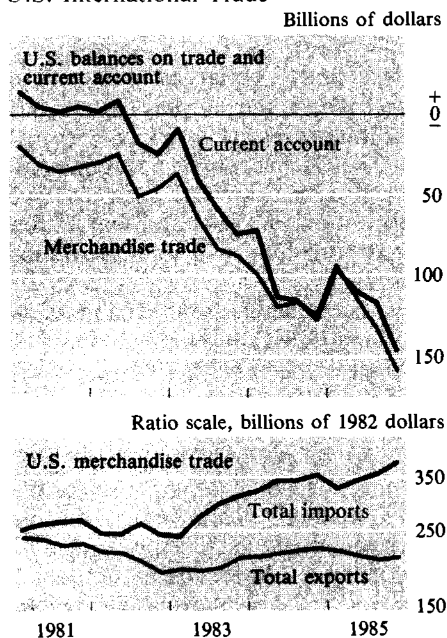
U.S. International Transactions

The U.S. merchandise trade and current account deficits widened further in 1985. A $6 billion decline in merchandise exports and a small increase in merchandise imports yielded a trade deficit of $124 billion, compared with a deficit of $114 billion in 1984. The current account deficit was $118 billion, up from $107 billion in 1984.

The decline of exports in 1985 largely reflected a sharp drop in the value of agricultural exports—25 percent, about half in price and half in volume. Ample foreign supplies, relatively high U.S. price support levels for various crops, and the effect on prices of the high exchange value of the dollar seriously affected the ability of U.S. farmers to market their goods abroad. The value of nonagricultural exports in 1985 was only marginally higher than in 1984. Economic activity in major industrial countries expanded at about the same 3 percent rate as in the previous few years, but demand for U.S. goods was restrained by the cumulative effect of the dollar's appreciation through early 1985 on the foreign-currency price of U.S. goods. In 1985 the volume of nonagricultural exports was about the same as in 1984; the average price increased about 1 percent.

The small increase in the value of imports in 1985 reflected an expansion in volume that was almost entirely offset by a decline in import prices for the year as a whole. The volume of imports increased 4 percent in 1985 compared with a 25 percent increase in 1984. The volume of non-oil imports in 1985 responded to the slower

U.S. International Trade



Data are seasonally adjusted at annual rates and are from the U.S. Department of Commerce.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

U.S. International Transactions[1]
Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
			1984	1985			
	1984	1985	Q4	Q1	Q2	Q3	Q4
Current account	**−107**	**−118**	**−32**	**−24**	**−28**	**−29**	**−37**
Merchandise trade balance	−114	−124	−31	−23	−28	−33	−39
Exports	220	214	56	55	54	52	53
Imports	334	338	87	78	82	85	92
Investment income (net)	19	25	4	3	5	9	8
Direct investment, net	13	26	3	2	6	9	9
Portfolio investment, net	6	−1	1	*	*	*	−1
Other services (including military transactions)	−1	−3	−1	*	−1	−1	−1
Unilateral transfers, private and government	−11	−15	−4	−3	−3	−4	−4
Private capital flows	**82**	**93**	**13**	**26**	**17**	**20**	**31**
Bank-reported capital, net (outflows, −)	23	35	−1	13	4	5	12
U.S. net purchases (−) of foreign securities	−5	−8	−4	−2	−2	−2	−1
Foreign net purchases (+) of U.S. Treasury securities	22	21	10	3	5	7	6
Foreign net purchases of U.S. corporate bonds	14	46	10	11	7	10	18
Foreign net purchases of U.S. corporate stocks	−1	5	−1	−1	*	1	4
U.S. direct investment abroad	−5	−19	−5	2	−5	−7	−9
Foreign direct investment in United States	23	16	5	2	7	6	1
Other corporate capital flows, net	11	n.a.	−1	−1	1	−1	n.a.
Foreign official assets in United States (increase, +)	3	−2	7	−11	8	2	−2
U.S. official reserve assets, net (increase, −)	−3	−4	−1	*	*	*	−3
U.S. government foreign credits and other claims, net	−6	−3	−1	−1	−1	*	−1
Seasonal adjustment discrepancy	...	...	4	*	−1	−4	5
Statistical discrepancy	30	33	9	11	4	11	6

1. Details may not add to totals because of rounding.
*Less than $50 million.

SOURCE. U.S. Department of Commerce, Bureau of Economic Analysis.

rate of U.S. economic growth than in 1984 and the lagged effects of the appreciation of the dollar that occurred through early 1985. While imports of consumer goods and automotive products increased fairly strongly in 1985, imports of industrial supplies (excluding oil) and capital goods increased only fractionally and imports of oil declined. Sagging prices in world oil markets early in the year, a potential for further price declines, and slower U.S. growth helped reduce demand for imported oil in 1985. The depreciation of the dollar from its February 1985 peak began to reduce the price competitiveness of foreign goods noticeably toward the end of the year. After a prolonged period of weakness, import prices turned up in the fourth quarter of 1985, particularly for various types of manufactured goods.

Among the nontrade components of the current account, increased net in-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

come receipts from U.S. direct investment abroad were largely offset by a reduction in income from net portfolio investments. During 1985, net portfolio income swung from net receipts to steadily increasing net payments; this development reflected the shift in the U.S. position from that of a net international creditor to that of a net debtor during the course of 1985 as a consequence of cumulative large current account deficits over the past few years.

The recorded $118 billion current account deficit for 1985 was balanced by recorded net capital inflows of $85 billion and a statistical discrepancy of $33 billion. While official transactions, both U.S. and foreign, resulted in an outflow of $8 billion, private capital transactions produced a net inflow of more than $93 billion. Net purchases of U.S. stocks and bonds by private foreign investors accounted for more than half of the inflow, with Eurobonds accounting for most of this share. Facing lower interest rates, U.S. corporations chose to restructure their balance sheets and to issue debt in large amounts in both the domestic and Eurobond markets. The proportion of all bonds publicly offered by U.S. corporations that were sold abroad was almost 25 percent in both 1984 and 1985.

Net sales of U.S. Treasury securities to private foreign investors continued strong in 1985 although somewhat below the record 1984 level. Of the $21 billion purchased by private foreign buyers, $17.5 billion was purchased by residents of Japan, up from $4.7 billion in 1984. The Treasury sold only $1 billion in the form of issues specially targeted for foreigners in 1985.

Inflows reported by banks were also substantial in 1985, totaling about $35 billion. Continuing pressure on U.S. banks to improve capital adequacy led to efforts to reduce assets with low profit margins; claims on foreigners in the form of bankers acceptances declined by $9 billion. In addition, bank liabilities to private nonbanks, particularly residents of Latin America, continued to grow.

Foreign official assets in the United States declined slightly in 1985. A decline in holdings of OPEC countries was almost matched by increases by other countries. Despite large intervention sales of dollars by the foreign G-10 countries in 1985, their holdings of official assets in the United States showed essentially no change. U.S. holdings of official reserve assets did increase as a result of the intervention.

Foreign Currency Operations

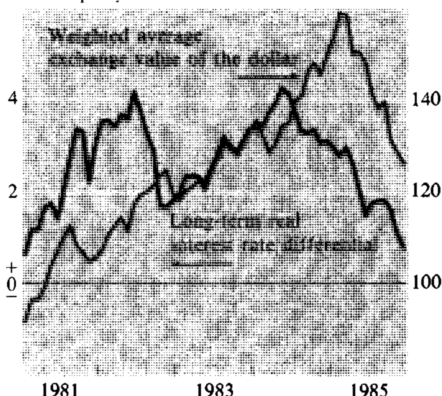
In early 1985 the dollar continued to advance strongly, reaching a peak in late February that was about 85 percent above its 1980 fourth-quarter level on a trade-weighted average basis. This surge prompted heavy sales of dollars by foreign central banks. U.S. monetary authorities also intervened, selling a total of $660 million from late January through early March. From March through late August the dollar declined fairly steadily, reaching a point about 18 percent below its February peak. This decline reflected a substantial decline in long term real interest rates in the United States relative to those abroad, which reflected, in turn, the disappointment of expectations of a lift in U.S. economic activity and a relatively accommodative U.S. monetary policy.

From late August through mid-September, however, the dollar rebounded sharply on the basis of more favorable U.S. economic statistics and revised

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Weighted Average Exchange Value of the Dollar and Interest Rate Differential

Percent per year March 1973 = 100



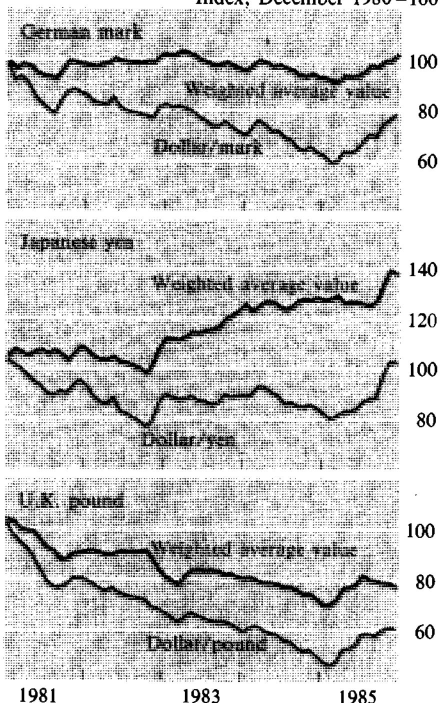
Exchange value of the U.S. dollar is the index of the weighted average exchange value of the dollar against currencies of the other Group of Ten (G-10) countries plus Switzerland, using 1972–76 total trade weights.

Differential is rates on long-term U.S. government or public authority bonds minus rates on comparable foreign securities, both adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation or by staff forecasts where needed.

expectations of the likelihood of a Federal Reserve tightening to curb rapid M1 growth. With this renewed strengthening of the dollar and in the context of swelling protectionist threats in Congress, officials of the G-5 countries met in New York on the weekend of September 21–22. The G-5 announcement of September 22 pointed to recent changes in economic fundamentals—the convergence of economic performance and policies among major countries—which market participants seemingly had not yet taken into account in determining exchange rates. To underscore this view, the monetary authorities of the G-5 countries initiated a program of concerted intervention in the exchange markets to bring about the appreciation of nondollar currencies—without, however, adopting any exchange-rate targets for the dollar. This initiative appeared to have a shock effect on the market, and the dollar resumed its downward trend. By year-end the dollar had declined a further 12 percent on a weighted average basis. G-5 monetary authorities sold about $13 billion from September 23 through the end of November, including combined sales of $3,301 million by the Federal Reserve and the U.S. Treasury. From its February 1985 peak to the end of December the dollar depreciated by 25 percent on a weighted average basis, by 24 percent against the Japanese yen, and by 29 percent against the

Weighted Average Exchange Values and Dollar Exchange Rates

Index, December 1980 = 100



The weighted average value for each currency is its exchange value against the currencies of the other G-10 countries plus Switzerland, using 1972–76 total trade weights.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

German mark. The dollar's decline after late February was consistent with a sharp drop in the real long-term interest rate differential between assets denominated in dollars and those denominated in foreign currencies.

For the year as a whole, U.S. monetary authorities intervened to sell $3,943 million—$1,488 million against yen and $2,455 million against marks. One-half of these amounts was for the account of the Federal Reserve, and one-half for the account of the Exchange Stabilization Fund of the U.S. Treasury.

Holdings of foreign currencies by the Federal Reserve at year-end totaled $7,016 million equivalent, essentially all of which consisted of German marks, Japanese yen, and Swiss francs. The valuation gains on these holdings, about $1,210 million for the year, reflected the appreciation of foreign currencies against the dollar. There were no realizations of profits during the year as the Federal Reserve did not sell any foreign currencies.

There were no drawings or repayments on the Federal Reserve Swap Network during 1985.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Monetary Policy Reports to the Congress

Given below are reports submitted to the Congress by the Federal Reserve on February 20 and July 16, 1985, pursuant to the Full Employment and Balanced Growth Act of 1978.

Report on February 20, 1985

The Outlook for the Economy in 1985

Nineteen eighty-four was another year of substantial economic growth in the United States. Production and employment gains were large, making the expansion of the past two years—with growth in real gross national product averaging 6 percent per year—the strongest cyclical upswing since the early 1950s. Moreover, continued vigor of the economy was accompanied by signs of some further lowering of inflationary expectations. Aggregate price measures rose around 4 percent last year, about the same as during the two preceding years. While prices of services continued to rise 5 to 6 percent, prices of many goods were relatively flat, and underlying wage trends seemed to be moderating.

Economic growth had been extraordinarily rapid in the first half of 1984 and then slowed abruptly around midyear. Although some slowing in growth was widely anticipated, the abruptness of the change raised some question about the continuing strength of expansionary forces. However, during the last few months of the year, output and employment were clearly rising, though at a more moderate pace than earlier in the year.

The strong gains in overall activity during the year drew attention away from a number of continuing problems, but those problems are nonetheless real and serious. The overall rate of unemployment is still uncomfortably high, and the joblessness among certain groups—for example, teenagers and blacks—remains well above the average. Sectors of the economy facing intense competition from abroad, such as agriculture and certain mining and manufacturing industries, have not participated in the rapid economic expansion overall and have been under strong financial stress. Strains also remain evident among financial institutions: a number of depository institutions have experienced a deterioration in the quality of their loan portfolios, and the earnings of thrift institutions remain constrained by low-yielding assets accumulated in earlier years.

While it has not been an impediment to economic expansion to date, growth in credit has been exceptionally rapid, and many households and businesses have accumulated substantial indebtedness, often in short-term or variable-rate forms that make them especially vulnerable to unexpected economic developments. Also, despite the impetus from strong U.S. demand, growth in economic activity has been limited in a number of important industrialized countries; and many developing countries, in Latin America and elsewhere, are still struggling to restore satisfactory growth. While progress was made in stabilizing the external finances of some of the largest of those countries, that progress can only be secure in the context of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

greater stability in their own economies and of sustained growth in the industrialized world.

Many of the problems afflicting particular industries have causes and complications that, at least in part, must be dealt with in direct and specific ways. But it is also evident that the enormous imbalances in our federal fiscal posture and in our trade and current account position have aggravated the problems and made constructive solutions much more difficult. In an expanding economy requiring more private credit, the need to finance the large federal deficits has contributed to the pressures that have held real interest rates at historically high levels. The failure to deal with budgetary deficits also has sustained doubts in the minds of the public about the ability of the government to continue to curb inflation over the long run.

The large federal deficits are mirrored in our external imbalance. Many foreign investors have been attracted to the comparatively high real rates of return offered on dollar-denominated assets, and U.S. lending abroad has been reduced. Other forces stimulating capital inflows have been at work as well, including political and economic uncertainties in other countries and the relative stability and vigor of our economy. The shift in capital flows has supplemented domestic saving and helped finance the federal government deficit and private investment. But, at the same time, the strong demand for the dollar has driven its value on foreign exchange markets to extremely high levels. As the dollar has appreciated, the demand for our exports has suffered and our purchases of imported goods have increased dramatically, resulting in strong competitive pressures on the manufacturing, mining, and agriculture sectors and leading to calls for protectionist measures. Moreover, the capital inflows lead to mounting financial claims of foreigners that the nation must be prepared to deal with in future years, through reduced imports or increased exports, in either case lowering domestic consumption.

The Economic Projections of the FOMC

Notwithstanding the risks associated with the domestic and international problems just outlined, the weight of the evidence points to reasonably favorable near-term prospects for aggregate economic performance. In recent months, personal income growth has been strong, reflecting continuing substantial gains in employment and helping to support consumer spending. Overbuilding of multifamily residential units and offices in some parts of the country may pose questions about the outlook in these areas, but the lower interest rates that developed over recent months suggest that single-family homebuilding may strengthen. Surveys of businesses indicate plans for continued growth in plant and equipment spending in the coming months, though at a slower pace than last year; meanwhile, some imbalances in business inventories that developed during 1984 appear to be well along in the process of correction, and in some sectors inventories are quite lean relative to sales. Many states and localities are experiencing an improvement in their finances, which portends further support to the expansion from that sector. And, at the federal level, there continues to be a strongly stimulative thrust from fiscal policy.

The smallest increases in nominal wages and compensation in more than a decade have been accompanied by an

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Economic Projections for 1985
Percent

Item	FOMC members and other FRB Presidents		Administration	Congressional Budget Office
	Range	Central tendency		
Change, fourth quarter to fourth quarter				
Nominal GNP	7 to 8½	7½ to 8	8.5	7.7
Real GNP	3¼ to 4¼	3½ to 4	4.0	3.4
GNP deflator	3 to 4¾	3½ to 4	4.3	4.2
Average unemployment rate in the fourth quarter	6½ to 7¼	6¾ to 7	6.9	7.0

improvement in productivity and downward pressures on energy and commodity prices. These developments help support the possibilities of continuing restraint in price increases. Also, in the context of an economy expanding at a sustainable rate, they are consistent with continuing growth in average real income.

Taking account of these factors, the members of the Federal Open Market Committee (as well as Federal Reserve Bank Presidents who are not at present FOMC members) now foresee the probable continuation of the economic expansion through its third year, although at a more moderate pace than in the first two years. The central tendency of the members' forecasts indicates the probability of an increase in real gross national product of between 3½ and 4 percent this year. The unemployment rate is expected to decline in 1985 to a level of between 6¾ and 7 percent by the fourth quarter. At the same time, most members expect general measures of price inflation to remain close to recent trends.

When considering the general outlook for 1985, members of the FOMC recognized that persisting problems could become aggravated for particular sectors of the economy, and that there are risks for the economy as a whole. Clearly, there is growing distress in many farm communities. Incomes from farming have been low, land prices are falling, and many producers face heavy debt burdens. In the household and business sectors, higher levels of indebtedness are unlikely to forestall further gains in spending, but unless moderated, they would in time add to financial pressures.

Favorable price performance has been encouraged by the strength of the dollar in the exchange markets. A sharp and large reversal of that strength could be reflected in at least temporarily stronger inflationary pressures. Greater confidence in prospects for price stability is, of course, dependent over time on suitably restrained growth in the money supply; and that necessary approach and more moderate real interest rates would be facilitated by effective action to reduce substantially the size of federal budget deficits in the upcoming and subsequent fiscal years. Action to restore balance in the government's fiscal position is important to the achievement of an environment conducive to stable, strong economic growth. In their forecasts, the Committee members assumed that the exchange rate would remain within the range of recent months and that effective fiscal action is in prospect.

The "central tendency" forecast of the FOMC members is broadly con-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sistent with that of the administration, as indicated in the Economic Report of the President, and that of the Congressional Budget Office. The Administration's projections for both real GNP growth and inflation do fall, however, toward the upper part of the ranges of Committee members' forecasts, while the CBO's estimate of real growth is a bit lower than the central tendency range of the FOMC.

The Federal Reserve's Objectives for Money and Credit in 1985

At its meeting of February 12-13, the FOMC set monetary and credit growth ranges for 1985 designed to be consistent with further sustainable economic growth and progress toward reasonable price stability over time. Specifically, the Committee (1) set a growth range for M1 of 4 to 7 percent from the fourth quarter of 1984 through the fourth quarter of 1985, the same as that tentatively selected last July; (2) established target ranges of 6 to 9 percent and 6 to 9½ percent for M2 and M3 respectively, ½ percentage point higher at the upper end of the range than that tentatively set in July; and (3) set an associated monitoring range of 9 to 12 percent for the debt of domestic nonfinancial sectors, 1 percentage point higher than tentatively indicated. The upper end of the range for M1 is 1 percentage point below that of 1984, and the range for M2 is the same as last year's. The upper end of the target range for M3 is slightly above that for last year. That increase, as well as the upward adjustment in the associated monitoring range for the debt of domestic nonfinancial sectors, reflects analysis of developments during 1984 suggesting that growth somewhat greater than anticipated earlier may be consistent with Committee objectives for the year. Expansion within these ranges would represent a significant deceleration in the actual growth of M3 and debt from the experience of last year when the target ranges were exceeded.

In formulating these objectives, the Committee assumed that no new statutory or regulatory developments would be enacted that would appreciably influence the behavior of the monetary and credit aggregates in 1985. Although at the beginning of the year the minimum denomination of super NOW and money market deposit accounts was reduced from $2,500 to $1,000, to date the promotional activity accompanying this change has been minor, and it appears that M1 and M2 have not been affected significantly.

On average, the behavior of M1 velocity—nominal GNP divided by the money stock—during 1984 was broadly consistent with previous cyclical patterns. Together with other evidence, this development suggests that the factors responsible for the highly unusual velocity behavior over 1982 and early 1983 have receded.

Nonetheless, a range of uncertainty inevitably remains about the trend of M1 relative to nominal GNP in light of recent deposit deregulation and other financial innovations that have affected the funding policies of banks and the cash management practices of the public. On balance, it appears likely that the process of deposit deregulation will lead to a trend rate of increase in the velocity of M1 that may be somewhat lower than in the period as a whole since World War II. However, in view of the multiplicity of changes in financial instruments and practices that influence the behavior of all the monetary measures, interpretation of all the aggregates will continue to be made within the context of the outlook for economic activity, inflationary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

pressures, and conditions in domestic and international financial markets, including the strength of credit demands.

The new target range of 4 to 7 percent for M1 encompasses growth in M1 consistent with velocity expansion over the coming year approximating that of last year, and also higher M1 growth than would be needed should velocity grow at a rate approximating the reduced trend suggested above. The movements in velocity during 1984 occurred in a context of moderate increases in interest rates over much of the year; however, velocity has slowed substantially in recent months in the context of an appreciable rise in money growth and following declines in interest rates. In all the circumstances, a somewhat higher rate of money growth than implied by straight-line projections from the fourth quarter 1984 base to the targets for the fourth quarter of 1985 may be appropriate early in the year, but growth of M1 would be expected to slow, and velocity growth to rise, as the current adjustments are completed. Thus, as the year progresses, growth of M1 would be expected to move gradually toward and into the FOMC's target range. Depending upon developments with respect to velocity and price behavior, growth of M1 and of the other monetary aggregates in the upper parts of their ranges may be appropriate over the year as a whole. Those developments will, of course, be closely monitored over the year.

Like M1, growth of M2 and M3 have been particularly strong in recent months, reflecting the unusually favorable yield spreads in favor of monetary assets that emerged temporarily toward the end of last year; open market interest rates dropped more swiftly than rates offered by depository institutions on retail deposits and returns on money market mutual funds. In addition, M3 growth has reflected substantial issuance of large CDs by thrift institutions to support their lending in mortgage and consumer loan markets.

Growth of the broader monetary aggregates is influenced, as well, by the pattern of international capital inflows associated with the huge current account deficit. Domestic banks may continue to borrow sizable amounts of Eurodollar funds from their foreign branches and unaffiliated foreign banks; such borrowings are not included in the measured monetary aggregates. By reducing the need for funding through other managed liabilities included in M2 and M3, these inflows tend to restrain measured monetary growth in relation to growth of bank credit and of credit generally. Moreover, many domestic borrowers, including the federal government and private corporations, may continue to tap overseas securities markets directly, reducing the need for credit expansion by U.S. intermediaries.

Given the federal budget deficit as projected by the administration for 1985—as well as a likely expansion of spending by domestic sectors in excess of nominal GNP growth, as part of that spending flows abroad—the Committee contemplates that domestic nonfinancial debt may continue to increase more rapidly than nominal GNP. Still, actual growth of debt in 1985 should be markedly less than in 1984, as nominal GNP growth and overall credit demands moderate. Growth within the debt range for 1985 assumes also a slowing in credit for mergers, leveraged buyouts, and other financial restructuring. Such credit led to some erosion in corporate equity cushions last year, and a more cautious approach is anticipated this year.

The outlook for financial conditions

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

generally is again expected to be affected importantly by current and prospective federal budget deficits, which will remain enormous in comparison with experience in previous economic expansions. This massive federal borrowing will compete for available domestic savings with the strong private credit demands accompanying further growth of economic activity, keeping interest rates and exchange rates higher than they otherwise would be. Such relatively high interest rates and exchange rates limit expansion in those sectors that are most sensitive to the cost of credit and impair the competitive positions of domestic import-competing and export industries. Decisive and credible actions to reduce federal budget deficits would have favorable effects on investors' expectations and help to lower interest rates, especially longer-term rates, even before these reductions become fully effective. Such actions would work to relieve the imbalances and strains within the economy, contribute to further abatement of inflationary expectations, and so reinforce the prospects for continued growth and stability.

The Performance of the Economy in 1984

The economy recorded major gains in 1984, with the real gross national product up 5½ percent and the unemployment rate down more than 1 percentage point over the year. The growth in output and employment was exceptionally strong in comparison with experience in other post-Korean War expansions. But even more striking, in terms of its departure from past norms, was the extraordinary rise in domestic spending, which again appreciably outstripped growth in domestic production. Over the course of the year such spending rose about 6¾ percent in real terms. Consumers and businesses purchased greatly increased quantities of imported goods, whose relative prices were lowered by the appreciation of the dollar in exchange markets, and the U.S. trade deficit reached record proportions.

Last year's economic gains were achieved without a pickup in inflationary pressures, in part owing to the rise in the exchange value of the dollar. Aggregate indexes of prices rose about 4 percent or less, similar to rates of inflation recorded in 1983. Ample availability of industrial capacity here and abroad helped to contain price increases. Labor cost pressures also were limited, as wage increases actually were slightly lower than a year earlier. Labor markets continued to reflect the still considerable unemployment in the economy as well as the adjustments of wages in some sectors to the realities of forces associated with deregulation and foreign competition. Wage changes also reflected the favorable feedback effect of lower inflation on anticipatory or catch-up pay demands.

Although the nation as a whole has made substantial progress in the past two years toward the goals of sustained growth and high employment along with price stability, important segments of the economy have continued to experience considerable difficulty. One symptom of continuing imbalances has been interest rates that, relative to the prevailing rate of inflation, have remained exceptionally high by historical standards. However, after moving upward during the first half of the year when economic expansion was especially brisk, interest rates retraced their advances in the second half of the year. At year-end, they were, on balance, a little lower.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal government tax and spending policies have provided substantial stimulus to aggregate demands for goods and services, but in credit markets the deficits have added strongly to the demands for funds and have been one important force keeping interest rates high. Moreover, there is general agreement that, unless legislative measures are enacted, budget deficits are likely to increase further, even in the context of a reasonably growing economy. This prospect, with its implication of continuing pressures on the supply of savings, has been a factor in the rise in the foreign exchange value of the dollar and the attendant emergence of enormous deficits in our trade and current accounts with other nations. Although, as noted above, the sharply higher value of the dollar has been an important factor in the movement toward price stability, inflationary pressures could become more apparent if the U.S. dollar were to decline sharply—a risk that could increase as fundamentally unsustainable fiscal and external postures are extended.

The Household Sector

The household sector continued to benefit last year from the economic expansion. Adjusting for inflation, the rise in disposable income from the fourth quarter of 1983 to the fourth quarter of 1984 was 5¾ percent, surpassing the large gain in 1983. This strong increase in income supported a rapid rise in spending for consumer goods even as the personal saving rate rose.

Household sector outlays in this expansion have been tilted more toward durable goods than has been typical. In the 1980–82 period, a time of relatively slow income growth and high unemployment, consumers had curtailed discretionary purchases of household goods. Since the end of 1982, however, strong employment and income growth and rising consumer confidence have been translated into an appreciable restocking of household durables.

The strength of automobile purchases in 1984 was a part of this restocking process. As the stock of existing autos has aged, replacement demand has grown. Most recently, reductions in gasoline prices have lowered operating costs. Automobile sales in 1984 rose to 10½ million units, the highest level since 1979. The foreign share of the market declined, owing in large part to the impact of limitations on Japanese units during a period of expanding sales. Indeed, demand for domestic autos proved to be so strong that producers had difficulty supplying many of the more popular models, even though auto companies operated some factories at near full capacity over most of the year. Total auto production was up 14 percent from the preceding year, despite brief strikes in the autumn.

Spending for new homes slowed over the course of 1984, with rising mortgage interest rates through midyear a factor reducing housing activity. However, there were some initial signs of improvement in the housing sector at year-end, associated with earlier declines in interest rates during the fall. From the fourth quarter of 1983 to the fourth quarter of 1984, residential construction outlays, in real terms, were up 3½ percent after an extremely rapid advance in 1983. For 1984 as a whole, 1.7 million new housing units were started. This was below the peak rates in the 1970s, but a marked improvement over the performance of the first years of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1980s, as housing demand continued to be supported by favorable demographic factors and expanding incomes. Moreover, relatively stable house prices and the growing use of adjustable-rate mortgages made home purchases more accessible for many households.

The second year of strong growth in income and spending was accompanied by significant changes in household balance sheets. Late in 1983 and in the first half of 1984, financial assets declined relative to income—owing primarily to the sluggish performance of stock prices—retracing a portion of the strong gains made earlier in the recovery. However, the subsequent rise in equity prices helped to restore household asset positions to their previous high levels, and since the turn of the year, with stock prices up sharply, asset positions have improved further. Meanwhile, growth of household indebtedness picked up noticeably last year, and consumer installment debt as a share of disposable income moved to near its previous peak in the late 1970s.

Despite the rise in indebtedness, there were few signs of increased financial stress in the household sector. The incidence of payment difficulties on consumer installment debt remained historically low, and home mortgage delinquency rates were about unchanged for the year as a whole. Nonetheless, the proportion of problem loans in the home mortgage market has not receded from its recession high, and there is some special concern about future prospects in this area owing to the added risk exposure of homeowners who took on mortgages carrying adjustable features, especially those made with sizable initial interest rate concessions. The sustained high level of mortgage loan delinquencies to date appears attributable not so much to adjustable-rate loans as to a combination of unemployment that is still high and real estate prices that are more stable than some borrowers had anticipated.

The Business Sector

The increase in business spending for plant and equipment was greater in 1984 than in 1983. In fact, the rise in gross business capital outlays over these two years combined was much larger than in any other economic expansion since World War II. Profits in the nonfinancial corporate sector were up substantially in 1984, although by year-end the level had fallen back a bit owing to the slowing in sales growth.

Growth in business fixed investment spending was strongest in the first half of the year, but continued at a double-digit pace in real terms in the second half. For the year as a whole, large gains were registered for both equipment and structures outlays. The ebullience of total spending reflected a number of factors, including the more favorable tax laws enacted in 1981, the desire to take advantage of technological advances, and the further narrowing of the margin of unused factory capacity under strong demand growth. Continued competitive pressure from foreign producers provided additional impetus for rapid modernization. At the same time, many U.S. producers of capital equipment, especially outside the "high tech" area, did not fully benefit from this spending. Instead, foreign manufacturers captured an increasing share of capital goods purchased by U.S. firms; for domestic equipment spending, this share—approximately 25 percent—was nearly twice that experienced in the late 1970s.

Businesses accumulated inventories

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in 1984 after reducing stocks in the preceding two years. In real terms, business inventories rose $24 billion, a historically large gain. Those gains were concentrated largely in the first half of the year, alongside the rapid pace of the expansion of final demand. When sales growth slackened in the summer and autumn, businesses quickly cut back on orders and production to avoid severe imbalances.

In order to finance the combined increase in capital spending and inventory investment, businesses relied heavily on external sources of credit. Nonetheless, gross issuance of new equity weakened as stock prices declined early in the year and then failed to surpass earlier highs when they rallied in the summer. After accounting for the retirement of equity associated with merger activity and share repurchases, the net issuance of stock was decidedly negative. Shorter-term borrowing was favored by businesses in the first half of 1984, as firms elected to finance mergers initially through bank loans and commercial paper, and the high level of long-term interest rates discouraged bond issuance. In the second half of the year, merger financing slowed and the decline in interest rates contributed to some movement toward longer-term debt issuance. Even so, the traditional balance sheet ratios used to assess aggregate business financial strength worsened over the year: the ratio of loans and short-term paper to total debt of nonfinancial corporations rose, as did the ratio of debt to equity.

Severe financial strains, in many cases related to the high exchange value of the dollar, persisted in some of the nation's basic industries. Farmers continued to face less favorable export conditions than in much of the previous decade, land prices fell further, on average, and farm income remained depressed. As a result, farmers with large volumes of debt remaining from the late 1970s continue to face serious debt-servicing problems. The metals, agricultural implements, and some equipment industries also continue to face significant problems.

The Government Sector

The expanding economy lifted federal government receipts in 1984. At the same time, outlay growth was limited by further declines in recession-related expenditures and by a drop in agricultural support payments. Nonetheless, the federal budget deficit remained enormous—more than 5 percent of GNP and larger than total domestic personal saving. Moreover, at the end of the year the deficit was again rising.

Federal government purchases of goods and services, the component of the budget that directly adds to GNP and accounts for about a third of total federal outlays, rose strongly last year. Excluding changes in Commodity Credit Corporation farm inventories, federal purchases were up nearly 5½ percent, after adjustment for inflation. A major thrust to federal purchases came from defense spending, which increased almost 7 percent in real terms.

At the state and local government level, real purchases of goods and services rose 3½ percent in 1984, following two years of no change. The renewed growth in such spending followed an appreciable improvement in this sector's fiscal position: state and local governments experienced a sizable operating and capital surplus in 1983 and early 1984 owing to the effects of the economic recovery as well as to increases in tax rates.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Foreign Sector

The appreciation of the dollar over the past four years directly contributed to the imbalance between exports and imports in 1984. On a trade-weighted average basis, the dollar climbed a further 12 percent during the course of the year, bringing the cumulative appreciation since the end of 1980 to about 65 percent, and the rise has continued into 1985. Part of the dollar's strength in the first half of last year may have been generated by a widening of the differential between real interest rates in the United States and real rates abroad; however, the influence of this factor appears to have been reversed in the second half of the year. The relative dynamism of the U.S. economy and success in curbing inflation helped attract capital from abroad. Conversely, relatively slow economic growth elsewhere and economic and political uncertainties in various countries also may have contributed to the dollar's appreciation throughout the year.

Notwithstanding a further weakening of the international competitive position of U.S. firms owing to the dollar's appreciation, and despite the sluggishness of foreign economies, the volume of U.S. merchandise exports increased by 9 percent in 1984. Exports to Canada, some of which are reimported after further fabrication, accounted for about a third of the rise, with Western Europe and Mexico receiving most of the remainder of the increase in exports. Economic growth in many developing nations, oil-producing as well as others, was limited by their debt servicing problems, and demand by those countries for U.S.-produced goods remained generally depressed.

The vigorous expansion of the U.S. economy and the strength of the dollar pushed the volume of merchandise imports sharply higher. Consumer goods, materials, and capital equipment shared in the increase. The merchandise trade deficit rose to about $110 billion. In addition to the growing trade deficit, net service receipts were reduced, and the current account deficit was about $100 billion in 1984, compared with $42 billion in 1983.

Labor Market Developments

Developments in labor markets continued to be favorable during the second year of expansion. Reflecting the strength of activity and improved employment prospects, growth of the labor force picked up last year. But the number of new jobs expanded even more rapidly, and the unemployment rate was 7.2 percent in the fourth quarter, more than a percentage point below the rate at the end of 1983. Indeed, since the recession low in late 1982, nonfarm payroll employment has increased nearly 7 million, the largest two-year gain in three decades.

In 1984, employment growth continued to be widespread across industries. The trade and service sectors each added more than one million jobs. And there was a gain in construction employment, owing in large part to a rise in nonresidential building. Government employment was up a quarter of a million, reflecting the rise in spending by state and local units. The manufacturing sector, which has borne the brunt of increased foreign competition, registered a large increase of almost three-quarter million in 1984; even so, the level of manufacturing employment remained below its pre-recession peak.

Wage developments in 1984 were more favorable to the control of inflation; even though labor market slack was reduced substantially further dur-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ing the year, wage rates increased less than in 1983. The employment cost index, a comprehensive measure of change in wages and benefits, rose just 4 percent in 1984, nearly 1 percentage point less than the year earlier. Moreover, major collective bargaining agreements during the year showed no acceleration in nominal wage rates, even in those industries with improved economic conditions.

These wage developments suggest that inflationary expectations continued to moderate this past year; to an increasing degree, workers and managers now appear to be focusing on improving job security and on enhancing productivity, often in an attempt to remain competitive with foreign producers. Productivity increases in 1984 were substantial in the first half of the year, when output grew rapidly, and helped keep overall cost pressures down. Over the course of the year, labor productivity increased 2¼ percent, partly reflecting a cyclical adjustment to higher levels of output as well as some improvement apparently in the underlying trend rate of growth from the very low pace of the 1970s. The combination of moderate compensation increases and favorable productivity developments held down cost pressures on prices; unit labor costs rose 2 percent over 1984, less than a fifth of the rate experienced in 1979 and 1980.

Price Developments

Over 1984 the consumer price index rose 4 percent and the implicit deflator for the gross national product 3½ percent. The increases in these broad indexes represent little change from inflation rates that have prevailed since the beginning of the expansion. The producer price index for finished goods, which excludes the prices of services, rose less than 2 percent last year; basic commodity prices, which had advanced more than 30 percent early in 1983, fell during most of 1984.

The relative softness of demand in worldwide markets and the strength of the dollar against foreign currencies played a large role last year in holding down prices of basic commodities. Importantly, energy prices, which have been a major factor in inflation rate movements for more than a decade, moved down. The weakness of demand during the recession and early recovery period restrained energy prices in 1981 and 1982; moreover, conservation measures and additional oil production capacity in many countries have continued to relieve energy price pressures.

Food prices at the retail level rose about in line with overall prices in 1984. Early in the year, food prices jumped sharply because farm supplies were limited by the 1983 summer drought and a winter freeze. However, supplies again became plentiful as the year progressed, reflecting more favorable harvests and sagging export volume.

Apart from the food and energy areas, consumer price inflation was little changed from a year earlier. The rise in consumer goods prices slowed appreciably, owing in part to the relatively small increase in prices of imported goods, as well as the accompanying competitive pressures on domestic products. Service prices rose more rapidly over 1984 than in 1983, although the rate of inflation in the sector remained well below those recorded in the early 1980s.

Monetary Policy and Financial Developments in 1984

Monetary policy in 1984 aimed basi-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

cally at supporting sustainable economic growth within the context of long-term progress toward price stability. The target ranges for the monetary and credit aggregates chosen by the Federal Open Market Committee last February, and reaffirmed in July, called for growth rates ½ to 1 percentage point below those set for 1983. Measured from the fourth quarter of 1983 to the fourth quarter of 1984, the target ranges for the monetary aggregates were 4 to 8 percent for M1, and 6 to 9 percent for M2 and M3. The associated monitoring range for the debt of domestic nonfinancial sectors was fixed at 8 to 11 percent.

Underlying these objectives was the Committee's expectation that the special factors distorting monetary growth rates in 1982 and 1983 would be less important in 1984, and that relationships among the monetary aggregates—particularly M1—and economic activity and inflation would be more consistent with historical trends and cyclical patterns. Portfolio adjustments associated with the previous introduction of new deposit accounts and with the steep drop in interest rates during the 1982 recession appeared to have ended. Furthermore, the economic expansion seemed to be reducing uncertainties about employment and income prospects that earlier had boosted demands for liquid precautionary balances.

Over the year, increasing evidence suggested that M1 was in fact behaving more in line with historical experience. As a result, this aggregate was given more weight in policy implementation than had been the case during the latter part of the cyclical downswing and the early phase of the economic recovery. However, all of the monetary and credit measures continued to be evaluated in light of the outlook for the economy and domestic and international financial markets.

Money, Credit, and Monetary Policy

The actual growth rates of M1 and M2 over 1984 were well within the target ranges established by the Federal Reserve, with M1 expanding 5.2 percent, somewhat below the midpoint of its range, and M2 increasing 7.7 percent, a bit above its midpoint. As had been anticipated in the midyear policy report to the Congress, growth of M3 and domestic nonfinancial debt, at 10.5 percent and 13.4 percent respectively, exceeded their ranges.[1] The relatively wide divergence between M2 and M3 growth rates reflected mainly substantial issuance of large CDs and other managed liabilities by thrift institutions and commercial banks in the face of heavy credit demands.

Credit growth last year was the most rapid on record, and much stronger relative to GNP expansion than historical trends would suggest. An unusually large volume of mergers and related activity, including "leveraged buyouts," involving nonfinancial corporations accounted for about 1 percentage point of the growth of overall debt. Around $75 billion of equity was liquidated in this process, with much of it replaced, at least for a time, with short-term debt. In addition, more than $10 billion of equity was retired through corporate share repurchases, frequently in defensive maneuvers to ward off unfriendly takeover attempts.

Even after allowance is made for the unusually large volume of merger-re-

1. The figures cited herein for the monetary aggregates are based on recent benchmarks and seasonal; adjustment revisions. Before those revisions, the 1984 increases were measured at 5.0 percent for M1, 7.5 percent for M2, and 10.0 percent for M3.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Growth of Money and Credit[1]

Percent changes

Period	M1	M2	M3	Domestic non-financial sector debt
Fourth quarter to fourth quarter				
1979	7.5	8.1	10.3	12.1
1980	7.5	9.0	9.6	9.6
1981	5.1 (2.5)[2]	9.3	12.4	10.0
1982	8.8	9.1	10.0	9.1
1983	10.4	12.2	10.0	10.8
1984	5.2	7.7	10.5	13.4
Quarterly growth rates				
1984: 1	6.2	7.2	9.2	12.9
2	6.5	7.1	10.5	13.1
3	4.5	6.9	9.5	12.7
4	3.4	9.0	11.0	12.7

1. M1, M2, and M3 incorporate effects of benchmark and seasonal adjustment revisions made in February 1985.

2. M1 figure in parentheses is adjusted for shifts to NOW accounts in 1981.

lated borrowing, it is clear that total credit demands were exceptionally strong last year. Federal debt expansion, at more than 16 percent, was unprecedented for the second year of an economic expansion, both in absolute terms and in relation to income. Private domestic nonfinancial debt grew about 11½ percent (abstracting from growth of merger-related debt issues), also faster than, but much closer to, comparable stages of previous recoveries.

The behavior of M1 velocity in 1984 was broadly consistent with past cyclical patterns. In contrast to the unusual weakness of the previous two years, M1 velocity in 1984 increased 4 percent, only a little above the average rate of growth during the second year of previous economic expansions. M2 velocity increased 1½ percent, reversing two consecutive yearly declines. The strengthening of velocity over 1984 apparently reflected, in part, some unwinding of the precautionary and other motives that had swelled demands for liquid assets in 1982 and early 1983, as well as the rise of short-term interest rates in the first part of the year and, in the case of M2, the abatement of dramatic inflows to money market deposit accounts (MMDAs) associated with the initial authorization of these accounts.

Demands for M1 balances, and for bank reserves to support deposit growth, were robust early in the year as the economy expanded rapidly. Credit demands also were very strong, and market interest rates began rising even as the Federal Reserve, through open market operations, was keeping the degree of pressure on bank reserve positions unchanged. In early spring, with credit and money demands continuing unabated and with economic growth continuing at an extraordinary pace, the FOMC adopted a somewhat more restraining posture toward supplying reserves, and both short- and long-term interest rates rose further as banks relied more heavily on discount window credit to meet their reserve needs.[2] Borrowing for adjustment and seasonal purposes increased to around $1 billion in March and April after averaging about $650 million during the first two months of the year. In April, the discount rate was raised ½ percentage point, to 9 percent, to bring this rate into better alignment with short-term market rates.

Despite the absence of any further tightening of reserve availability by the Federal Reserve, pressures on private

2. Annual seasonal and benchmark revisions to the monetary aggregates subsequently lowered somewhat the growth of M1 in the first half of 1984 relative to what was estimated during the period.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

short-term interest rates intensified around early May in reaction to the well-publicized liquidity problems of Continental Illinois Bank.[3] Uncertainties related to the international debt situation also added to market concerns. In this environment, quality differentials between yields on private money market instruments and Treasury securities widened substantially.

While M1 growth early in the year remained in the upper part of the FOMC's target range, M2 increased at a pace slightly below the midpoint of its range even as the economy expanded rapidly. Growth in M2 relative to income may have been damped by substantial inflows to IRAs and Keogh accounts, which are excluded from the monetary aggregates. Also, as market interest rates firmed, sizable spreads developed between these rates and yields on retail deposits and money market mutual funds, likely encouraging some investors to place funds directly in credit market instruments. M3, meanwhile, pushed above its longer-run range, as banks and thrift institutions issued large CDs and other managed liabilities to accommodate rapidly rising credit demands.

After midyear, economic expansion slowed markedly, particularly during the summer, tending to reduce transaction demands for money. Growth in M3, though remaining somewhat above the upper limit of its range, also moderated as demands for short-term business credit slackened and as some banks adopted more cautious lending and funding policies in light of the strains on financial markets.

3. Large discount window borrowing by Continental Illinois Bank, beginning in May, was offset in terms of its impact on overall reserve supplies through open market operations.

Initially, the slowing in M1 was not resisted, as it reversed a bulge that had brought M1 growth well above the midpoint of the FOMC's target range. However, by late August and early September, as evidence appeared of much slower economic growth, with financial tensions high and with the dollar rising rapidly on foreign exchange markets, the Federal Reserve moved to lessen the degree of restraint on bank reserve positions. That process continued through much of the rest of the year. Borrowing at the discount window receded, reaching levels of around $575 million by late in 1984 and dropping further to around $340 million, on average, during January 1985. Total reserves and nonborrowed reserves, which had shown little expansion since June, increased markedly in the final two months of the year and into early 1985.

Mirroring the easing of reserve market conditions, short-term interest rates dropped considerably from their late-summer highs. Moreover, quality spreads on various money market instruments returned to within normal ranges as the strains related to the problems of Continental Illinois Bank remained contained and progress was made in Latin American debt negotiations. Responding to the provision of reserves and the reduced rates on alternative outlets for liquid funds, M1-type balances rose rather sharply in late 1984 and early 1985. Growth of M2 also was very rapid, as open market interest rates fell below average yields on MMDAs, small-denomination time deposits, and money market mutual fund shares.

The easing in financial markets during the second half of 1984 was reflected in, and to an extent encouraged by, two successive reductions in the discount rate, first to 8½ percent in

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

November and then to 8 percent in December. By year-end, short-term interest rates were 2½ to 3½ percentage points lower than they had been during the summer, and ¾ to 1½ percentage points below their levels at the beginning of the year—in some cases near their cyclical lows of early 1982.

Long-term interest rates also declined in the second half of the year, in part reflecting some moderation of inflationary expectations. But for the year as a whole, most long-term rates declined less than ½ percentage point, and remained above their earlier cyclical lows. The still relatively high level of long-term rates appears to be influenced by the continuing budgetary uncertainties, current strong demands for total credit, and lingering, though lessened, fears of inflation.

Other Developments in Financial Markets

Foreign savings financed a large share of the domestic borrowing in 1984. Net inflows of capital from abroad were more than double the already advanced pace of 1983, thus supplementing domestic saving and enabling the financing of the massive federal deficits at the same time that private investment expanded rapidly. Banks continued to intermediate substantial amounts of these inflows, and sales of Eurobonds by U.S. corporations reached record levels. Direct investment in the United States also was very strong, reflecting several large takeovers of domestic firms by foreign corporations.

Much of the credit market borrowing—particularly that related to merger activity—was at short term. Commercial paper debt of nonfinancial businesses surged more than 50 percent, offsetting two consecutive years of runoffs. With strong loan demands in business, real estate, and consumer areas, total loans at commercial banks grew more than 14 percent.

Given only moderate inflows to core deposits in the face of this brisk loan growth, commercial banks increased their outstanding CDs in 1984 more than 14 percent, after having allowed a large volume of CDs to run off during 1983. Credit growth at banks was especially rapid during the first half of last year, reflecting a wave of bank-financed mergers. The bulk of the CD issuance was concentrated in this period and likely would have been even greater had not banks also borrowed heavily from their foreign offices. In the second half, loan expansion slackened appreciably, and large time deposit growth tapered off, as some earlier merger-related loans were repaid with the proceeds from issuance of commercial paper and other debt obligations and from selective sales of assets of the merged companies.

Strains on some sectors of the economy, as well as the effects of overly aggressive lending policies by some institutions, continued to be reflected in relatively high levels of nonperforming and other troubled loans in a number of depository institutions. As the year wore on, there were signs of more forceful efforts to deal with these problems and their consequences. Loan-loss provisions were significantly increased, and steps are being taken to correct weaknesses in credit standards. The largest bank holding companies generally improved their capital positions over the year, partly in response to supervisory guidelines to raise capital ratios. These approaches will take time to bear full fruit, and progress in strengthening balance sheets will be dependent on reasonable profitability as well as on

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

developments external to the banking system. In that connection, the strains in agricultural areas, on heavily indebted foreign countries, and in sectors of the energy industry pose continuing challenges.

In long-term markets, municipal bond offerings achieved new highs in 1984. Tax-exempt offerings were relatively light over the first half of the year as authority to issue single-family housing revenue bonds lapsed and as the market anticipated the imposition of retroactive ceilings on issuance of industrial development bonds (IDBs). But volume rebounded in early summer after passage of the Deficit Reduction Act, which reauthorized housing bonds and stimulated a flood of issues toward year-end to avoid stricter rules for IDBs and student loan bonds, effective January 1, 1985. Financial and nonfinancial corporations also raised record amounts through bond offerings; however, the maturities of new issues tended to be much shorter than in previous years, and many offerings carried provisions that essentially transformed these obligations into short-term or variable-rate debt.

Variable-rate instruments exhibited increasing popularity within the home mortgage sector as well. Adjustable-rate mortgages (ARMs) accounted for almost two-thirds of the number of conventional first mortgages on homes at major institutional originators in 1984, up considerably from only one-quarter of such originations the previous year. Thrifts, in particular, preferred to acquire ARMs rather than fixed-rate mortgages in an attempt to reduce their already acute exposure to interest rate risk. The widespread acceptance of ARMs by consumers was attributable partly to substantial initial rate advantages offered on ARMs compared with fixed-rate mortgages, as well as to other features that limited borrower exposure to higher future interest payments, at least for several years. Large initial rate discounts became less prevalent after the adoption of somewhat tighter standards both for purchases by federal credit agencies and for the underwriting of ARMs by private mortgage insurers. Yet, despite the shift toward ARMs during 1984 and increased consumer and business lending, the assets of thrifts remained heavily concentrated in relatively low-yielding instruments.

Report on July 16, 1985

Monetary Policy and the Economic Outlook for 1985 and 1986

The fundamental objective of the Federal Reserve in charting a course for monetary and debt expansion remains unchanged—to foster a financial environment conducive to sustained growth of the economy, consistent with progress over time toward price stability. In working toward those goals, developments with respect to the dollar and our external position have necessarily assumed greater prominence. More generally, while policy initiatives are stated in terms of growth rates of certain monetary and credit aggregates, the Federal Open Market Committee has emphasized the need to interpret those aggregates in the light of other information about the economy, prices, and financial markets. Moreover, the monetary targets for 1985 needed to be evaluated, and in the case of M1 adjusted, in light of the unusual and unexpected behavior of gross national product relative to money during the first half of this year.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Economic and Financial Background
Economic activity continued to expand during the first half of 1985, but at a relatively slow pace. Real gross national product probably increased at an annual rate of less than 2 percent, falling short of the expectations of many forecasters and of the rate anticipated for the year by members of the Federal Open Market Committee (FOMC) when they formulated their annual monetary policy plans in February. While the economic environment was conducive to the containment of inflation within the 3½ to 4 percent range of the past few years, there has been no further progress toward full employment of the nation's labor resources or industrial capacity. Indeed, the unemployment rate has remained at about 7¼ percent, well below the peak of the 1981-82 recession, but still a historically high level.

The slowing of output growth, which began in the middle of 1984, has brought into sharper focus the unevenness of this business expansion and the significance of some basic structural imbalances in the economy. The federal budget deficit has remained in the neighborhood of $200 billion, rather than moving in the direction of balance as might normally be expected in the course of an upswing in economic activity. The heavy demands placed on the credit markets by the Treasury's financing activities have, in turn, been one factor helping to hold real interest rates at historically high levels. And those high rates have contributed to the strong demand of international investors for dollar-denominated assets and thus to the strength of the dollar on foreign exchange markets.

Although the dollar was little changed on balance over the first half, with a spike in its value early in the year being subsequently reversed, the adverse effects on the U.S. trade position of the appreciation of the preceding several years, together with slow economic growth abroad, were very much in evidence. U.S. firms continued to face severe competitive pressures, and our exports fell while our imports rose. The widening current account deficit was mirrored in the continuing gap between the growth of domestic spending and domestic production. Moreover, the effects of this imbalance were felt with particular severity in the manufacturing, mining, and agricultural sectors of the economy, in which profitability was squeezed overall and employment declined.

The lagging growth of production, relatively well contained inflationary pressures on resources, and the high value of the dollar on exchange markets provided the backdrop for the conduct of monetary policy in the past several months. Reserves available to the banking system expanded substantially over the first half of the year, and the discount rate was cut ½ percentage point in the spring. With the economic expansion slowing, interest rates—which had declined sharply from the summer of 1984 to early 1985—dropped somewhat further on balance by midyear.

The declines in market interest rates in the latter part of last year and this year had substantial effects, lasting for a number of months, on the demands for assets contained in M1. Some savings apparently were shifted into interest-earning checking accounts (negotiable order of withdrawal accounts) from other instruments, and demand deposits also rose, as the cost of holding these accounts in terms of earnings

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

forgone was reduced. As a result of the shifts of funds, M1 expanded at an annual rate of about 10 1/2 percent over the first half of the year (measured from the fourth quarter of 1984 to the second quarter of 1985), well above the range of 4 to 7 percent established by the FOMC in February. At the same time, however, the broader monetary aggregates remained within their designated ranges. Over the period, M2 and M3 expanded at annual rates of 8 3/4 and 8 percent respectively, as compared with their growth ranges of 6 to 9 and 6 to 9 1/2 percent. Growth in domestic nonfinancial sector debt over the first two quarters of the year was a little above its monitoring range of 9 to 12 percent, as debt issued to finance mergers and otherwise retire stock issues continued stronger than had been expected earlier.

The rapid growth of M1 in the first half of the year was accompanied by a sharp drop in the velocity of the aggregate: M1 velocity—the ratio of nominal GNP to money—declined at an annual rate of about 5 percent. In some respects, that development is reminiscent of experience in 1982–83, when a large drop in interest rates also was accompanied by a marked decline in M1 velocity, with the attractiveness of M1-type balances enhanced by the availability of explicit interest on NOW accounts. There is evidence from recent experience, as well as from research on the interest responsiveness of the demand for money, suggesting that such episodes might be expected as the economy and financial markets adjust over time to further progress toward price stability and as the inflation premium in interest rates consequently diminishes. As this occurs, probably in unpredictable spurts, the public's demand for M1 will tend to rise and the level of M1 velocity could drop more or less "permanently." However, there will be uncertainty about such a conclusion until it becomes apparent in the period ahead whether velocity is returning toward trend or whether it is tending to rise rapidly because the public is reducing its "excess" money balances by spending or investing them; in the latter case, the drop in velocity in the past two quarters could be reversed to some extent.

The recent developments affecting M1 illustrate the still considerable uncertainties about the shorter-run behavior and trend of its velocity. Over the past three and one-half years, the income velocity of M1 actually has declined slightly on balance. In contrast, over the preceding three decades, velocity had increased more than 3 percent per year, on average. Velocity changes are influenced by the behavior of interest rates, but the extent of interest rate impact is variable and may be changing as the public and depository institutions adjust to the new deposit instruments and deregulation of deposit ceiling rates of recent years. Moreover, the underlying trend of velocity will also be influenced by the rate of financial innovation. While that may slow down once the adjustment is made to a deregulated environment and with lower interest rates, increased computerization could also work toward a rise in velocity over time as the efficiency of the payments system increases.

Ranges for Money and Debt Growth in 1985 and 1986

In reexamining its M1 range for 1985 and in setting a tentative range for 1986, the Committee expected that velocity, after its sharp decline in the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Ranges of Growth for
Monetary and Debt Aggregates

Percent changes

Aggregate	1985	Tentative for 1986
M1	3 to 8 [1]	4 to 7
M2	6 to 9	6 to 9
M3	6 to 9½	6 to 9
Debt	9 to 12	8 to 11

1. Applies to period from second quarter to fourth quarter.

first half of this year, would cease falling rapidly—while recognizing that much of the recent decline may not be reversed. Allowance also needed to be made for the high degree of uncertainty surrounding the behavior of M1 velocity, given the experience of the past few years. To take account of these considerations, the base for the range of M1 was shifted forward to the second quarter of 1985, and the range was set to encompass growth at an annual rate of 3 to 8 percent over the second half of this year. This range contemplates a substantial slowing in growth from the pace of the first half, and the lower part of the range implies a willingness to see relatively slow growth should the recent velocity decline be reversed and economic growth be satisfactory. The appropriateness of the new range will be under continuing review in light of evidence with respect to economic and financial developments, including conditions in foreign exchange markets. It was noted that, because of the burst of money growth in June, the current level of M1 is high relative to the new range. The Committee expected that the aggregate would move into the new range gradually over time as more usual behavior of velocity emerged.

For 1986 the M1 range was tentatively set at 4 to 7 percent. The Committee recognized that uncertainties about interest rates and other factors that could affect velocity would require careful reappraisal of the range at the beginning of that year. In addition, it was noted that actual experience with institutional and depositor behavior after the completion early next year of deposit-rate deregulation would need to be taken into account in judging the appropriateness of the ranges. At the beginning of next year, regulatory minimum balance requirements on Super NOW accounts and money market deposit accounts will be removed, and at the end of March 1986, deposit ceiling rates will be lifted entirely, affecting savings deposits and regular NOW accounts.

The accompanying table summarizes decisions with respect to the ranges of growth for the aggregates for 1985 and 1986. Except for M1 in 1985, the growth ranges apply to one-year periods measured on a fourth-quarter-to-fourth-quarter basis. The M1 range for 1985 applies to the second half of the year, as noted above.

With respect to the broader monetary and credit aggregates, the Committee reaffirmed the 1985 ranges for M2, M3, and domestic debt that had been established in February. It is recognized, as at the start of the year, that actual growth over the four quarters of 1985 might be toward the upper parts of the ranges, and it was felt that this would be acceptable, depending on developments in the velocities of the various measures, as long as inflationary pressures remained subdued.

The tentative ranges for 1986 for M3 and total debt embody reductions from 1985—in the case of debt by a full percentage point and in the case of M3 by ½ percentage point on the upper limit. The range for M2 was left

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

unchanged. In the case of the monitoring range for debt, it was assumed that, while debt might well continue its tendency of recent years to grow considerably faster than GNP, its expansion would be tempered by a drop-off in the net redemption of equity shares that has boosted corporate credit use dramatically in the past year or two.

Economic Projections

All the monetary ranges specified were felt to be consistent with somewhat more rapid economic growth than has characterized the first half of the year, as long as inflationary pressures remain contained. At the same time, Committee members felt that the present circumstances in the economy contain particular risks and uncertainties that can imperil progress toward either growth or price stability over the next year and a half. Clearly, the serious imbalances referred to earlier cannot be remedied through the actions of the central bank alone. Attainment of fully satisfactory economic performance and minimization of risks will require timely action in other areas of policy, here and abroad.

The economic projections of the members of the FOMC, as well as of the Reserve Bank Presidents who are not at present members of the Committee, are summarized in the accompanying table. The central tendency of the forecasts for real GNP points to some pickup in the pace of expansion in the second half of this year. The expected strengthening, given the slow growth in the first half, still would leave the GNP expansion for the year as a whole short of the range reported by the Federal Reserve in February and below the forecasts published by the administration to date.

The FOMC members and the other Reserve Bank Presidents expect growth in the range of 2 1/2 to 3 1/4 percent during 1986. Such a rise in output is seen as entailing substantial gains in employment, enough to bring about a small decrease in the civilian unemployment rate to around 7 percent by the end of next year. With pressures in labor and product markets limited, most FOMC members and other Presidents foresee only a marginal increase, if any, in the rate of inflation in 1986. It should be noted, however, that these projections are based on an assumption that the exchange value of the dollar will not de-

Economic Projections for 1985 and 1986 [1]

Item	FOMC members and other FRB Presidents	
	Range	Central tendency
	1985	
Percent change, fourth quarter to fourth quarter		
Nominal GNP	6 1/4 to 7 3/4	6 1/2 to 7
Real GNP	2 1/4 to 3 1/4	2 3/4 to 3
Implicit deflator for GNP	3 1/2 to 4 1/4	3 3/4 to 4
Average level in the fourth quarter, percent		
Unemployment rate	6 3/4 to 7 1/4	7 to 7 1/4
	1986	
Percent change, fourth quarter to fourth quarter		
Nominal GNP	5 1/2 to 8 1/2	7 to 7 1/2
Real GNP	2 to 4	2 1/2 to 3 1/4
Implicit deflator for GNP	3 to 5 1/2	3 3/4 to 4 3/4
Average level in the fourth quarter, percent		
Unemployment rate	6 3/4 to 7 1/2	6 3/4 to 7 1/4

1. The administration has yet to publish its mid-session budget review document, and consequently the customary comparison of FOMC forecasts and administration economic goals has not been included in this report.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

viate substantially from its recent levels.

The projections for a pickup in GNP growth over the reduced rate of the first half of this year are based in part on the expectation that the declines in interest rates (and concomitant rise in stock prices) that have occurred over the past few quarters will be providing impetus to demand for goods and services in the months ahead. Consumer attitudes toward spending appear favorable, and housing activity already has shown improvement, although the FOMC members are somewhat concerned by the rising debt burdens of households and the increasing payment problems suggested by figures on consumer and mortgage loan delinquencies. In the business sector, inventory overhangs appear to be limited in scope and degree, and fixed investment seems to have picked up a little after exhibiting some weakness earlier this year; the lower cost of capital and desires to cut costs and maintain competitiveness are expected to keep investment on a moderate uptrend, even though pressures on capacity may not be great. Spending by the federal government and by states and localities is expected to grow rather slowly.

A key ingredient in many of the projections is the expectation that there will be a tendency in the coming year for our external position to stabilize, so that domestic production will more fully reflect the expansion of domestic demand. Developments in this area will, of course, depend in part on the course of economic expansion abroad. Were the U.S. external position to continue deteriorating as it has been, the sectoral imbalances in the economy would be exacerbated, creating further difficulties for many companies, their employees, and their communities. The draining off of income would jeopardize the sustainability of economic expansion, and the risks of economic and financial dislocations would intensify.

The FOMC members and other Presidents also assumed in their policy deliberations and in their projections that the Congress and the administration would achieve deficit reductions in the range of those in the recent House and Senate budget resolutions. Failure to move forward with those proposals would run a serious risk of reversing the favorable effects that congressional actions to date have had on investor expectations and would create a real impediment to the solution of the structural problems plaguing our economy today.

The Performance of the Economy in the First Half of 1985

After a year and a half of extraordinarily rapid growth, economic activity decelerated abruptly in the middle of 1984 and slowed somewhat further in the first half of 1985. Growth in real gross national product is estimated to have averaged less than 2 percent at an annual rate so far this year; the unemployment rate has remained flat at about 7¼ percent. Inflation has held at the lower pace reached during the 1981–82 recession.

To some extent, the moderation in growth during the past year has reflected the slowing in household and business spending that often occurs after the initial phase of cyclical recovery. Pent-up demand for housing and consumer durables generally fades as an expansion period lengthens, and growth in business fixed investment often exhibits some cyclical deceleration over time. However, the recent slowing in growth also reflects factors unique to this expansion.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In particular, this expansion has taken place in the context of a highly stimulative federal fiscal policy. Real GNP grew more rapidly in 1983 and the first half of 1984 than in any previous recovery since the Korean War. Ultimately, some slowing in growth would have been required to avoid inflationary overheating of the economy. However, even before that point was reached, the initial effect of the fiscal stimulus began to wane, dissipated in part through its contribution to a worsening U.S. competitive position in international trade and diversion of demand away from goods produced in the United States.

The pronounced increases in the merchandise trade and current account deficits have occurred as enormous federal deficits and resultant heavy borrowing by the federal government have added to other factors helping to keep U.S. interest rates at high levels, relative both to historical experience and to the rate of inflation. These credit demands have been met partly through a substantial inflow of foreign capital, which has been associated with a large appreciation in the foreign exchange value of the U.S. dollar. The strong dollar has encouraged U.S. consumers and businesses to increase greatly the portion of their expenditures devoted to imports, and at the same time has inhibited U.S. exports. Exports also have been restrained by slow growth in demand abroad. As a result, gains in domestic demand have outstripped those in domestic production by a wide margin throughout the expansion period.

The effects of the weakening trade balance in the past few years have been felt keenly in the manufacturing sector. Industrial production, which began to level off in the summer of 1984, remained stagnant in the first half of 1985, and employment in the manufacturing sector declined. The strong dollar also has exacerbated the economic problems of farmers, many of whom face difficult adjustments because of falling product prices and the need to service a large volume of debt accumulated during the inflationary period of the 1970s and early 1980s.

Thus far, however, the weakness in the manufacturing and agricultural areas has been more than offset by strong gains in other sectors. Domestic final demand rose at an annual rate of 3½ percent in the first quarter of 1985, about the same as in the second half of last year; second-quarter gains also appear to have been substantial. Spending in such interest-sensitive areas as autos and housing was particularly strong in the first half of 1985, reflecting in part lower credit costs that have emerged since mid-1984.

The strength of the dollar also has had a restraining influence on inflation, by reducing import prices and by forcing U.S. producers to adopt more competitive pricing strategies. Inflationary pressures have been limited, too, by the lack of pressure on resources here and the slack abroad. Most measures of overall price increase remained in the 4 percent range in the first half of 1985, but prices of manufactured goods rose little and significant downward pressures on prices were evident in markets for oil and basic commodities.

The Household Sector

Growth in real disposable income continued to slow in the first half of 1985, reflecting smaller increases in interest income as well as weakness in manufacturing payrolls and in farm income. Nonetheless, gains in household spending, especially in the interest-sensitive sectors, were sizable and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

supported by continued heavy borrowing. As a result, the personal saving rate fell appreciably below last year's level of 6 percent.

Consumer spending for new cars was particularly strong in the first half. Total auto sales averaged nearly 11 million units at an annual rate, with sales of domestic models around their highest level for a six-month period since 1979. The strength in auto sales was partly attributable to the improved availability of many popular domestic models since the strike-related disruptions in production last fall. In addition, auto demand was bolstered by generally lower interest rates compared with those of last year and by some special financing programs offered by manufacturers. Sales of foreign cars were held down in the first quarter because supplies of Japanese models were limited at the end of the annual period for the voluntary export restraint program. Foreign car sales picked up in the spring and early summer, however, when Japanese cars shipped after the start of the new annual period began to arrive at U.S. dealerships.

Meanwhile, activity in the housing market has rebounded since last fall. Housing starts rose to an annual rate of 1.8 million units on average in the first five months of 1985, retracing nearly all of the decline that occurred in the latter half of last year after rates on fixed-rate mortgages temporarily rose to the 14 percent range. Housing activity generally has been quite robust in this expansion period despite high real interest rates. Demand for owner-occupied units has been buoyed by the movement of the "baby boom" generation into its prime home-buying years, as well as by the beneficial effects of stable house prices and innovative financing techniques, such as adjustable-rate mortgages, on the affordability of homes.

The strong gains in household spending over the past two and one-half years have been accompanied by considerable alterations in balance sheets. The ratio of household debt to income has increased rapidly and is now well above its 1980 peak. Asset growth has been strong as well, however, and the ratio of financial assets to income has risen sharply in the past year, owing in part to the rapid rise in stock prices.

The incidence of payment difficulties on consumer installment debt has risen somewhat in the past half year or so from relatively low levels. Delinquency and foreclosure rates on home mortgages have been at high levels for some time, and they rose further in early 1985. The large number of defaulted mortgage loans partly reflects rates of unemployment that are still high and the weakness of home prices in many locales, which has left some homeowners with little equity to protect when they encounter financial difficulties. However, aggressive underwriting of some mortgages, including loans carrying lower payments in the first years, appears to be a contributing factor.

The Business Sector

Conditions in the business sector were mixed in the first half of 1985. Many industrial firms experienced pressures on profit margins in an environment of intense price competition and declining capacity utilization, and widespread financial strains continued to be present in the agricultural and energy sectors. At the same time, however, some other sectors of the economy recorded good gains in sales and income. Economic profits for corporations in the aggregate remained at the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

higher level reached after the sharp runup earlier in the expansion, with after-tax profits as a percent of GNP at the highest levels seen for any sustained period since the late 1960s.

Growth in business spending for fixed capital began to slow in the latter half of 1984, after a period of extraordinary expansion, and a further slowing occurred in the first part of 1985. The weakening has been most pronounced in equipment outlays, affecting both the high-technology categories and more traditional types of industrial equipment. Nevertheless, surveys of capital spending intentions taken in the first half of the year indicated that businesses still planned a healthy expansion in outlays for 1985 as a whole. A relatively large proportion of these expenditures reportedly was earmarked for replacement and modernization rather than expansion of capacity, reflecting a desire to cut costs and improve competitiveness. Meanwhile, spending for nonresidential construction, particularly offices and stores, continued at strong rates in the first half of 1985, and construction contracts rose further despite very high vacancy rates in many parts of the country.

The pace of inventory accumulation in the business sector has been moderate in recent months. In real terms, business inventories rose about $19 billion at an annual rate in the first quarter of 1985, compared with an average gain of $25 billion in 1984; inventory accumulation probably was still lower in the second quarter. Manufacturers, especially those facing intense import competition, have continued to be cautious in adding to inventories. Total stocks in this sector declined in both April and May, and inventory-sales ratios for the most part remain near historical lows. In the trade sector—with the notable exception of the car industry—inventory-sales ratios have remained a bit high, though, and selected efforts to pare stocks have continued.

With slower growth in investment in the first half of 1985, the gap between capital expenditures and internal funds of firms remained moderate. Nevertheless, businesses continued to borrow heavily, reflecting a continued massive amount of equity retirements by firms engaged in mergers and other corporate restructurings. As a result, debt-equity ratios have risen for a number of firms, especially in the petroleum industry in which a major restructuring is currently taking place. However, for most other firms, equity additions through retained earnings or sales of new shares have been considerable. With rising stock prices, debt-equity ratios for these firms, when their assets and liabilities are measured at current market values, have shown some decline in recent months.

Nonetheless, financial strains, in many cases related to the high foreign exchange value of the dollar, persist in some areas of the economy. In particular, low capacity utilization rates in a number of import-sensitive manufacturing industries, including machine tools, steel, some types of chemicals, and textiles, have intensified pressures on profitability. In addition, large segments of the farm sector continue to suffer greatly from reduced exports, depressed land prices, and low incomes; many farmers face serious debt-servicing problems, causing problems in turn for agricultural lenders. In the energy sector, continued downward pressure on world oil prices has caused petroleum drilling to be curtailed, which has strained the earnings of many oilfield equipment and servicing firms.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Government Sector

Federal tax receipts continued to rise substantially in the first half of 1985, but so too did outlays, and the deficit for fiscal year 1985 likely will be around $200 billion. This deficit represents about 5 percent of total GNP and more than half of net private domestic saving. Federal purchases of goods and services, the part of federal spending that enters directly into GNP and constitutes about a third of total outlays, rose comparatively moderately in the first half of 1985; defense procurement, an area of rapid growth in spending over the past few years, grew at a reduced pace as outlays lagged more than is typical relative to appropriations. Real nondefense purchases (excluding the Commodity Credit Corporation) continued to be relatively flat.

Purchases by state and local governments were essentially unchanged in the first quarter but evidently rose in the second as construction outlays increased significantly in the spring. States and localities, many of which had serious fiscal difficulties in the last recession, generally have been cautious in raising spending throughout this expansion period, though they have been endeavoring to address the problem of an aging infrastructure. The combination of spending restraint and improved revenues, owing both to legislated tax increases and to rising incomes, has resulted in a substantial rise in the operating and capital account surpluses of state and local governments since 1982.

The External Sector

The external sector has come to play an increasingly important role in the U.S. economy. Merchandise imports have risen rapidly in this expansion, moving above 15 percent of real domestic expenditures on goods in the first half of 1985. The increase in import penetration has been widespread, occurring in both the consumer and capital goods sectors as well as in industrial supplies.

Although U.S. exports increased in 1983 and 1984, they grew much less than imports and have not yet regained their previous peak. In the first half of 1985, exports, particularly of agricultural products, have declined somewhat. As a result of these trends, the current account deficit has widened dramatically over the past few years, reaching an annual rate of $120 billion in the first quarter of 1985.

Part of this imbalance reflects the stronger growth of demand in the U.S. economy since 1982 relative both to the other industrial countries and to the debt-burdened developing countries. Although this influence has lessened with the slowing of the U.S. economic expansion since the middle of last year, there has been no acceleration in growth in the other industrial countries, and many developing countries have continued to face financial constraints. The greater share of the imbalance, however, probably is attributable to the substantial appreciation of the dollar over the past few years. On average during the first half of this year, the trade-weighted value of the dollar was roughly 70 percent above its level five years earlier.

The appreciation of the dollar and the underlying demand of investors for dollar-denominated assets and other claims on the United States have been partly associated with differentials between real rates of return on U.S. and foreign assets. The enormous federal budget deficits have been an important factor contributing to these differentials. The moderation in interest rates that has accompanied the slowing of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the economic expansion in the United States since mid-1984 appears to have eased some of the upward pressure on the dollar; after rising sharply through the first two months of this year, the exchange value of the dollar has trended downward and is now around the level of late last summer. Nevertheless, the high level of the dollar continues to limit the ability of U.S. producers to compete both at home and abroad.

Labor Markets

Growth in labor demand generally remained strong in the first half of 1985, and the number of workers on nonfarm payrolls increased 1.4 million. The bulk of the job growth was in the service and trade sectors, in which employment in the past six months has expanded at rates similar to last year's rapid pace. Increases in the restaurant and business services areas have been especially large. Construction employment also showed a sizable gain in the first half of 1985, along with significant growth in both residential and nonresidential construction. In contrast, manufacturing employment dropped about 220,000, with cutbacks in payrolls widespread among industries.

Despite the substantial gains in overall payroll employment, the unemployment rate has remained at about 7¼ percent, the level that has prevailed since last June. The labor force participation rate was up appreciably on average during the first half; the rise occurred primarily among adult women, who evidently were responding to the increase in job opportunities in the service and trade sectors in which 80 percent of adult women are now employed.

Wage inflation has remained restrained. Year-over-year changes in the employment cost index for wages and salaries, a relatively comprehensive measure for the private nonfarm business economy, have held steady at just over 4 percent for nearly a year. This is about 1 percentage point less than in 1983 and early 1984, and substantially below the peak rate of about 9 percent reached in 1980. The slowing in union wage increases over the past several years has been especially large. Union wage gains both in and out of manufacturing have been below the increases posted in nonunionized sectors for the past year and a half, causing a partial erosion of the differential that had built up over the years before the last recession. Major collective bargaining agreements negotiated in early 1985 indicate continued moderate wage growth in the unionized sectors.

Productivity in the nonfarm business sector appears to have declined in the first half of 1985, after increases amounting to 4 percent in 1983 and 2½ percent in 1984. Both the recent slowing in productivity and the substantial gains earlier in the recovery largely reflect the fact that employment tends to respond more slowly than output to changes in demand. However, improvements in productivity appear to continue to be a major priority of both workers and management, as evidenced by widespread reports of modernization of facilities as well as relaxation of work rules and other steps to enhance efficiency and hold down costs.

The combination of improved productivity growth and relatively restrained wage gains in this expansion has resulted in a sizable deceleration in the average rate of increase in unit labor costs relative to the previous several years. Although unit labor costs have risen this year in response to the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

downturn in productivity, they are still only about 3 percent above their year-ago level.

Price Developments

After slowing sharply in the recession, the broadest measures of inflation have held fairly steady at about 4 percent during much of the expansion. While the stability of the inflation rate during this expansion partly reflects some special factors, significant progress appears to have been made in reversing the underlying momentum of the inflationary process that sustained the wage-price spiral of previous years. Inflation expectations have been more subdued, and both labor and management have exhibited a better appreciation of the fact that gains in real incomes cannot be achieved simply by marking up nominal wages or prices.

The strong dollar has reinforced other factors holding down inflation in this expansion period, both directly by reducing the prices of imported goods and indirectly by forcing U.S. manufacturers to restrain price increases in order to remain competitive. Retail prices of goods excluding food and energy rose about 3½ percent, at an annual rate, in the first half of 1985, about the same as the average rate of change in the two preceding years. Increases in prices of nonenergy services, which have not been affected nearly so much by import competition, have continued to be substantial, averaging a 5½ percent rate in the past six months, the same as in 1984.

Energy prices have been quite volatile over the past year, mainly reflecting movements in gasoline prices. From the autumn of 1984 through February of this year, gasoline prices fell about 3½ percent, as refiners sought to reduce excess inventories. Production was adjusted downward as well, resulting in a spurt in prices in the spring. However, gasoline prices appear to have stabilized more recently, as inventory levels have returned to normal while crude oil supplies remain abundant. Food prices have risen only a little this year, reflecting the moderate rate of increase in processing costs as well as plentiful agricultural supplies.

Prices of basic industrial commodities, which rose markedly in the initial stages of this upswing in business activity, have been trending downward for the past year and a half. The demand for materials by U.S. manufacturers has been weak, and world supplies have been ample, owing in part to the expansion of capacity in many developing countries in the past decade and their need to maintain export revenues.

Money, Credit, and Financial Markets in the First Half of 1985

In February of this year the FOMC established target growth ranges for the year (measured from the fourth quarter of 1984 to the fourth quarter of 1985) of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3. For domestic nonfinancial sector debt, an associated monitoring range was set at 9 to 12 percent. The M1 range for 1985 represented a reduction of 1 percentage point at the upper end from the range of the preceding year, while the range for M2 was unchanged. To reflect changes in the pattern of financial flows, the 1985 range for M3 was raised ½ point at the upper end, and the whole range for the debt aggregate was raised 1 percentage point. It was expected that these ranges would be adequate to encourage further real economic growth at a sustainable pace consistent with con-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tainment of inflationary pressures and a movement over time toward reasonable price stability.

In implementing policy throughout the period, the FOMC emphasized the need to evaluate growth in the monetary aggregates in the context of information available on economic activity, prices, and financial market conditions. Among other factors, the strength of the dollar and the related sluggishness of manufacturing activity required attention. As an operational matter, the degree of pressure on reserve positions of depository institutions was relatively unchanged during the period, and the discount rate was reduced once.

Money, Credit, and Monetary Policy

The unusually sharp drop in velocity in 1982 and early 1983, when growth of M1 greatly exceeded that of nominal GNP, had led the FOMC to place less reliance on M1 as an operational guide to policy. During the latter part of 1983 and in 1984, however, the patterns of M1 growth relative to other economic variables proved more consistent with historical experience, and Ml was given more weight in the conduct of policy. Nonetheless, considerable uncertainty remained, in part because of limited experience with the impact of deposit deregulation and financial market innovations on the behavior of M1 under varying economic and financial circumstances. Similar concerns about possible changes in the account offerings and pricing behavior of depositories and the asset demands of households affect all the monetary aggregates to some extent. These factors accounted in part for the need to interpret movement in the aggregates in the light of other information, including evidence on shifts in velocity.

In the event, monetary policy during the first half of the year had to be adapted to a further slowing in economic growth as manufacturing activity was essentially flat and the agricultural sector remained under pressure, to a continued high value of the dollar on exchange markets, and to a tendency for the velocity of money, particularly of M1, to fall. Price and wage pressures remained relatively well contained; indications of some acceleration in the early part of the year were followed by more moderate increases in subsequent months.

In that context, monetary policy basically accommodated the strong demands for reserves by depository institutions that emerged during the first half of the year. The total of adjustment plus seasonal borrowing varied within a generally narrow range over

Growth of Money and Credit

Percent changes

Period	M1	M2	M3	Domestic non-financial sector debt
1984:4 to 1985:2	10.5	8.8	7.9	12.8[e]
1984:4 to June 1985	11.6	9.3	8.2	12.7[e]
Fourth quarter to fourth quarter				
1979	7.5	8.1	10.3	12.1
1980	7.5	9.0	9.6	9.6
1981	5.1 (2.5)[1]	9.2	12.4	10.0
1982	8.8	9.1	10.0	9.1
1983	10.4	12.2	10.0	10.8
1984	5.2	7.7	10.4	13.6
Quarterly growth rates				
1984:1	6.2	7.2	9.2	13.0
2	6.5	7.1	10.5	13.0
3	4.5	6.8	9.5	12.6
4	3.2	9.1	11.0	13.4
1985:1	10.6	12.0	10.7	13.4
2	10.1	5.3	5.0	11.8[e]

1. M1 figure in parentheses is adjusted for shifts to NOW accounts in 1981.

e Estimated.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the period, though increasing for a time in the spring as a result of special situations affecting nonfederally insured thrift institutions in Ohio and Maryland. Reserve positions had been eased considerably in the latter part of 1984 and the early weeks of 1985. With an easing of reserve pressures and a slowing in economic growth, interest rates had declined sharply from their late summer peaks through the very early weeks of this year.

The decline of interest rates appeared to stimulate, with usual lags of some months, a sizable increase in demands for assets contained in M1, principally interest-bearing checking accounts (NOW accounts). Shifts of long-term savings and liquid funds out of market instruments and time deposits into these accounts in the early months of the year entailed a substantial rise in total reserves to support them. As the public's asset preferences shifted toward components of M1, its income velocity declined sharply because holdings of these assets increased relative to the GNP. Only minimal effects on M1 growth likely resulted from shifts of funds into Super NOW accounts after the minimum-balance requirement was reduced from $2,500 to $1,000 at the beginning of the year because the bulk of the funds shifted appeared to come out of regular NOW accounts.

Most market interest rates rose about a full percentage point from their January lows in the course of the winter, though the level of rates remained well below the 1984 peaks. Demands for credit remained strong. Economic growth had picked up in the fourth quarter and early data for the first quarter, though mixed, seemed generally consistent with moderate growth. While, as noted, reserve growth was sizable during the quarter to accommodate shifts in the public's asset preference, reserves were provided somewhat more cautiously through open market operations during the period of most rapid acceleration of M1 growth in the first quarter.

By early spring, incoming economic data made it clear that the rate of economic expansion remained limited. Inflation rates continued generally low, prospects for further oil price declines helped damp inflation expectations, and the market responded positively to signs of possible congressional action to reduce the budget deficit. Growth of M1 moderated substantially, and the aggregate began to decelerate toward its longer-run range in late winter and early spring. Interest rates reversed their earlier rise as market expectations changed. Rate declines were also influenced by a cut in the Federal Reserve's discount rate in May of 1/2 percentage point to 7 1/2 percent, which took place in the context of continued signs of economic weakness and against the background of restrained inflationary pressures and a strong dollar on exchange markets. By midyear, short-term rates were down to 3/4 to 1 1/4 percentage points from levels around year-end, while long-term rates had declined about 1 to 1 1/4 percentage points.

Growth in M1 spurted once again in the late spring. To some extent, interest rate decreases contributed to a strengthening of demand for M1-type assets during the latter part of the second quarter. Growth of NOW accounts, which had moderated in late winter, picked up as offering rates on Super NOW accounts adjusted sluggishly to the renewed decline in market rates of interest. However, the strength of M1 also reflected an unusual surge in demand deposit expansion in May that extended into June at

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

an even more rapid pace. The rise seems greater than is explainable by usual reactions to the reduced opportunity cost of holding such funds or to adjustments in compensating balances and may be partly related to sharp swings in U.S. Treasury balances. A question has been raised as to whether corporate cash management practices have become less aggressive in recent months, but there is no clear evidence on the point.

With the sharp late-spring expansion of M1, its velocity in the second quarter again declined at about the same rate as in the first. The decline in the velocity of M1 over the first half of this year—as well as the lesser declines in the velocity of M2 and M3—is reminiscent of experience in 1982–83. Indeed, both in the first half of this year and over the one-year period from mid-1982 to mid-1983 the income velocity of M1 declined at annual rates of about 4 1/2 to 5 percent. The drop in M1 velocity in both periods appears to have reflected, to a considerable degree and with usual lags, declines in market interest rates, although the magnitude of the declines was in both cases somewhat more than could be expected based on past relationships of money, income, and interest rates.

Episodes of velocity decline may be inherent in the disinflationary process. As interest rates adjust downward in reflection of lowering inflation rates, households and firms become increasingly less reluctant to tie up portions of their funds in lower-earning transaction balances. The adjustment has not been steady. Yield declines have been bunched in time, and the ensuing bunched additions to money balances have led to sudden drops in velocity. Unfortunately, the timing of such velocity changes is no easier to predict than is the timing of interest rate changes. Deposit deregulation may have contributed to the extent of velocity adjustments by making the demand for the group of assets in Ml more responsive to interest rate changes than it used to be.

While growth of M1 was quite high relative to its long-run range for 1985, the broader aggregates remained generally within their ranges. Growth of M2 from the fourth quarter of 1984 to the second quarter of 1985, at an 8 3/4 percent annual rate, was a little below the upper limit of its range, expressed graphically as a cone based in the fourth quarter of 1984. However, expansion of this aggregate in June brought its monthly average a little above the upper end of the range.

Given the deregulation of bank deposit rates, the growth of M2 should be less affected over periods of as long as a half year by interest rate developments because offering yields on most of its components are adjusted in line with market rates and many of the shifts of funds engendered by interest rate changes are among assets within this broader aggregate. But because the adjustments in offering yields tend to lag market changes, M2 does show considerable short-term responsiveness to interest rate changes. Deposit rates, especially on money market deposit accounts (MMDAs), fell much less than market yields last fall, so M2 rose rapidly for several months. Then rising market yields in February and March held back M2. The nontransaction portion of M2 actually declined in April for the first time in 15 years, although this may have been partly the result of difficulties in seasonal adjustment owing to the limited experience with individual retirement accounts

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(IRAs), which are excluded from M2, and with tax payments made out of MMDAs and money market funds. After rates fell back, M2 picked up again strongly in late spring.

M3 growth, meanwhile, was comfortably within its target range during the first half of the year. Issuance of large CDs has slowed substantially from last year at both banks and thrift institutions. Core deposit flows have accelerated while the rate of loan expansion has held about steady. Furthermore, perhaps in response to new Federal Home Loan Bank Board regulations raising net worth requirements for fast-growing institutions, thrift institutions have reduced net acquisitions of assets. In doing so, some institutions have taken advantage of declining yields by using the capital gains from asset sales to boost reported earnings.

Growth in total debt remained extremely strong in the past two quarters, averaging a bit above its monitoring range, though below the record pace of 1984. Federal government borrowing continued to absorb more than a fourth of total funds made available to domestic nonfinancial sectors. An increasing proportion of the Treasury's debt carries distant maturity dates; 90 percent of net marketable borrowing this year has been in issues of notes and bonds maturing in 2 to 30 years. Issues of 20- and 30-year debt, in particular, are increasing and now dominate the new-issue market for taxable long-term bonds, accounting for more than two-thirds of new offerings in that maturity class. This large volume of new long-term debt has changed the makeup of the secondary market as well. The supply of Treasury issues outstanding with 15 or more years remaining to maturity has doubled in little more than 2 years, while the amount of private issues in that maturity range has shown little net change.

Borrowing of state and local governments has been unexpectedly strong so far this year, but an unusually high proportion has been for advance refunding of existing issues, as governments have sought to take advantage of lower interest rates. Because the funds borrowed in such operations are reinvested in financial instruments, they have little net impact on credit market pressures. Indeed, most of these funds are required by law to be invested in specially issued Treasury debt, thus reducing the Treasury's need for public offerings. Single-family housing revenue bonds have slowed from the second half of last year. But last year's issues were heavily concentrated in the later part of the year because of delays in the reauthorization of such bonds; recent volume has been close to the 1984 average rate.

Business credit demands have remained strong this year. Slowing growth of both profits and expenditures for fixed capital and inventories has, on balance, had little effect on total borrowing needs. Corporate borrowing has been heavier in the short-term paper and loan categories than in bonds, but not to the same extent as in the early part of 1984 when interest rates were rising. In addition, while new-issue bond volume has picked up in response to the lowest long-term yields in five years, maturities of new bond issues have been concentrated in the short- and intermediate-term areas, as they were last year.

An unusual portion of the borrowing, also like last year, has been used to finance equity retirements of one sort or another. Mergers, buyouts,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

share repurchases, and swaps with shareholders of new debt for stock have continued on the same massive scale as last year. Borrowing initiated with the purpose of financing these transactions may have accounted in gross terms for more than a percentage point of the growth rate of total nonfinancial debt over the first half. But such an estimate may overstate the net effects of recent corporate recapitalizations on debt growth. A number of firms involved in mergers or restructurings this year and last have recently completed large asset sales, some for the explicit purpose of repaying debt. Furthermore, merger activity may be indirectly responsible for some of the increased new equity offerings because of its generally stimulative effect on stock prices as funds paid to shareholders are reinvested.

Household borrowing also has remained strong. Demand for mortgage loans has been buoyed by declining interest costs. At the lower rates, households have found adjustable-rate loans less attractive than last year, reducing from two-thirds to about one-half the proportion of new conventional mortgages with these features. Installment debt continued to rise faster than income in the first half of the year, but the second-quarter data show some deceleration in line with signs of a slowing in the growth of consumption spending on large-ticket items.

Other Developments in Financial Markets

Signs of strain in financial markets have persisted this year, but without causing major disruptions in general credit market conditions. Although the government securities market as a whole has been performing well, the failures of three secondary government securities dealers caused losses, sometimes substantial, for some of their customers. A number of local governments and savings and loans were among those hurt, and losses by one large thrift institution in Ohio had further repercussions, threatening to bankrupt the statewide private insurance system and, for a time, generating some concerns here and abroad about the safety of other financial institutions. Runs on privately insured savings and loans in Maryland, some of which also lost money as a result of the failure of securities firms, followed the problems in Ohio. Privately insured savings and loans in both states were closed or limited to small withdrawals for a time, causing serious inconvenience to some depositors, and some institutions remain closed or restricted.

However, these various problems have been relatively well contained, without significant effects on other institutions and markets. A number of institutions have switched to federal insurance. And the Federal Reserve, acting in its role as lender of last resort, made advances to nonfederally insured thrift institutions in Ohio and Maryland to help facilitate adjustments in the face of large deposit outflows. For a while, the borrowing affected the amount of adjustment credit at the discount window but because of the special conditions did not add to reserve market pressures as perceived by other institutions. After a time the borrowings were classified as extended credit.

The thrift industry as a whole continues to suffer from low net worth and mismatched balance sheets, but the recent declines in interest rates are improving earnings. The Federal Home Loan Bank Board (FHLBB) has taken

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

a number of steps, including increased capital requirements for rapidly growing institutions, to encourage the stabilization of the industry over time. Capital requirements also have been raised for banks, some of which have suffered from a high incidence of nonperforming loans and loan losses in recent quarters. The troubled loans are concentrated in energy, agriculture, and real estate sectors and to borrowers of some foreign countries. Bad news about the loan portfolios of individual institutions and other reported losses have produced some ripples in market rates generally, but spreads between borrowing rates of financial institutions and the Treasury have been quite low for the most part. To some extent, loan losses reflect overly aggressive lending decisions, but the problems of borrowers in the hardest hit industries are partly a result of difficult adjustment to a higher value of the dollar and lower rates of inflation than were expected when the loans were made. In the agricultural as in other sectors, investors and borrowers have discovered that the inflation of land and commodity prices can no longer be taken for granted.

In light of strains relating to agricultural credit, the Federal Reserve liberalized its regular seasonal borrowing program and initiated a temporary special seasonal program. However, there has been only relatively limited use of seasonal credit owing to the easing of money market conditions as the spring progressed.

With regard to conditions among nonfinancial businesses, the prospects of some of those in the weaker industries—especially those most adversely affected by the high dollar—are subject, of course, to considerable uncertainty. But, in addition, many firms have deliberately chosen a more precarious financial structure in order to enhance current market valuations of shares or to fend off undesired takeover bids. Nevertheless, financial markets have not shown generalized concern about corporate financial structure; notably, spreads between corporate and Treasury debt are unusually narrow, having shrunk since the beginning of the year.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Part 2

Records, Operations, and Organization

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Record of Policy Actions of the Board of Governors

Regulation B (Equal Credit Opportunity)

November 7, 1985—Revision

The Board revised Regulation B as part of its Regulatory Improvement Project, a continuing program to clarify, simplify, and update regulations.

Votes for this action: Messrs. Volcker, Partee, and Rice. Vote against this action: Mr. Martin. Absent and not voting: Mr. Wallich and Ms. Seger.[1]

Regulation B implements the Equal Credit Opportunity Act, which prohibits discrimination in credit transactions on the basis of race, color, religion, national origin, sex, marital status, age, and other factors. The regulation also sets out specific rules governing appropriate credit application procedures, maintenance of credit histories, procedures for credit denials and terminations, and the notation of race, national origin, and other characteristics for monitoring creditor compliance. The major provisions of the regulation are unchanged in the revised format; they have been rewritten in simpler, clearer language. A revised official staff commentary explains the new Regulation B and offers guidance in applying its requirements to an institution's operations.

These are the principal substantive changes: (1) procedures for incomplete credit applications were revised, and a broader selection of sample forms for advising applicants of credit denials was provided; (2) data notation requirements for certain mortgage loan applications were changed; and (3) the definition of "applicant" was changed to give guarantors legal standing in the courts when a violation of the signature provisions in the regulation is alleged.

With regard to the revisions affecting data notation, Regulation B requires that creditors record—from observation or reference to the applicant's surname—the race or national origin and the sex of an applicant seeking certain types of residential mortgage credit if the applicant does not volunteer that information. The requirement is intended to assist regulators in detecting patterns of discrimination. Governor Martin, although not objecting to the entire regulation, was concerned that requiring creditors to check visually an applicant's race or nationality would place too much importance on those factors, and he preferred to give creditors the choice of whether to record such factors if an applicant omitted them. The other members noted that the provision aided in detection of unlawful credit discrimination and that allowing creditors such a choice would impede detection. The Board adopted the revised Regulation B, including that requirement, Governor Martin dissenting.

The Board also considered whether credit for business or commercial purposes should be subjected more fully to certain provisions of Regulation B than is currently the case. The Board decided to take no regulatory action at this time, but to monitor developments and take appropriate action if necessary. In the

1. On this and subsequent pages, footnote 1 indicates that there was a vacancy on the Board at the time the action was taken.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

meantime, an educational pamphlet is being developed to inform women and minority entrepreneurs of their rights under the law in business credit transactions.

The revised Regulation B is effective December 16, 1985; however, creditors may continue to comply with the current regulation until October 1, 1986.

Regulation D (Reserve Requirements of Depository Institutions)

December 4, 1985—Amendments

The Board amended Regulation D, effective December 31, 1985, (1) to increase the amount of transaction accounts to which the lower reserve requirement applies; and (2) to increase the amount of reservable liabilities subject to a zero percent reserve requirement.

Votes for these actions: Messrs. Volcker, Martin, Partee, Rice, and Ms. Seger. Votes against these actions: None. Absent and not voting: Mr. Wallich.[1]

Under the Monetary Control Act of 1980, depository institutions, Edge and agreement corporations, and U.S. agencies and branches of foreign banks are subject to reserve requirements set by the Board. Initially, reserve requirements were set at 3 percent of an institution's first $25 million in transaction balances and 12 percent on balances above that level. The act directed the Board to adjust annually the amount subject to the lower reserve requirement to reflect changes in the amount of transaction balances in the banking system nationwide. By the beginning of 1985, the amount had been raised to $29.8 million. Recent growth in such balances indicated that a further increase of $1.9 million was warranted. The Board, therefore, amended Regulation D to increase to $31.7 million the amount to which the 3 percent reserve requirement applies.

The Garn–St Germain Depository Institutions Act of 1982 established a zero percent reserve requirement on the first $2 million of an institution's reservable liabilities. It also provided for annual adjustments to that exemption based on nationwide deposit growth. Recent growth in deposits indicated that the amount subject to a zero percent reserve requirement should be increased from $2.4 million to $2.6 million, and the Board amended Regulation D accordingly.

Regulation G (Securities Credit by Persons Other than Banks, Brokers, or Dealers), Regulation T (Credit by Brokers and Dealers), and Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks)

March 13, 1985—Amendments

The Board amended Regulations G and U to exclude face-amount certificates from the definition of margin securities. In a companion action, the Board amended Regulation T to clarify that broker–dealers selling such certificates would not be considered to be in violation of the regulation's provisions on arranging credit. The amendments to the three regulations are effective April 19, 1985.

Votes for these actions: Messrs. Volcker, Martin, Partee, Rice, Gramley, and Ms. Seger. Votes against these actions: None. Absent and not voting: Mr. Wallich.

Face-amount certificates are securities issued by certain investment com-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

panies that promise to pay investors a fixed amount at a specified date in return for a designated payment. Holders of these certificates may obtain loans from the issuers at interest rates of up to 6 percent, the maximum set by law. Because the certificates function more like life insurance policies than mutual funds, and because the certificates have limited investor appeal, the Board believed no useful purpose would be served by subjecting them to margin regulations.

Regulation G (Securities Credit by Persons Other than Banks, Brokers, or Dealers) and Regulation T (Credit by Brokers and Dealers)

June 19, 1985—Amendments

The Board amended Regulations G and T, effective July 22, 1985, to permit lenders to extend credit on a good-faith basis to qualified employee stock-ownership plans.

The Board amended Regulation T, effective September 30, 1985, to permit a uniform, premium-based system of margin requirements for all types of option contracts.

Votes for these actions: Messrs. Partee, Rice, Gramley, and Ms. Seger. Votes against these actions: None. Absent and not voting: Messrs. Volcker, Martin, and Wallich.

The amendment to Regulation G allows lenders, such as savings and loan associations, finance companies, and insurance companies, to extend credit, on the same basis that banks do, to trusts for employee stock-ownership plans that qualify under section 401 of the Internal Revenue Code. The related amendment to Regulation T permits brokers and dealers to arrange and to extend credit for such qualified plans on the same good-faith basis.

The second amendment to Regulation T makes the initial margins required for the writing of options on equity securities identical to the maintenance margins required by the rules of the exchange or association on which the options are traded, if those rules have been approved by the Securities and Exchange Commission. The change will facilitate adoption by the SEC of a proposed new margin system under which the margins required for all types of options would be based on a premium plus a percentage of certain market variables.

Regulation J (Collection of Checks and Other Items and Wire Transfers of Funds)

January 23, 1985—Amendment

The Board amended Regulation J, effective October 1, 1985, to improve the procedures for notifying banks that certain checks are being returned unpaid.

Votes for this action: Messrs. Volcker, Partee, Rice, Gramley, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Martin and Wallich.

The Board's existing procedures had required a payor institution that returned unpaid a check of $2,500 or more to provide notification of nonpayment. Typically, the payor institution notifies the institution that presented the check to it, which usually is a Federal Reserve Bank. This practice had proved unsatisfactory for several reasons, and the Board amended the regulation to incorporate the following modifications: (1) specifying an institution's liability for failing to provide notice; (2) requiring that the payor institution notify the depositing institution; and (3) specifying a

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

period within which the notification must be provided. Regulation J, as amended, requires that notification be provided directly to the institution of first deposit by midnight of the second banking day after the day on which a check of $2,500 or more is dishonored. The notice must include certain information that allows the depositing institution to identify the returned check. An institution that fails to exercise ordinary care in providing a timely and accurate notification will be liable for losses incurred by the institution of first deposit, up to the amount of the returned check.

In connection with this action, the Reserve Banks improved their procedures so they could better assist payor institutions in providing the required notification information.

Regulation K (International Banking Operations)

August 14, 1985—Revision

The Board revised Regulation K pursuant to provisions in the International Banking Act of 1978 that require a review of the regulation every five years.

Votes for this action: Messrs. Volcker, Wallich, Partee, Rice, Gramley, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Martin.

The International Banking Act requires periodic review of Regulation K to ensure that Edge and agreement corporations remain competitive with foreign-owned banking organizations in the United States and abroad, under prevailing economic conditions and banking practices. Having completed such a review, the Board revised Regulation K in the following areas: activities of Edge corporations in the United States, changes in control, and investment procedures. The Board also made several technical and clarifying amendments, but deferred action on proposed capital requirements for Edge corporations.

The revisions affecting permissible activities allow Edge corporations to provide full banking services to a class of companies that are restricted by their licenses to international business. The regulation also was revised to require that parties give the Board advance notice before acquiring control of an Edge corporation. This requirement will allow the Federal Reserve to assess the financial strength of proposed acquiring organizations and will improve the Board's supervision of Edge corporations. Other revisions increase from $2 million to $15 million the amount that a U.S. banking organization may invest in another company without prior Board approval, and permit some leeway in the requirement that subsidiaries confine their activities to those specified in Regulation K.

The revisions are effective October 24, 1985, except for the provisions affecting investment procedures, which are effective immediately.

Regulation T (Credit by Brokers and Dealers)

March 13, 1985—Amendments
June 19, 1985—Amendments

These actions are discussed under Regulation G.

Regulation U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks)

March 13, 1985—Amendments

These actions are discussed under Regulation G.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Regulation AA (Unfair or Deceptive Acts or Practices)

April 22, 1985—Amendment

The Board amended Regulation AA, effective January 1, 1986, to adopt a rule for banks substantially similar to the Credit Practices Rule recently adopted by the Federal Trade Commission for other types of creditors.

Votes for this action: Messrs. Martin, Wallich, Partee, and Rice. Votes against part of this action: Mr. Gramley and Ms. Seger. Absent and not voting: Mr. Volcker.

The new rule prohibits banks from entering into any contract for consumer credit that contains the following: a confession-of-judgment clause; a limitation or waiver of exemption from attachment, execution, or other process; an assignment of future wages to the creditor in the event of default; or a security interest in a consumer's household goods other than those purchased with the credit. The new rule also prohibits the imposition of multiple late charges for a single late payment that is paid in full before the next timely payment, and it requires banks to provide to cosigners of a credit contract a notice of their obligation and potential liability. The notice may be included in the loan contract or provided as a separate document.

Governors Gramley and Seger dissented from adoption of that portion of the rule that prohibits creditors from taking a security interest in household goods. Although they did not object to adoption of the rule in general, they believed that consumers should have the option of using certain household goods as collateral for a loan, provided those goods are specified in the contract. They preferred not to prohibit such provisions. The other Board members were sympathetic to this view; however, they believed that the Board's rule and that of the FTC should be uniform, unless there were a compelling reason for the variance arising out of a basic difference between banks and other types of creditors.

Policy Statements and Other Actions

March 1, 1985—Revisions to Capital Adequacy Guidelines and Adoption of a Procedural Regulation

The Board revised its guidelines for capital adequacy for state member banks and bank holding companies, and adopted a regulation that defines the procedures the Board may use to require banking organizations to maintain appropriate capital levels. The guidelines and the regulation are effective May 15, 1985.

Votes for these actions: Messrs. Volcker, Martin, Wallich, Partee, Rice, and Ms. Seger. Votes against these actions: None. Absent and not voting: Mr. Gramley.

The revisions, made in conjunction with new standards adopted by the Comptroller of the Currency and the Federal Deposit Insurance Corporation, establish uniform minimum capital requirements for all banking organizations that are federally supervised. In adopting the new standards, the Board retained use of target ranges—called zones—for capital adequacy to indicate various levels of capitalization and to enable bank managers to plan for needed additions to capital.

The new guidelines raise the minimum capital levels for multinational and regional banking organizations to the levels already in place for smaller banks and bank holding companies. All institutions supervised by the Federal Re-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

serve should have a ratio of primary capital to total assets of at least 5.5 percent, and a ratio of total capital to total assets of at least 6 percent.

The Board made the following changes in its capital standards for state member banks to maintain consistency with the regulations adopted by the Comptroller and the FDIC: (1) goodwill is excluded from primary and total capital; (2) equity commitment loans are excluded from primary capital; and (3) capital ratios are calculated on the basis of average assets over the reporting period rather than at the end of the period.

The procedural regulation adopted by the Board requires compliance with the minimum capital ratios and the capital guidelines in general. Banks and bank holding companies that do not meet the minimum capital requirements must promptly submit plans indicating how they intend to increase capital to the required level within a reasonable period. The regulation also describes administrative and judicial enforcement procedures.

April 3, 1985—Revisions to the Policy on Guaranteed Loans

The Board revised its policy for supervising institutions that purchase or sell loans guaranteed by the U.S. government.

Votes for this action: Messrs. Wallich, Partee, Gramley, Rice, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Volcker and Martin.

The revised statement, endorsed by the Federal Financial Institutions Examination Council, affirms the guidelines adopted in 1979 and incorporates changes since that time in the loan programs of agencies such as the Small Business Administration and the Farmers Home Administration. The new policy statement reminds institutions selling guaranteed loans that the premiums received in lieu of servicing fees should be amortized over the life of the loans. Institutions purchasing such loans are reminded that any premium paid in excess of the face value of the loan is not guaranteed and is not paid by the guaranteeing federal agency when the loan is prepaid.

October 30, 1985—Repurchase Agreements

The Board issued a policy statement specifying prudential practices for institutions that transact repurchase agreements.

Votes for this action: Messrs. Volcker, Partee, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Martin, Wallich, and Rice.[1]

Under a repurchase agreement, an institution owning U.S. government or agency securities temporarily transfers the securities to another party in exchange for funds and agrees to repurchase them at a later date.

The Board and the other member agencies of the Federal Financial Institutions Examination Council became increasingly concerned that some financial institutions involved in repurchase agreements did not adopt sufficient safeguards to minimize risks. To address these concerns the agencies approved a joint supervisory policy statement to provide financial institutions with minimum safety and soundness guidelines for managing credit exposure. The statement points out the need for full collateralization of repurchase transactions, maintenance of specified collateral margins, and frequent marking to market. In addition, institutions doing business with unregulated security dealers are

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

urged to verify that those dealers comply with the minimum capital guidelines developed by the Federal Reserve Bank of New York for government security dealers. The statement also advises on appropriate standards for control of securities involved in repurchase agreements and notes that the Reserve Banks can assist institutions seeking to obtain control of securities that are maintained in the Federal Reserve's book-entry system.

November 7, 1985— Payment of Dividends

The Board issued a policy statement on the payment of cash dividends by member banks and bank holding companies.

Votes for this action: Messrs. Volcker, Martin, Partee, and Rice. Votes against this action: None. Absent and not voting: Mr. Wallich and Ms. Seger.[1]

The policy statement, part of a program to strengthen supervision of banking organizations, encourages banks and their holding companies to adopt prudent dividend policies that take into account not only the organization's earnings and financial condition but also its capital level and growth prospects. The statement particularly urges institutions experiencing weak earnings or reduced capital to consider reducing or eliminating cash dividends on common stock if such dividend payments would not be covered by earnings; if borrowed funds would be used to make the dividend payment; or if the dividend payment was possible because of an unusual or nonrecurring profit, such as the sale of real property or other assets.

The policy statement reminds holding companies that they should serve as sources of strength for their subsidiary banks. Therefore, a holding company should not pay a cash dividend that strains the capital of its bank subsidiary or that can be funded only by borrowings or other measures that impair its ability to remain a source of strength for the bank. If a bank subsidiary is unable to pay dividends to its parent, either because of statutory limitations, intervention by its primary supervisor, or capital adequacy requirements, the holding company should seriously consider reducing or eliminating its dividend to preserve its own capital base and to assist its bank subsidiary.

1985 Discount Rates

The Board approved one change in the basic discount rate during 1985, a reduction from 8 to 7½ percent in mid-May. During the year the Board also voted at 11 meetings to turn down requests for reductions submitted by individual Federal Reserve Banks. In March the Board approved modifications in its seasonal credit program.

The reasons for the Board's decisions are reviewed below. Those decisions were made in the context of broad economic and financial developments that are covered in greater detail elsewhere in the REPORT. A listing of the Board's actions on the discount rate during 1985, including the votes on those actions, follows this review.

Actions on the Basic Discount Rate

January–April: No Change

During January and February the Board disapproved two requests by a Federal Reserve Bank to reduce the basic rate from 8 percent, the level in effect since late 1984, to 7¾ percent and to 7½ percent. The other Federal Reserve Banks did not propose any changes in the basic rate during that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

period. In denying the two requests, the Board took account of business and financial developments, including the level of short-term market interest rates and the recent rapid expansion of the monetary aggregates. In mid-April a request by another Reserve Bank to lower the basic rate 1/4 percentage point was turned down for similar reasons.

May: Reduction
On May 17 the Board approved a decrease of 1/2 percentage point in the basic rate to 7 1/2 percent. The Board's action was taken against the background of relatively slow growth in overall economic activity; that pace reflected especially the generally sluggish performance of the industrial sector, which was experiencing the adverse effects of a strong dollar and rising imports. Price pressures appeared to be well contained in goods-producing industries, and sensitive commodity prices had been trending lower. The growth of the monetary aggregates had slowed appreciably during previous weeks and market interest rates had declined.

June–December: No Change
From the latter part of July to mid-October, the Board disapproved several requests by two Federal Reserve Banks to reduce the basic rate 1/2 percentage point. Late in the year a number of Reserve Banks sought reductions of 1/4 or 1/2 percentage point in the basic rate, but the Board tabled those requests pending evaluation of emerging economic and financial conditions. In its assessment of discount rate proposals in the latter half of the year, the Board took account of various economic and financial circumstances, including the business outlook and price pressures, the strength of the monetary aggregates, overall credit conditions, and developments affecting the foreign exchange value of the dollar.

Modifications in Seasonal Credit Program

On March 8 the Board approved a two-part modification of its seasonal credit program. The changes were designed to help small and medium-size agricultural banks meet temporary liquidity needs that might arise as they sought to accommodate agricultural borrowers during the planting and production period. The regular seasonal credit program was modified to increase the availability of credit at the discount window to depository institutions that lack effective access to the national money markets and that demonstrate recurring needs related to seasonal fluctuations in their deposit flows and loan demands. In addition, a temporary simplified program was created as an alternative to the regular program for smaller banks that are active in agricultural lending. The rate under the special program was set at 1/2 percentage point above the basic rate and was to remain fixed over the term of a loan. Loans under this program could be extended by the Reserve Banks through September 1985, but they had to be repaid as seasonal credit needs abated and could not be outstanding beyond February 1986. Apart from the seasonal loan program, the discount window remained available to provide regular adjustment or extended credit when unusual demands developed in local areas as a result of the agricultural credit situation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Extended Credit Program

The interest rate on credit advanced to depository institutions for an extended period for other than seasonal purposes rises relative to the basic rate as the period of borrowing lengthens. During 1985 the schedule of fixed rates for extended credit was reduced 1/2 percentage point when the basic rate was lowered by that amount in mid-May. In addition, the Board retained the policy of allowing the Reserve Banks to charge a flexible rate on loans that have been outstanding for more than 150 days, or for a shorter period if they are expected to be outstanding for an unusually long time and in relatively large amounts. The flexible rate, which has a floor that is 1 percentage point above the basic discount rate, takes account of the rates on market sources of funds and was changed periodically during the year.

Rates at Year-End

As of December 31, 1985, the structure of discount rates was as follows: a basic rate of 7 1/2 percent for short-term adjustment credit and for credit under the regular seasonal program; and a rate on extended credit at the basic rate of 7 1/2 percent for the first 60 days of borrowing, 8 1/2 percent for the next 90 days of borrowing, and 9 1/2 percent after 150 days. The flexible rate on certain extended credit borrowing was 8 1/2 percent at year-end.

Votes on Reserve Bank Requests 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, depository institutions at least every 14 days and to submit such rates to the Board of Governors for review and determination. The Board votes listed below are those that involved approval or disapproval of Reserve Bank actions to change the basic discount rate. Votes involving the reestablishment of existing rates are not shown.

January 28, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on January 24 to reduce the basic discount rate to 7 3/4 percent (from 8 percent).

> Votes for this action: Messrs. Volcker, Martin, Wallich, Partee, Rice, Gramley, and Ms. Seger. Votes against this action: None.

February 19, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on February 14 to reduce the basic discount rate to 7 1/2 percent.

> Votes for this action: Messrs. Volcker, Wallich, Partee, Rice, and Gramley. Votes against this action: None. Absent and not voting: Mr. Martin and Ms. Seger.

April 15, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of San Francisco on April 12 to reduce the basic discount rate to 7 3/4 percent.

> Votes for this action: Messrs. Volcker, Martin, Gramley, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Wallich, Partee, and Rice.

May 17, 1985

Effective May 20, 1985, the Board approved actions taken by the directors

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the Federal Reserve Banks of Boston, New York, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, and Dallas to reduce the basic discount rate to 7½ percent, with corresponding reductions of ½ percentage point in related rates, including the rate for new loans under the special seasonal credit program and, when applicable, the flexible rate on extended credit.

Votes for this action: Messrs. Volcker, Martin, Wallich, Partee, and Gramley. Votes against this action: None. Absent and not voting: Mr. Rice and Ms. Seger.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Cleveland, St. Louis, and San Francisco, effective May 21, and the Federal Reserve Bank of Philadelphia, effective May 24, 1985.

July 22, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on July 11 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Volcker, Martin, Partee, Rice, Gramley, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Wallich.

July 29, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on July 25 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Volcker, Martin, Wallich, Partee, Rice, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Gramley.

August 13, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on August 8 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Volcker, Wallich, Partee, Rice, and Gramley. Votes against this action: None. Absent and not voting: Mr. Martin and Ms. Seger.

August 26, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on August 22 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Martin, Wallich, Partee, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Volcker, Rice, and Gramley.

September 9, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on September 5 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Martin, Partee, Rice, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Volcker and Wallich.[1]

September 16, 1985

The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on September 12 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Volcker, Martin, Wallich, Partee, Rice, and Ms. Seger. Votes against this action: None.[1]

1. See footnote 1 on p. 63.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

October 7, 1985
The Board disapproved actions taken by the directors of the Federal Reserve Banks of Minneapolis and Dallas on September 26 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Martin, Partee, Rice, and Ms. Seger. Votes against this action: None. Absent and not voting: Messrs. Volcker and Wallich.[1]

October 15, 1985
The Board disapproved an action taken by the directors of the Federal Reserve Bank of Minneapolis on October 10 to reduce the basic discount rate to 7 percent.

Votes for this action: Messrs. Volcker, Martin, Partee, and Rice. Votes against this action: None. Absent and not voting: Mr. Wallich and Ms. Seger.[1]

Digitized for FRASER
http://fraser.stlouisfed.org/
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 1985, 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 made 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 1985 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.*

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market activities, the Federal Reserve Bank of New York operates under two separate directives from the Open Market Committee: an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, 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 1985. 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, 1985

1. The Federal Open Market Committee authorizes and directs the Federal Reserve

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

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 $6.0 billion[1] during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to 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 $100 million;

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

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the basis set forth in paragraph 1 (a) under

1. Pursuant to an action taken by the Committee at its meeting on December 17–18, 1984, the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities was set at $6.0 billion for the period through the close of business on February 13, 1985, at which time it would revert to $4.0 billion, unless the Committee specifically authorized a different amount.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

agreements providing for the resale by such accounts of those securities within 15 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(c), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

Domestic Policy Directive

In Effect January 1, 1985[2]

The information reviewed at this meeting indicates a mixed pattern of developments but on balance suggests that economic activity is continuing to expand in the current quarter at a rate approximating the considerably reduced pace recorded in the third quarter. Nonfarm payroll employment rose substantially further outside of manufacturing in November, and the civilian unemployment rate fell from 7.4 to 7.2 percent. After two months of decline, industrial production increased somewhat in November, largely reflecting a rebound in auto production from strike-reduced levels. Retail sales registered a large gain in November after changing little in October. Information on outlays suggests substantially slower expansion in business fixed investment, following exceptionally rapid growth earlier. Since the beginning of the year, broad measures of prices generally have continued to rise at rates close to, or somewhat above, those recorded in 1983, and the index of average hourly earnings has risen somewhat more slowly.

Growth of the monetary aggregates strengthened markedly in November. The November expansion in M1 offset the decline in October, and this aggregate has grown little on balance since early summer; from the fourth quarter of 1983 through November, M1 grew at a rate in the lower half of the Committee's range for 1984. Growth in the broader aggregates was especially rapid in November, bringing M2 to the midpoint of its longer run range and M3 a bit further above the upper limit of its range. Expansion in total domestic nonfinancial debt is continuing above the Committee's monitoring range for the year, reflecting very large government borrowing and strong private credit growth. Interest rates have fallen further since the November meeting of the Committee, with the largest declines concentrated in short-term markets. On November 21, the Federal Reserve approved a reduction in the discount rate from 9 to 8½ percent.

Since early November the foreign exchange value of the dollar against a tradeweighted average of major foreign currencies has appreciated substantially, reversing most of the previous decline from its mid-October peak. The merchandise trade deficit in October was significantly reduced from the rate in the third quarter, mainly reflecting a sharp decline in non-oil imports.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at the July meeting to reaffirm the ranges for monetary growth that it had established in January: 4 to 8 percent for M1 and 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1983 to the fourth quarter of 1984. The associated range for total domestic nonfinancial debt was also reaffirmed at 8 to 11 percent for the year 1984. It was anticipated that M3 and nonfinancial debt might increase at rates somewhat above the upper limits of their 1984 ranges, given developments in the first half of the year, but the Committee felt that higher target ranges would provide inappropriate benchmarks for evaluating longer term trends in M3 and credit growth. For 1985 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1984 to the fourth quarter of 1985, of 4 to 7 percent for M1, 6 to 8½ percent for M2, and 6 to 9 percent for M3. The associated

2. Adopted by the Committee at its meeting on December 17–18, 1984.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

range for nonfinancial debt was set at 8 to 11 percent.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluations of conditions in domestic credit and foreign exchange markets.

In the implementation of policy in the short run, the Committee seeks to reduce pressures on reserve positions consistent with growth of M1, M2, and M3 at annual rates of around 7, 9, and 9 percent, respectively, during the period from November to March. Somewhat more rapid growth of M1 would be acceptable in light of the currently estimated shortfall in growth for the fourth quarter relative to the Committee's expectations at the beginning of the period, particularly in the context of sluggish growth in economic activity and continued strength of the dollar in exchange markets. Greater restraint on reserve positions might be acceptable in the event of substantially more rapid monetary growth and indications of significant strengthening of economic activity and inflationary pressures. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Authorization for Foreign Currency Operations

In Effect January 1, 1985

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

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

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

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

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

D. To maintain an overall open position in all foreign currencies not exceeding $8.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

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

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Foreign bank	Amount (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	700
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

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

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at nonmarket exchange rates.

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

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

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

7. The Chairman is authorized:

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

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

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

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

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(1) of the Board of Gover-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

nors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive

In Effect January 1, 1985

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

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Meeting Held on February 12–13, 1985

1. Domestic Policy Directive

The information reviewed at this meeting suggested that the rate of economic expansion strengthened in late 1984. For the fourth quarter as a whole, growth in real gross national product picked up to an annual rate of about 4 percent, according to the preliminary estimate of the Commerce Department, from about 1½ percent in the third quarter, and there was evidence of continued moderate expansion in early 1985. The pickup in growth from the third to the fourth quarter was attributable in large part to stronger domestic final demand and a reduction in the current account deficit with foreign countries after a sharp further widening of that deficit in the third quarter. Broad measures of prices and wages generally continued to rise in 1984 at rates close to those recorded in 1983.

Industrial production increased 1.0 percent in the November–December period, offsetting the declines in the preceding two months, and preliminary indications suggested a further gain in January. The December rise was broadly based, in contrast to the increase in November, which was concentrated in the automotive category. The index of industrial capacity utilization moved up to 81.9 percent in December, but remained almost 1 percentage point below its recent high in mid-1984.

Nonfarm payroll employment, adjusted for strike activity, rose more than 300,000 further in January. The largest gain occurred at retail trade establishments, but employment growth was also strong in services and in construction, where unseasonably mild weather boosted hiring in both December and early January. In manufacturing, employment rose moderately after a large gain in December, and the length of the workweek edged down but remained above the average level in the fourth quarter. Despite the continued rise in employment, the civilian unemployment rate increased slightly to 7.4 percent, as the civilian labor force grew substantially.

Retail sales rose 0.7 percent in January, continuing at about the same pace as the average for November and December. Much of the January rise was attributable to sales at automotive outlets. Sales of new domestic automobiles were at an annual rate of 8½ million units, about 1 million units higher than the average in the fourth quarter of 1984. Stores selling primarily discretionary items such as general merchandise, apparel, furniture, and appliances registered a marked decline in sales in January, after substantial increases in the final months of 1984.

The decline in housing activity that had characterized the second half of 1984 appeared to be ending as the year drew to a close. Total private housing starts, though down about 6 percent in the fourth quarter as a whole to an annual rate below 1.6 million units, edged up in the November–December period, and sales of existing homes rose somewhat over the final two months of the year.

Business fixed investment spending continued to grow in the fourth quarter, although at a less rapid pace than in the first three quarters of 1984. Shipments of nondefense capital goods increased moderately in the fourth quarter, and spending on nonresidential construction advanced substantially. In contrast, new orders for plant and equipment fell in December and over the fourth quarter as a whole.

Some imbalances in business inven-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tories had developed during 1984, but businesses appeared to have made substantial progress toward attaining desired inventory levels, and in some sectors inventories relative to sales were quite lean. Investment in business inventories slowed markedly in late fall, largely in response to the earlier weakness in orders and sales. In November, stocks at all manufacturing and trade establishments were little changed in real terms, after average monthly increases in the range of $20 billion to $25 billion at an annual rate during prior months in 1984.

In December, the producer price index for finished goods and the consumer price index edged up 0.1 percent and 0.2 percent respectively. During 1984 the rise in producer prices was 1.8 percent, compared with 0.6 percent in 1983, while the increase of 4 percent in consumer prices was about the same as that in the previous year. The advance in the average hourly earnings index was 3.0 percent last year, compared with 3.9 percent in 1983.

The foreign exchange value of the dollar rose about 5½ percent to a new high over the intermeeting period. After the announcement on January 17 by the G-5 Ministers of Finance and Central Bank Governors regarding coordinated intervention in exchange markets, and subsequent exchange market operations, the dollar tended to stabilize. The rise resumed in early February, apparently in association with a perception that the outlook for economic activity in the United States was improving without signs of a strengthening in inflationary pressures. The U.S. merchandise trade deficit declined sharply in December and for the fourth quarter as a whole, primarily because imports dropped substantially from the high rate in the third quarter. Nevertheless, the trade deficit for 1984 totaled nearly $108 billion, compared with $61 billion in 1983.

At its meeting on December 17–18, 1984, the Committee had adopted a directive that called for some further reduction in the degree of restraint on reserve positions. The members expected that such an approach to policy implementation would be consistent with growth of M1, M2, and M3 at annual rates of around 7, 9, and 9 percent respectively during the four-month period from November to March.[1] Given the estimated shortfall in growth of M1 for the fourth quarter relative to the Committee's expectations at the beginning of the period, the members agreed that somewhat more rapid growth would be acceptable, particularly if the faster growth occurred in the context of sluggish expansion in economic activity and continued strength of the dollar in foreign

1. These growth rates and all subsequent data on the monetary aggregates reflect annual benchmarks and seasonal factors as published on February 14, 1985.

The monetary aggregates are defined as follows: M1 comprises demand deposits at commercial banks and thrift institutions, currency in circulation, travelers checks of nonbank issuers, negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts at banks and thrift institutions, and credit union share draft accounts. M2 contains M1 and savings and small-denomination time deposits (including money market deposit accounts (MMDAs) at all depository institutions, overnight repurchase agreements (RPs) at commercial banks, overnight Eurodollars held at foreign branches of U.S. banks by U.S. residents other than banks, and money market mutual fund shares other than those restricted to institutions). M3 is M2 plus large-denomination time deposits at all depository institutions, large-denomination term RPs at commercial banks and savings and loan associations, institution-only money market mutual funds, and term Eurodollars held by U.S. residents in Canada and the United Kingdom and at foreign branches of U.S. banks elsewhere.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

exchange markets. The Committee also indicated that greater restraint on reserve positions might be acceptable if growth in the monetary aggregates were substantially more rapid than expected and if there were indications that economic activity and inflationary pressures were strengthening significantly. The intermeeting range for the federal funds rate was set at 6 to 10 percent.

After growing little on balance since early summer, M1 expanded at estimated annual rates of about $10\frac{1}{2}$ and 9 percent respectively in December and January. M2 and M3 also expanded rapidly over the two months, rising on average at annual rates estimated to be around 14 and $13\frac{1}{2}$ percent respectively, considerably above the short-run objectives for the November-to-March period established at the December meeting. Relative to the Committee's longer-run objectives for the period from the fourth quarter of 1983 to the fourth quarter of 1984, M1 grew at a rate of about $5\frac{1}{4}$ percent, somewhat below the midpoint of its 4 to 8 percent range, and M2 increased at a rate of about $7\frac{3}{4}$ percent, a bit above the midpoint of its 6 to 9 percent range. M3 and domestic nonfinancial sector debt expanded at rates of about $10\frac{1}{2}$ and $13\frac{1}{2}$ percent respectively, above the Committee's ranges of 6 to 9 percent and 8 to 11 percent for the year. The rapid growth in total debt reflected very large government borrowing and strong private credit growth that was boosted in part by the unusual size of merger-related credit activity.

Over the December–January period, the average level of borrowing by depository institutions at the discount window declined on balance, despite a bulge around the year-end statement date, and both nonborrowed and total reserves expanded at very rapid rates. In the first part of the recent intermeeting interval, open market operations were directed toward achieving some further reduction in pressures on reserve positions. Adjustment plus seasonal borrowing at the discount window, after bulging around year-end, declined to the $250 million to $300 million range over much of January. By the latter part of January, against the background of continued rapid growth in the monetary and credit aggregates and the relatively good performance of the economy, the easing process came to an end; reserves were provided more cautiously through open market operations, and borrowing rose somewhat, partly because of unexpectedly large demands for excess reserves. Reflecting variations in actual pressures on bank reserve positions, but in part in anticipation of an easing in pressures, the federal funds rate declined in the early part of the period from around $8\frac{3}{4}$ percent to the 8 to $8\frac{1}{4}$ percent area; subsequently it rose to around $8\frac{1}{2}$ percent or somewhat higher. Other short-term market interest rates generally rose somewhat on balance over the intermeeting interval, while most long-term rates were roughly unchanged or a little lower.

The staff projections presented at this meeting suggested that real GNP would grow at a moderate pace in 1985. Business fixed investment was likely to expand further during the year, and anticipated gains in real disposable income were expected to support continued sizable advances in consumption expenditures. The unemployment rate was expected to edge down over the period, and the rate of increase in prices was projected to remain close to, or slightly below, that experienced in 1984.

In the Committee's discussion of the economic situation and outlook, the members agreed that continuing ex-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

pansion in business activity was a likely prospect for 1985, though at a more moderate rate than in the first two years of the current cyclical upswing. As they had at previous meetings, however, members referred to persisting problems and financial strains in various sectors of the economy that constituted threats to the sustainability of the overall expansion, especially if substantial progress was not made toward reducing the massive deficit in the federal budget. Moreover, the high level of the dollar and large trade deficit were increasingly being reflected in pressures on some sectors of the economy. Most of the members expected about the same rate of inflation in 1985 as that experienced in 1984, assuming that the dollar exchange rate remained in the range of recent months, but some saw the odds as tilted in the direction of some modest further progress toward price stability.

At this meeting the members of the Committee and the Federal Reserve Bank presidents not currently serving as members presented specific forecasts of economic activity, the rate of unemployment, and average prices. For the period from the fourth quarter of 1984 to the fourth quarter of 1985, the forecasts for growth of real GNP centered on a range of 3½ to 4 percent, with an overall range of 3¼ to 4¼ percent. Forecasts of the rate of inflation, as indexed by the GNP deflator, also centered on a range of 3½ to 4 percent, and the central tendency of the forecasts for growth in nominal GNP was a range of 7½ to 8 percent. Forecasts of the rate of unemployment in the fourth quarter of 1985 varied from 6½ to 7¼ percent, but most of the members anticipated unemployment rates ranging from 6¾ to 7 percent. These forecasts were based on the Committee's objectives for growth in money and credit established at this meeting. The members also assumed that significant progress would be made toward reducing future deficits in the federal budget, thereby helping over the nearer term to moderate inflationary expectations and pressures on interest rates, and they assumed that the foreign exchange value of the dollar would fluctuate within the range experienced in recent months.

While a number of members commented during the discussion that actual growth in line with the forecasts would represent a favorable development for the third year of an economic expansion, several observed that growth might well be faster, especially in the short run. This possibility was raised by current indications of appreciable strength in both consumer and business spending and an expansive fiscal policy. It was also pointed out that a large decline in the foreign exchange value of the dollar, should it occur, would tend to stimulate domestic business activity while also adding to inflationary pressures. Several members noted their concern that strong growth in spending by the private sectors in the context of a stimulative fiscal policy could lead to some inflationary pressures, particularly as the margin of unutilized productive resources diminished, with adverse consequences for interest rates and interest-sensitive sectors of the economy and ultimately for the sustainability of the expansion itself.

While the overall expansion in economic activity was currently displaying some momentum, the members also referred to the decidedly uneven participation in the expansion of different sectors of the economy or parts of the country, including adverse conditions in agriculture and in certain sectors of industry. Circumstances and problems varied from one industry or

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

region to another, but particular concern was expressed about the damaging impact that a rising dollar internationally was having on a number of manufacturing and extractive industries and on agriculture, with attendant financial difficulties for those sectors of the economy and related strains on the financial institutions that serviced them. Reference was also made to the overbuilding of multifamily housing and office structures in some parts of the country and to the problem loans associated with such overbuilding. Some concern was expressed about the rapid accumulation of debt by many households and businesses that rendered these borrowers more vulnerable to adverse economic developments. It was generally expected that such problems would not significantly retard overall economic expansion in the near term, but several members indicated that they were more troubled by the economic prospects for the longer run. The members agreed that the odds of prolonging the expansion would be greatly enhanced by a substantial reduction in federal budgetary deficits and the emergence of a more sustainable pattern of international transactions.

With regard to the outlook for inflation, most of the members anticipated that continuing economic expansion in line with their forecasts would probably be associated with little change in the rate of inflation during 1985. Some members were more optimistic and viewed the prospects for some decline in inflation as relatively favorable. Although the members had assumed in presenting their forecasts that the dollar would remain within its recent range of fluctuation in foreign exchange markets, they recognized that the future performance of the dollar was in fact highly uncertain.

Members who were relatively sanguine about the outlook for inflation cited the favorable trend in wages, the strong competition from abroad in many industries, the growth of productive capacity, and the widespread efforts of businesses to improve productivity. The possibility of further declines in oil prices was also cited. The removal of quotas on imports of automobiles from Japan would also help to restrain the rise in average prices, although the extent of that effect was uncertain. Members who were less optimistic about the outlook for inflation noted that unit labor costs could be expected to be under upward pressure because productivity gains would tend to diminish as the nation continued to move toward fuller utilization of its productive resources during the third year of the current expansion. One member also raised the prospect of at least some pressures from rising commodity prices in 1985.

At this meeting the Committee reviewed the 1985 growth ranges for the monetary and credit aggregates that it had tentatively set in July 1984 within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act). Those tentative ranges included growth—measured from the fourth quarter of 1984 to the fourth quarter of 1985—of 4 to 7 percent for M1, 6 to 8½ percent for M2, and 6 to 9 percent for M3. The associated range for total domestic nonfinancial debt had been provisionally set at 8 to 11 percent for 1985.

The Committee's discussion focused on whether the tentative ranges for 1985 remained appropriate in light of developments since mid-1984 and foreseeable economic and financial circumstances. There were a number of proposals for small changes in the ranges. With respect to M1, a majority of the members wanted to retain the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tentative range of 4 to 7 percent, but the remaining members expressed a preference for raising the upper limit to 7½ or 8 percent. In the majority view, the tentative range provided adequate room to accommodate a desirable and sustainable rate of economic expansion and retention of that range would also serve to underscore the Committee's commitment to an anti-inflationary policy. The members who preferred a higher limit for the M1 range gave considerable emphasis to the uncertainties that surrounded both the economic outlook and the relationship between money growth and GNP. They did not necessarily disagree that the tentative range might in fact prove to be consistent with a satisfactory economic performance, but they believed that some additional leeway was desirable for use if needed.

In the course of their discussion, the members referred to evidence that the income velocity of M1—nominal GNP divided by the M1 stock—seemed to be returning to a more normal or predictable pattern. Some analysis suggested that the trend growth of M1 velocity might be somewhat lower than that experienced over much of the postwar period, reflecting in part the deregulation of deposits and other financial changes in recent years and the related prospect of a slower rate of financial innovation in the future. A number of members emphasized that such a development would imply the need for M1 growth in the upper part of the Committee's tentative range. It was also noted that the lagged effects of the interest rate declines during the latter part of 1984 were likely to depress velocity growth in the first part of 1985. Other members raised the prospect that the growth in M1 velocity might not decline as much as expected from the rate experienced in 1984 and in that event growth of M1 near the upper limit of the tentative range, or above it, would have inflationary implications. The members agreed that the trend rate of increase in M1 velocity, as well as the velocity of the other monetary aggregates, remained subject to a considerable range of uncertainty, given the still limited experience with a relatively deregulated financial environment. Under these conditions, the Committee members indicated the need to continue to judge the behavior of the monetary aggregates in light of the flow of information on business activity, inflationary pressures, and conditions in domestic credit and foreign exchange markets.

With regard to M2, most of the members indicated that they could accept an increase of ½ percentage point in the upper limit of the tentative range, although some expressed an initial preference for no change in the range. The small upward adjustment reflected the technical judgment, based upon an assessment of recent developments, that growth in M2 for the year could revert to its earlier pattern that was more in line with the growth in nominal GNP.

Most of the members also supported an increase of ½ percentage point in the upper limit of the tentative range for M3 and an increase of 1 percentage point in the provisional monitoring range for total domestic nonfinancial debt. Growth within both ranges in 1985 would represent a considerable slowing from the actual pace in 1984. Some members questioned the need for any increase in those ranges, both because of the anticipated moderation in the expansion of GNP and because the higher ranges could convey a wrong impression of the Committee's anti-inflationary policy. Nonetheless, total debt was expected to continue to grow at a faster rate than nominal

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

GNP, reflecting further rapid expansion in the federal debt, larger than normal growth in merger and other corporate restructuring activities, and the continuing need to finance increases in spending by domestic sectors that exceeded the rise in nominal GNP, as reflected in the expected further widening of the nation's large deficit in its external trade balance.

In the course of the Committee's discussion, consideration was given to a proposal for using the midpoint of the previous year's fourth-quarter target range, rather than the actual fourth-quarter outcome, as the base for the following year's target range. This issue had been discussed in some detail at the previous meeting of the Committee. No support was expressed in favor of such an approach, although the members recognized that in some circumstances such an alternative might be appropriate. In setting its objectives for a current year, the Committee already took into account the prior year's monetary developments and their implications for the evolving relationship between money and GNP. It was generally felt that employing the midpoint of the previous year's target range as the base for the current year's target would have the disadvantage of introducing a degree of rigidity in the decisionmaking process; it would impose a base that was decided upon many months before under possibly quite different circumstances. In the current situation, such problems were particularly evident for M3 and total credit whose levels at the end of 1984 were well above their long-run ranges; use of a previously targeted fourth-quarter base would therefore imply either a wrenching slowdown in actual growth for 1985 or adoption of very high target ranges for growth in 1985.

The members also noted that the levels of the monetary aggregates at the start of the year were all above the target ranges under consideration, as those ranges were conventionally illustrated, because monetary growth had been relatively rapid in late 1984 and early 1985. No member expressed concern about this development, since it was contemplated that monetary growth would slow as the year progressed and expansion for the year as a whole would be consistent with the target ranges. With reference to the Humphrey–Hawkins testimony, the pictorial representation of the targets as "cones" would be supplemented by other lines to indicate that the Committee was not concerned about variations in money growth outside the relatively narrow portion of the cones early in the year.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or found acceptable a policy that included retention of the tentative range for M1, increases of 1/2 percentage point in the upper limits of the tentative ranges for M2 and M3, and an increase of 1 percentage point in the provisional monitoring range for total domestic nonfinancial debt. The members indicated that it might be appropriate for growth in the aggregates to be in the upper part of their ranges for the year, depending on developments with respect to velocity and provided that inflationary pressures remained subdued. In keeping with the Committee's usual procedures under the Humphrey–Hawkins Act, the ranges would be reviewed at midyear against the background of economic and financial developments.

The following paragraph relating to the longer-run ranges was approved:

> The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustain-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

able basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at this meeting to establish ranges for monetary growth of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for the year 1985. the Committee agreed that growth in the monetary aggregates in the upper part of their ranges for 1985 may be appropriate, depending on developments with respect to velocity and provided that inflationary pressures remain subdued.

Votes for this action: Messrs. Volcker, Corrigan, Boykin, Gramley, Mrs. Horn, Messrs. Partee, Rice, Ms. Seger, and Mr. Balles. Votes against this action: Messrs. Boehne, Martin, and Wallich. (Mr. Balles voted as an alternate.)

Messrs. Boehne and Martin dissented because they preferred a somewhat higher upper boundary for the M1 range in order to provide enough leeway, if needed, to accommodate a satisfactory rate of economic expansion. In their view, the additional leeway was desirable because of the uncertainties surrounding the outlook for velocity, and it took account of the favorable outlook for inflation and the continuing financial strains in some sectors of the economy. Mr. Boehne also noted that M1 growth in 1984 was in the lower part of the Committee's range.

Mr. Wallich dissented because he wanted to retain the ranges for the broad monetary aggregates that were tentatively adopted in July 1984. In his view those ranges provided adequate room for fostering a sustainable rate of economic expansion. They were more consistent with the Committee's long-run objective of bringing down inflation, and raising them might be misinterpreted by the market as a weakening of policy in that regard.

In the Committee's discussion of policy implementation for the weeks immediately ahead, all of the members indicated their support of an approach directed toward maintaining the reserve conditions characteristic of recent weeks. Such an approach was thought likely to be associated with reduced growth in the monetary aggregates over the balance of the first quarter, although growth for the quarter as a whole would probably exceed the Committee's longer-run ranges for the year. That approach was reinforced by the current strength of the dollar in the exchange markets and the sense that the outlook for the economy and prices did not appear to signal a need for a change.

With regard to M1, the members referred to an analysis, which suggested that expansion in this aggregate should moderate as the lagged effects of earlier declines in market interest rates on the demand for money balances dissipated. With respect to the outlook for the broader aggregates, the members viewed appreciably slower growth as a reasonable expectation, partly because of the prospect that inflows of funds to money market deposit accounts and to money market mutual funds would moderate as the interest paid on such accounts was brought into better alignment with short-term market rates. Indeed, evidence of such a development was already apparent with respect to money market mutual funds. Additionally, the expansion in M3 might be held down by continued moderation in the issuance of large-denomination certificates of deposit by commercial banks.

Despite the prospects for more moderate growth in the monetary aggregates, some members were concerned that such growth might not slow sufficiently over the period ahead and that some firming of reserve conditions might be needed to foster a desirable rate of monetary expansion. They found the current approach to policy implementation appropriate for the present, but they did not want to rule out the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

possible need for some modest firming over the weeks ahead. Several members indicated that the degree of any firming should remain fairly limited even if money growth was above expectations for a time because they were concerned about the adverse impact that a substantial rise in market interest rates over the near term could have on the exchange market situation and on interest- or trade-sensitive sectors of the economy and ultimately on the economic expansion itself. Members concluded that evaluation of the desirability for firming should take account of the strength of the dollar in exchange markets as well as the business outlook and inflationary pressures and that any firming of reserve conditions over the weeks ahead should be undertaken in a limited and gradual manner. Accordingly, relatively rapid monetary growth would not automatically call for more reserve restraint if it occurred in the context of emerging weakness in business conditions and a strong dollar in the foreign exchange markets. The members also agreed on the possibility of some easing in reserve conditions, but in the view of at least some of the members, any potential need for easing seemed less likely, given the recent strength of the monetary aggregates and the performance of the economy.

At the conclusion of the Committee's discussion, all of the members indicated their acceptance of a directive that called for maintaining the degree of reserve pressure that had prevailed in recent weeks. The members agreed that modest increases in reserve restraint would be sought if growth in M1 appeared to be exceeding an annual rate of about 8 percent and M2 and M3 a rate of around 10 to 11 percent during the period from December to March, particularly if such monetary expansion was associated with satisfactory growth in business activity and diminishing pressures in exchange markets. The members also agreed that lesser restraint on reserve positions would be acceptable in the event of substantially slower growth in the monetary aggregates, especially against the background of sluggish growth in economic activity and continued strength of the dollar in foreign exchange markets. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

The following directive, embodying the Committee's longer-run ranges and its short-run operating instructions, was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that real GNP expanded at a moderate pace in the fourth quarter, reflecting some strengthening in late 1984 after several months of considerably reduced growth, and there was evidence of continued moderate expansion in early 1985. Total retail sales rose in January at about the same pace as the average for November and December, while the decline in housing starts appears to have ended. Industrial production and nonfarm payroll employment increased appreciably in the November–December period and nonfarm payroll employment rose substantially further in January. The civilian unemployment rate rose slightly in January to 7.4 percent. Information on business spending suggests less rapid expansion in outlays for fixed investment, following exceptional growth earlier; businesses also appear to have made substantial progress in adjusting their inventories. During 1984 broad measures of prices generally increased at rates close to those recorded in 1983, and the index of average hourly earnings rose somewhat more slowly.

The foreign exchange value of the dollar against a trade-weighted average of major foreign currencies has continued to appreciate strongly since mid-December. After the announcement of January 17 by the G-5 Ministers of Finance and Central Bank Governors regarding coordinated intervention in exchange markets, and subsequent operations, the dollar's rise modertes somewhat. The merchandise trade deficit declined

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sharply in December and for the fourth quarter as a whole, primarily because of a large drop in imports from the high rate in the third quarter. Nevertheless, the deficit for the full year 1984 was substantially higher than in 1983.

After growing little on balance since early summer, M1 expanded at a rapid pace in late 1984 and early 1985. The broader aggregates also expanded rapidly in recent months. For the period from the fourth quarter of 1983 to the fourth quarter of 1984, M1 grew at a rate of about 5¼ percent, somewhat below the midpoint of the Committee's range for the year, and M2 increased at a rate of about 7¾ percent, a bit above the midpoint of its longer-run range. Both M3 and total domestic nonfinancial debt expanded at rates above the Committee's ranges for the year, reflecting very large government borrowing and strong private credit growth, boosted in part by the unusual size of merger-related credit activity. Short-term interest rates have risen somewhat on balance since the December meeting of the Committe, but long-term rates are about unchanged to a little lower. On December 21, the Federal Reserve approved a reduction in the discount rate from 8½ to 8 percent.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at this meeting to establish ranges for monetary growth of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for the year 1985. The Committee agreed that growth in the monetary aggregates in the upper part of their ranges for 1985 may be appropriate, depending on developments with respect to velocity and provided that inflationary pressures remain subdued.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

In the implementation of policy for the immediate future, taking account of the progress against inflation, remaining uncertainties in the business outlook, and the strength of the dollar in the exchange markets, the Committee seeks to maintain reserve conditions characteristic of recent weeks. Should growth in M1 appear to be exceeding an annual rate of around 8 percent and M2 and M3 a rate of around 10 to 11 percent during the period from December to March, modest increases in reserve pressures would be sought, particularly if business activity is rising at a satisfactory rate and exchange market pressures diminish. Lesser restraint on reserve positions would be acceptable in the event of substantially slower growth in the monetary aggregates, particularly in the context of sluggish growth in economic activity and continued strength of the dollar in foreign exchange markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for short-run operational paragraph: Messrs. Volcker, Corrigan, Boehne, Boykin, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Ms. Seger, Messrs. Wallich, and Balles. Votes against this action: None. (Mr. Balles voted as an alternate.)

2. Authorization for Domestic Open Market Operations

At this meeting the Committee voted to increase from $4 billion to $6 billion the limit on changes between Committee meetings in System account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective for the intermeeting period ending with the close of business on March 26, 1985.

Votes for this action: Messrs. Volcker, Corrigan, Boehne, Boykin, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Ms. Seger, Messrs. Wallich, and Balles. Votes against this action: None. (Mr. Balles voted as an alternate.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that substantial net purchases of securities were likely to be necessary over the upcoming intermeeting interval in order to offset the estimated absorption of reserves stemming from technical factors including changes in currency in circulation, vault cash, and required reserves.

Meeting Held on March 26, 1985

1. Domestic Policy Directive

The information reviewed at this meeting suggested that real GNP, which had grown at an annual rate of about 4¼ percent in the fourth quarter, was expanding at a slower pace in the current quarter. Growth in domestic spending appeared to be relatively strong in early 1985, but an increased share of the demand for goods apparently was being met by imports rather than domestic production. Broad measures of prices and wages generally were continuing to rise at rates close to those recorded in 1984.

Total retail sales rose considerably over the first two months of 1985; outlays in February were more than 2 percent above the average in the fourth quarter. Sales of new domestic automobiles were at an annual rate of 8½ million units in January and February, about 1 million units higher than the average in the fourth quarter of 1984. Auto sales during the first 20 days of March remained strong, at a rate a little below the January–February pace.

Nonfarm payroll employment rose 120,000 in February after average increases of about 300,000 in the preceding four months. Retail trade and service establishments reported further strong job gains in February, but employment in the manufacturing sector fell 75,000. The average length of the workweek in manufacturing also declined, partly because of adverse weather during the survey week. The civilian unemployment rate was 7.3 percent, little changed from its level at year-end, and within the range of 7.2 to 7.5 percent that has generally prevailed since mid-1984.

Industrial production declined 0.5 percent in February, and data for the three preceding months were revised to show smaller increases than previously had been estimated. The recent sluggishness in production apparently reflected the continuing substitution of imports for domestically produced goods and ongoing corrections of inventory imbalances in some industries.

The U.S. merchandise trade deficit increased sharply in January, as nonoil imports rose by 16 percent from the reduced fourth-quarter rate. The trade balance had deteriorated markedly last year and was the principal contributor to a current account deficit in the balance of payments of $102 billion in1984, as compared with $42 billion in the previous year.

Total private housing starts declined in February after a sharp rise in January. Nevertheless, the average for the two months, at an annual rate of nearly 1¾ million units, was somewhat higher than the rate in the fourth quarter. Issuance of residential building permits during the January–February period was also above the fourth-quarter pace. Sales of new homes picked up slightly in January, according to preliminary data, but sales of existing homes edged down in February after posting four consecutive monthly gains.

Information on business capital spending suggested less rapid expan-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sion in early 1985. Shipments by domestic producers of nondefense capital goods dropped sharply in January and recovered only a little in February; imports of business equipment, however, were especially strong in January. Spending on nonresidential construction continued at a relatively brisk pace in both months. New orders for nondefense capital goods fluctuated widely in January and February, but on balance were little changed from the average level in the second half of 1984. With respect to broader indicators of future business spending plans, recent surveys of anticipated plant and equipment expenditures pointed to continued, though moderating, gains in 1985.

Overall investment in business inventories has remained moderate thus far in 1985 though recent inventory developments have varied considerably across industries. In the manufacturing sector stocks fell in January for the third month in a row, largely in response to earlier weakness in orders and sales. On the other hand, retail trade inventories rose substantially, primarily reflecting increased stocks at automobile dealers to alleviate short supplies of some popular models.

The producer price index for finished goods, which was unchanged in January, edged down 0.1 percent in February. Petroleum prices fell sharply in both months, and food prices also declined as reductions for meats and most livestock offset weather-related increases for fresh fruits and vegetables. The consumer price index rose 0.3 percent in February, about the same as its monthly average over the past year; substantial declines in prices of energy-related items tempered the increases in prices of food and other commodities. Over the first two months of the year, the average hourly earnings index was rising at a rate close to that recorded in 1984.

Since the Committee's meeting in mid-February, the trade-weighted value of the dollar in foreign exchange markets had fluctuated widely under often volatile market conditions. During the early part of the intermeeting period, the dollar rose about 5 percent. At that time, especially during the last few days of February and the beginning of March, monetary authorities sold dollars on a large scale. More recently, the dollar dropped sharply on exchange markets, more than offsetting the earlier rise. The reversal was attributed in part to indications of slower growth in U.S. economic activity than many in the market had anticipated and to concerns abroad about the implications of problems with non-federally insured thrift institutions in Ohio.

At its meeting on February 12–13, 1985, the Committee had adopted a directive that called for maintaining the degree of reserve pressures that had characterized the weeks preceding the meeting. The members agreed that modest increases in reserve restraint would be sought if growth in M1 appeared to be exceeding an annual rate of about 8 percent and growth in M2 and M3 was running above 10 to 11 percent during the period from December to March. Lesser restraint on reserve positions would be acceptable in the event of substantially slower growth in the monetary aggregates. Such adjustments in the degree of pressure on reserves would be considered in the context of developments in the U.S. economy and conditions in foreign exchange markets. The intermeeting range for the federal funds rate was set at 6 to 10 percent.

Growth in M1 accelerated to an annual rate of about 14 percent in February from 9 percent in January, but par-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tial data available for March indicated a considerable slowing. Growth in M2 and M3 moderated somewhat in February and averaged about 12 percent and 9 percent respectively over the January–February period. As with M1, growth in the broader aggregates appeared to be slowing considerably in March. Expansion in total domestic nonfinancial debt remained relatively rapid over the first two months of the year, though somewhat below the pace of previous months.

The average level of adjustment plus seasonal borrowing by depository institutions at the discount window rose somewhat over the intermeeting interval, averaging around $600 million in the two complete maintenance periods after the February meeting and $428 million in the first half of the current statement period. The higher level of borrowing for the most part reflected unexpectedly large demands for excess reserves, but for a time was also influenced to an extent by more cautious provision of reserves through open market operations, given the strength of the monetary aggregates, especially M1.

Federal funds traded mainly between 8 3/8 and 8 3/4 percent during the intermeeting interval, averaging a little above 8 1/2 percent, about the same as in the first half of February. Other short-term rates rose about 1/4 to 1/2 percentage point while long-term yields generally increased 1/2 percentage point or more. Several measures of interest rates on new commitments for home mortgage loans also showed increases of about 1/2 percentage point from their levels in mid-February.

The staff projections presented at this meeting continued to suggest that real GNP would grow at a moderate pace in 1985. Business fixed investment, though slowing from the exceptionally rapid rates of increase in the past two years, was likely to expand further in 1985. Consumer spending was expected to remain relatively brisk during the year, supported by gains in real disposable income and in employment. Growth of real output, however, was expected to fall short of the rise in aggregate demand. The unemployment rate was projected to edge down over the period and the rate of increase in prices was expected to remain close to, or slightly below, that experienced in 1984.

During the Committee's review of current economic and financial conditions and the outlook for economic activity, most of the members agreed that continuing expansion at a moderate pace remained a reasonable expectation for 1985. However, considerable concern was expressed about the sensitive conditions in domestic financial and foreign exchange markets, especially against the background of the distortions and uncertainties stemming from massive and persisting deficits in the federal budget and the record and still widening gap in the nation's balance of trade. The members referred to the quite different trends in various sectors of the economy; in general, the service industries were doing well while industries related to agriculture, mining, energy, and a number of manufacturing activities were experiencing a variety of problems and were subject to varying degrees of financial strain. With a number of lending institutions, especially those associated with relatively depressed industries and with housing finance, also experiencing financial pressures, the overall economy was vulnerable to adverse developments. In this difficult set of circumstances several members commented that the risks of any deviation in the economy from their current expectations were in the direction of slower growth; a few members referred to the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

possibility of little or no expansion later in the year.

A good deal of concern was expressed during the meeting about the adverse effects on domestic economic activity stemming particularly from the rising tide of imports but also from difficulties in export markets. With a large amount of domestic demand continuing to be met through imports rather than domestic production, adjustments were beginning to be made in production and distribution facilities that would not easily be reversed later. It was also noted that the growing trade deficit appeared to be damping incentives to invest domestically in a wide range of manufacturing industries. More generally, the point was made that, to a considerable extent, foreign trade developments were tending to offset the stimulus provided by an expansive fiscal policy and the still considerable upward momentum of private final demands.

The prospective performance of business fixed investment was cited as a key element in the outlook for economic activity. While the members generally anticipated further expansion in investment spending, developments over the course of recent months together with the results of surveys of business intentions suggested a pronounced deceleration from the unusually rapid growth experienced during the first two years of the current expansion. Moreover, the demand for domestically produced business equipment was being inhibited to an unusual extent by the level of the dollar internationally and the competitiveness of foreign substitutes. In addition, the exception demand for technically advanced, computer-related, equipment might not be sustained at the earlier rate of increase, according to reports from various contacts around the country. Commercial construction, including office structures, was still showing considerable strength, but some members questioned the sustainability of such investment over time in the face of relatively high vacancy rates and other factors. While lower interest rates since last summer were a supporting factor in housing, reference was also made to the possible vulnerability of multifamily housing construction, given the apparent overbuilding in some parts of the country. Construction of single-family housing appeared to be rising, but this sector was not thought likely to be the source of substantial further economic stimulus in the view of at least some members. One member expressed a relatively pessimistic view about the outlook for housing, partly because many mortgage lenders and private insurers were imposing stricter credit standards after experiencing losses, and incentives for investment in housing clearly had dimmed in many parts of the country.

A number of members observed that consumer expenditures would probably remain a source of strength in the economic expansion, although some commented that consumer sentiment—while still favorable—may have been negatively affected by the news about the problems of some financial institutions. Members also took note of the rapid growth of consumer debt and its potentially adverse implications for future retail sales. It was observed that automobile sales had remained strong, but the prospects for added economic thrust from this sector appeared limited, in part because any further expansion in the demand for automobiles might well be met largely through imports.

With regard to the outlook for inflation, it was noted that prices of services were still tending to rise with some momentum, while prices of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

most goods were basically flat. Given the members' expectations for economic activity and assuming no major changes in the value of the dollar or developments abroad, the members saw little basis for expecting significant deviations from recent price trends.

At its meeting in February the Committee had agreed on policy objectives that called for monetary growth ranges for the period from the fourth quarter of 1984 to the fourth quarter of 1985 of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for 1985. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, these ranges would be reviewed at the July meeting or sooner if warranted by unanticipated economic and financial developments.

In the Committee's discussion of policy implementation for the intermeeting period, the members did not differ greatly in their views regarding the appropriate operational approach, and all indicated that they could support an approach directed, at least initially, toward maintaining about the current degree of restraint on reserve positions. The members recognized that current uncertainties about the economic outlook and the sensitive conditions in domestic credit and foreign exchange markets weighed against a significant increase in the degree of reserve restraint. At the same time, several placed considerable emphasis on the desirability of fostering slower monetary expansion over the period ahead to help assure growth within the Committee's target ranges for the year. While growth in M1 and M2 appeared to be decelerating appreciably in March and a staff analysis suggest that current reserve conditions might be associated with considerably slower growth in the second quarter than over the first three months of the year, a number of members expressed concern that such growth might remain more rapid than was desirable. A rate of growth in coming months higher than seemed reasonably consistent with the growth targets for the year might raise questions about the Committee's commitment to an anti-inflationary policy, with adverse effects on inflationary expectations and possibly also on financial markets. Conversely, if monetary growth over the next few months were held within the Committee's ranges for the year, it was observed that the Committee would have more flexibility later in fostering monetary growth consistent with continuing economic expansion and progress toward containing inflation. In any event, the members generally felt that under prevailing circumstances monetary growth might appropriately remain relatively high within the ranges for the year, a prospect that the Committee also had contemplated at the previous meeting.

The members gave considerable attention to the question of possible intermeeting adjustments in the degree of reserve restraint. In keeping with past practice, the members agreed that such adjustments should not be made automatically in response to the behavior of the monetary aggregates alone, but needed to take account of emerging evidence on the business situation, domestic credit conditions, and the foreign exchange value of the dollar. Nonetheless, there was some difference of views among the members with regard to their willingness to tolerate relatively rapid growth in the monetary aggregates, should it occur, over the period ahead. While no member contemplated the need for a substantial move toward greater reserve

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

restraint, some commented that a small but timely move might well avert the necessity for a more vigorous, and potentially more disruptive, adjustment later. On the other hand, a number of members felt that the current economic uncertainties and related volatility that appeared to pervade domestic credit and foreign exchange markets would argue for more tolerance toward growth in the aggregates, particularily to the extent that such growth might signify an increase in demands for liquidity.

At the conclusion of the Committee's discussion, a majority of the members favored and all could accept a directive that called for no change in reserve conditions, though a few members indicated some preference for a directive that specified a slight increase in the degree of reserve restraint. The members anticipated that the approach to policy implementation adopted by the Committee would be consistent with growth of M1, M2, and M3 at annual rates of around 6, 7, and 8 percent respectively for the period from March to June. The members agreed that somewhat lesser restraint might be acceptable in the context of substantially slower growth in the monetary aggregates, while somewhat greater restraint might be acceptable if monetary growth were substantially faster. In either event, the need for greater or lesser restraint would also be appraised against the background of developments relating to the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, would be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that real GNP is currently expanding at a slower pace than in the fourth quarter, with an increased share of domestic spending apparently being met out of imports. Total retail sales rose considerably for January and February combined and housing starts, though declining in February, were above their fourth-quarter pace. However, information on business capital spending suggests less rapid expansion in early 1985. Business inventory investment continues at a moderate rate. Industrial production declined on balance in January and February and, with employment falling in the manufacturing sector, total nonfarm payroll employment increased at a somewhat reduced pace. The civilian unemployment rate, at 7.3 percent in February, was little changed from its level at year-end. Broad measures of prices and the index of average hourly earnings appear to be continuing to rise at rates close to those recorded in 1984.

Since the Committee's meeting in mid-February, the foreign exchange value of the dollar has fluctuated widely in often volatile market conditions. Most recently, the trade-weighted value of the dollar rose against major foreign currencies has dropped sharply, more than offsetting its rise earlier in the intermeeting interval. Monetary authorities sold dollars on a large scale during the period, especially in late February and early March. The merchandise trade deficit increased sharply in January from relatively low December and fourth-quarter rates. The current account deficit for the full year 1984 was more than double that recorded in 1983.

Growth in M1 accelerated in February, following relatively rapid expansion in other recent months, but information available through mid-March indicates a considerable slowing. Growth in the broader aggregates moderated in February and appears to be slowing further in March. In January and February expansion in total domestic nonfinancial debt remained relatively rapid, though somewhat below the pace of previous months. Most interest rates have risen somewhat since the February meeting of the Committee.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote in output on a sustainable basis, and contribute to an improved pattern of international transac-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tions. In furtherance of these objectives the Committee agreed at its meeting in February to establish ranges for monetary growth of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3 for the period from the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for the year 1985. The Committee agreed that growth in the monetary aggregates in the upper part of their ranges for 1984 to the fourth quarter of 1985 may be appropriate, depending on developments with respect to velocity and provided that inflationary pressures remain subdued.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

In the implementation of policy for the immediate future, taking account of the progress against inflation, uncertainties in the business outlook, and the exchange value of the dollar, the Committee seeks to maintain the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M1, M2, and M3 at annual rates of around 6, 7, and 8 percent respectively during the period from March to June. Somewhat lesser reserve restraint might be acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially higher growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None.

2. Review of Continuing Authorizations

The Committee followed its customary practice of reviewing all of its continuing authorizations and directives at this first regular 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, 1985. The Committee reaffirmed the authorization for foreign currency operations, the foreign currency directive, and the procedural instructions with respect to foreign currency operations in the forms in which they were currently outstanding.[1]

Votes for these actions: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against these actions: None.

3. Authorization for Domestic Open Market Operations

On the recommendation of the Manager for Domestic Operations, System Open Market Account, the Committee amended paragraph 1(a) of the authorization for domestic open market operations to raise from $4 billion to $6 billion the limit on intermeeting changes in System account holdings of U.S. government and federal agency securities. The Manager noted that the Committee had found it necessary to authorize temporary increases in the limit with greater frequency, primarily because of the increased size of the net variation, especially from seasonal influences, in market factors such as the Treasury balance that affect reserves.

1. Before this meeting, on March 6, 1985, certain other routine authorizations of the Committee, including various resolutions, rules, and procedures, and the agreement with the U.S. Treasury to warehouse foreign currencies, were distributed to the Committee members and Reserve Bank Presidents for their review. It was agreed that these authorizations would continue to stand as previously adopted and would not be placed on the agenda for consideration at this meeting unless any member so requested, and no such requests were received.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In 1984 such temporary increases had been authorized on six occasions, more than in any other recent year. A permanent increase in the limit to $6 billion would reduce the number of occasions requiring special Committee action, while still calling needs for particularly large changes to the Committee's attention. The Committee concurred in the Manager's view that such an increase would be appropriate.

Accordingly, effective immediately, paragraph 1(a) of the authorization for domestic open market operations was amended to read as follows:

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 $6.0 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.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None.

Subsequently, on April 15, 1985, the Manager advised that projections indicated very large needs for reserves during the current intermeeting period, mainly because of sharply increasing Treasury balances in April. Accordingly, effective April 16, 1985, the Committee approved the recommendation of the Manager that the limit in paragraph 1(a) be raised from $6 billion to $9 billion for the intermeeting period ending May 21, 1985.

Votes for this action: Messrs. Volcker, Balles, Black, Forrestal, Gramley, Keehn, Martin, Ms. Seger, and Mr. Timlen. Votes against this action: None. (Absent and not voting: Messrs. Corrigan, Partee, Rice, and Wallich. Mr. Timlen voted as alternate for Mr. Corrigan.)

Meeting Held on May 21, 1985

Domestic Policy Directive

The information reviewed at this meeting suggested only a modest pickup in real GNP in the current quarter from the 0.7 percent annual rate of growth reported for the first quarter. Spending by domestic sectors has been relatively well maintained, but a large share of the demand for goods apparently has been met by imports rather than through an expansion of domestic production. Broad measures of prices and wages generally were continuing to rise at rates close to those recorded in 1984.

After declining in March, total retail sales rebounded in April to a level nearly 3/4 percent above the average for the first quarter. Gains were particularly strong at automotive outlets and at food and general merchandise stores. Sales of new domestic automobiles have been running at an annual rate of about 8½ million units since the beginning of April, in line with the strong pace posted in the first quarter and considerably above last year's av-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

erage. Part of the recent strength in car sales was attributable to below-market financing incentives offered by major manufacturers.

Total private housing starts increased about 14½ percent in March to an annual rate of 1.9 million units and continued at that advanced level in April. Newly issued permits for residential building fell somewhat in April but, at an annual rate of nearly 1.7 million units, remained in the improved range recorded in the first quarter. Sales of new and existing homes improved in March, the latest month for which data were available, as the general decline in mortgage credit costs continued to bolster demand.

The index of industrial production declined 0.2 percent in April, after rising little in the first quarter. Production of defense and space equipment continued to advance, but output in most other major market sectors fell. Reflecting these widespread declines in output, the capacity utilization rate for total industry dropped ½ percentage point to 80.6 percent in April, its lowest level since January 1984.

The decline in industrial production in April was associated with further reductions in manufacturing employment. The loss of 45,000 manufacturing jobs in April brought the cumulative loss in that sector to 130,000 thus far in 1985. Outside of manufacturing, sizable job gains were reported for April in the services industry and in construction. On balance, total nonfarm payroll employment rose 215,000 in April compared with average monthly gains of 285,000 since last fall. The civilian unemployment rate remained at 7.3 percent in April, little changed from the rates recorded over the previous three quarters.

Information on business capital spending suggested that expansion was continuing at a much less rapid rate than earlier in the economic expansion, though trends in business equipment orders placed with domestic producers have been obscured lately by extreme volatility in monthly data for orders of office and computing equipment. Imports apparently have continued to account for a sizable share of outlays for equipment, but shipments of capital goods by domestic producers picked up in February and March. Spending on nonresidential construction has continued at a relatively brisk pace in recent months. Moreover, according to recent surveys of business spending plans, firms still expect to increase nominal outlays for plant and equipment 8½ to 11 percent in 1985.

The producer price index for finished goods rose 0.3 percent in April, somewhat more than in other recent months. The rise was attributable to a surge in energy prices that apparently reflected a temporary reduction in petroleum inventories; prices of other finished goods changed little or declined. A sharp increase in prices of petroleum products was also the major factor in the 0.4 percent increase in the consumer price index in April. Thus far in 1985 consumer prices had risen at an annual rate of about 4¼ percent, close to the 4 percent rate in 1984. On balance, recent wage developments indicated little if any acceleration in wage costs from the pace in 1984. While the index of average hourly earnings increased at an annual rate of 2½ percent in the first four months of this year compared with a rise of about 3 percent in 1984, the increase in hourly compensation in the nonfarm business sector thus far this year was running above its year-earlier pace. The rise in compensation reflected in part legislated changes in social security taxes and higher employ-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ers' contributions for unemployment insurance.

Since the Committee's meeting in late March, the trade-weighted value of the dollar against major foreign currencies had continued to fluctuate widely in volatile market conditions and had declined a little more than 4 percent on balance. The U.S. merchandise trade deficit and the current account deficit widened in the first quarter as a rebound in non-oil imports from the low fourth-quarter level extended the pattern of sharp quarter-to-quarter swings experienced since the beginning of 1984.

At its meeting on March 26, 1985, the Committee had adopted a directive that called for maintaining the existing degree of pressure on reserve positions. That action was expected to be consistent with growth in M1, M2, and M3 at annual rates of around 6, 7, and 8 percent respectively during the period from March to June. The members agreed that somewhat lesser restraint might be acceptable in the event of substantially slower growth in the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially higher growth. In either case, adjustments in the degree of reserve pressures would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

Growth in M1, which had slowed markedly in March from the rapid pace of earlier months, remained moderate in April at an annual rate of about 6 percent. M2 and M3, after slowing appreciably in March to annual rates of growth of about 3¾ and 5½ percent respectively, were little changed in April. Thus, while expansion in M1 was about in line with the Committee's expectations for the March-to-June period, growth in the broader aggregates was running well below the rates anticipated. Weakness in these aggregates stemmed in large part from a substantial reversal of earlier increases in banks' managed liabilities, as banks obtained funds from a sharp rise in U.S. government deposits after mid-April. Expansion in total domestic nonfinancial debt continued relatively rapid at an annual rate of about 11¾ percent in April, the same as in March. For the period from the fourth quarter of 1984 through April, growth in M1 was running above the Committee's range for the year 1985 while M2 and M3 were growing at rates within their long-term ranges; expansion in domestic nonfinancial debt was somewhat above the upper limit of its monitoring range for the year.

The level of adjustment plus seasonal borrowing averaged about $475 million over the three complete reserve maintenance periods between meetings, enlarged by borrowing by some nonfederally insured thrift institutions to meeting deposit withdrawals. Over the last week or so, total adjustment plus seasonal borrowing was running over $800 million, boosted in part by a further increase in borrowing by thrifts and overnight borrowing by a few large banks faced with unexpected needs for funds.

The federal funds rate had declined from the 8½ percent rate prevailing at the time of the March meeting and had averaged just over 8⅛ percent in recent weeks. Other market rates had fallen about ¾ to 1¼ percentage points over the period since the previous Committee meeting until the announcement by the Federal Reserve on May 17 of a reduction in the discount rate from 8 to 7½ percent. On the day

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

before this meeting, when the new discount rate went into effect, the federal funds rate moved lower, with trading averaging around $7^3/_4$ percent, and most other interest rates fell about 15 to 35 basis points further. The average rate on new commitments for fixed-rate conventional home mortgage loans declined about 30 basis points over the intermeeting period.

The staff projections presented at this meeting suggested that growth in real GNP, after a modest pickup in the current quarter from the reduced pace in the first quarter, would be slightly faster in the second half of the year. The unemployment rate was projected to edge down, and the rate of increase in prices was expected to remain close to that experienced in 1984 and early 1985.

During their review of the economic situation and outlook, the Committee members focused with concern on evidence that the economy, despite elements of strength, was expanding at a relatively sluggish pace; and they also stressed the uncertainties that surrounded the prospects for some pickup in the rate of economic growth. The currently mixed pattern of developments greatly complicated the forecasting process, especially against the background of the distortions and pressures associated with massive deficits in the federal budget and the balance of trade, together with persisting strains in financial markets. While acknowledging the considerable risks of unexpected developments in these circumstances, several members commented that improvement in the rate of economic growth remained the most reasonable expectation for the second half of the year. Others gave more weight to the downside risks in the economy and were concerned that the expansion might well remain relatively weak and considerably below the economy's potential.

A number of members expressed particular concern about the depressing impact that the competition of foreign goods was having on domestic production, and some commented that the outlook for the dollar in the exchange markets constituted the major uncertainty in assessing economic prospects. While domestic final demands were being reasonably well maintained, a strong dollar was diverting these demands toward imports, which were growing rapidly, and holding back domestic output. The strength of the dollar was also tending to curb the expansion of exports. Members cited examples of a wide range of manufacturing firms, including small firms, that along with some agricultural and extractive businesses were being severely affected by foreign competition. The exchange value of the dollar also appeared to be curbing expansion in domestic plant and equipment spending and fostering decisions to establish or expand productive facilities abroad rather than in the United States.

Members who were relatively optimistic about the economic outlook stressed the favorable impact that recent declines in interest rates were likely to have on interest-sensitive sectors of the economy. Housing had already responded to earlier reductions in interest rates. Consumer spending was holding up well, with automobile sales continuing to display notable strength, and consumer sentiment remained favorable. Some members commented that the negative impact of growing imports might diminish over the quarters ahead, especially if the dollar fell further from its recent highs. Reference was also made to continuing indications that businesses

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

were planning further, if more moderate, increases in their investment spending. One member expressed the view that rapid growth in M1 during late 1984 and early 1985 would exert an expansive influence on the economy over the months ahead.

Members who felt less comfortable with economic developments referred to the vulnerabilility of the manufacturing sector and also agriculture to the high value of the dollar on exchange markets. Moreover, business and consumer confidence could be adversely affected by ongoing problems in financial sectors of the economy. Other potential areas of vulnerability in the economy included nonresidential construction and multifamily housing; as they had at previous meetings, members cited instances of apparent overbuilding of office structures and of multifamily dwellings in various parts of the country. In addition, problems in agriculture and related industries might worsen, with retarding consequences for overall economic activity.

With regard to the outlook for inflation, members commented on the highly competitive pricing situation in many industries, and reference was also made to favorable developments in recent labor negotiations. In general, price pressures appeared to be relatively well contained in goods-producing sectors of the economy. Most commodity prices had fallen further to their lowest levels in about 2 years. At the same time, significant increases in prices and costs were continuing to occur in the service industries. Given the relative low rates of capacity utilization and the outlook for only limited growth in economic activity, members indicated that the risks of an acceleration in the rate of inflation appeared to be low. Some members noted their concern, however, that current inflation rates were too high—with recent tendencies in consumer prices worrisome—especially in light of the inflationary implications of a possible decline over time in the foreign exchange value of the dollar.

At its meeting in February the Committee had agreed on policy objectives that called for monetary growth ranges for the period from the fourth quarter of 1984 to the fourth quarter of 1985 of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for 1985. In keeping with the usual procedures under the Humphrey-Hawkins Act, these ranges would be reviewed at the July meeting and provisional ranges would be established for 1986.

In discussing policy implementation for the weeks ahead, Committee members, taking account of the recent reduction in the discount rate, generally favored maintaining about the same degree of pressure on bank reserve positions as in recent weeks, abstracting from special situation borrowing by thrift institutions. It was recognized that the recent decline in market rates and the lower discount rate would tend to increase the demands for money and credit under those circumstances as compared with what they otherwise would be. Most members found this acceptable particularly in view of the recent weakness in the broader monetary aggregates and sluggishness in the overall economy.

In the course of discussion it was noted that M1 had been growing about as expected at the previous meeting, but that some pickup in growth could develop in the period ahead. A number of members indicated that they were prepared to accept a little more

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

rapid expansion against the background of relatively weak economic performance, strains in financial markets, and the recent behavior of the broader aggregates. It was also pointed out that much of the increase in M1 thus far this year reflected expansion in interest-bearing checking accounts. Banks and thrifts had reduced interest rates on these accounts only slowly in response to declines in market yields that had begun in the latter part of last year, thereby making it relatively more attractive for the public to hold savings in such instruments. Nonetheless, M1 was running above the path associated with its long-run target and some members stressed the desirability of holding down near-term M1 growth, partly because a rate of growth that appeared unduly high could risk having an adverse impact on inflationary sentiment. However, one member also questioned whether the behavior of M1 should be interpreted as in the past given the present institutional environment and taking account of such other factors as the very high level of the dollar in foreign exchange markets.

Given the strength of M1 relative to its long-run target for the year, members indicated that they were prepared to accept slower growth in M2 and M3 for the quarter than they had expected earlier. One member observed, however, that continued weakness in the broader aggregates would be a matter of some concern and that somewhat faster growth than was now expected for the quarter should not be resisted. A differing view emphasized that the broader aggregates had less information content than M1 and that some aberration in their behavior should be tolerated. Another member highlighted the desirability of a decline in long-term interest rates over time, but felt that further monetary ease at this point might work against that objective by fostering inflationary expectations.

In keeping with the Committee's usual practice, the members contemplated that operations might be adjusted during the intermeeting period toward implementing somewhat lesser or somewhat greater restraint on reserve positions if monetary growth should appear to be substantially slower or faster than was currently expected for the quarter. While no member wanted to rule out possible adjustments in either direction, a majority believed that policy implementation should be alert to the potential need for some easing of reserve conditions. Other members, however, put more stress on the desirability of moving promptly, if necessary, to curb unduly rapid monetary expansion. It was understood that any adjustment should not be made automatically in response to the behavior of the monetary aggregates, but should be undertaken only after an appraisal of the strength of economic activity and inflationary pressures and evaluations of conditions in domestic and international financial markets.

In light of recent declines in market interest rates and the reduction in the discount rate, it appeared likely that the degree of reserve restraint contemplated by most of the Committee members would be associated with a lower federal funds rate, on average, than had prevailed until just before today's meeting. Nonetheless, the members anticipated that the rate would remain well within the 6 to 10 percent federal funds range established earlier by the Committee, and no sentiment in favor of changing that range was expressed.

At the conclusion of the Commit-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tee's discussion, a majority of the members indicated their acceptance of a directive that, against the background of the recent reduction in the discount rate, called for maintaining the current degree of reserve restraint, abstracting from special situation borrowing by thrift institutions. The members expected such an approach to policy implementation to be consistent with growth of M1 at an annual rate of about 6 percent or a little higher for the period from March to June. Given the weakness in M2 and M3 in April, growth in these broader aggregates over the three-month period was now expected to be slower than had been anticipated at the time of the previous meeting. The members agreed that somewhat lesser restraint on reserve conditions would be acceptable in the context of substantially slower growth in the monetary aggregates, while somewhat greater restraint might be appropriate if monetary growth were substantially faster. It was understood that the need for lesser or greater restraint would be considered against the background of developments relating to the strength of the business expansion, inflationary pressures, and conditions in domestic credit and foreign exchange markets. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests only a modest pickup in real GNP in the current quarter from the reduced rate of growth in the first quarter. Total retail sales rose in April to a level somewhat above the average for the first quarter, and housing starts increased further after rising substantially in the first quarter. Information on business capital spending suggests further growth, though at a much less rapid pace than earlier in the economic expansion. Industrial production declined slightly in April after rising little over the first quarter. Total nonfarm payroll employment increased at a somewhat reduced pace in April with employment in manufacturing registering another decline. The civilian unemployment rate remained at 7.3 percent in April. Broad measures of prices and wages appear to be rising at rates close to those recorded in 1984.

Since the Committee's meeting in late March, the trade-weighted value of the dollar against major foreign currencies has continued to fluctuated widely in often volatile market conditions and has declined moderately on balance. The trade and current account deficits widened in the first quarter as a rebound in non-oil imports from their low fourth-quarter level extended the pattern of sharp quarter-to-quarter swings experienced since the beginning of 1984.

Growth in M1 slowed markedly in March from the rapid pace of earlier months and remained moderate in April. The broader aggregates showed little change in April after their growth had slowed appreciably in March. Expansion in total domestic nonfinancial debt has remained relatively rapid. Interest rates have declined considerably since the March meeting of the Committee. On May 17, the Federal Reserve Board approved a reduction in the discount rate from 8 to 7½ percent.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at its meeting in February to establish ranges for monetary growth of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for the year 1985. The Committee agreed that growth in the monetary aggregates in the up-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

per part of their ranges for 1985 may be appropriate, depending on developments with respect to velocity and provided that inflationary pressures remain subdued.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

In the implementation of policy for the immediate future, and against the background of the recent reduction in the discount rate, the Committee seeks to maintain about the same degree of pressure on bank reserve positions. This action is expected to be consistent with growth in M1 at an annual rate of around 6 percent or a little higher during the period from March to June, while M2 and M3, in the light of their weakness in April, are expected to grow more slowly over the quarter than the 7 and 8 percent annual rates, respectively, anticipated earlier. Somewhat lesser reserve restraint would be acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially higher growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: Mr. Black.

Mr. Black dissented because he preferred to direct policy implementation in the weeks immediately ahead toward achieving somewhat slower expansion in M1. In his view, bringing M1 growth more promptly within the Committee's range for the year would help guard against a possible worsening of inflationary expectations and would limit the risk of a potentially unsettling movement in interest rates later in the year.

Meeting Held on July 9-10, 1985

Domestic Policy Directive

The information reviewed at this meeting indicated that expansion of economic activity has picked up in recent months, following virtually no growth in the first quarter of the year. Rates of increase in prices and wages had slowed a bit recently after indication of some acceleration early in the year, and for the year to date inflation appeared to be running at about the same pace as in 1984.

The nominal value of retail sales fell in May after an extraordinary rise in April, but the average level of sales for the April-May period was about 2¼ percent above the average for the first quarter. Over the two-month period, sales of durable goods were especially strong, fostered by a surge in sales at automotive outlets in April and a sharp rebound in sales at furniture and appliance stores in May. In the automotive sector, financing incentives on many domestic models and increased availability of imported cars boosted total automobile sales to an annual rate of 11.3 million units in May, the highest monthly pace in six years. Many of the special financing programs were phased out by the end of May, however, and sales of domestic cars slowed substantially in June.

Activity in the housing sector appeared to be holding earlier gains. Total private housing starts averaged 1.8

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

million units at an annual rate in the April–May period, the same as the advanced first-quarter pace, and newly issued permits for residential building rose in May to their highest level in nearly a year. Combined sales of new and existing homes remained strong, as the general decline in mortgage credit costs apparently continued to bolster demand.

Information on business capital spending suggested further growth in that sector, though at a much less rapid pace than earlier in the economic expansion. Most of recent strength in business fixed investment has been concentrated in expenditures for nonresidential construction. Imports apparently have continued to account for a sizable share of outlays for equipment; new orders for nondefense capital goods and shipments by domestic producers have changed little on balance since last fall. The Commerce Department's survey of business spending plans, conducted in late April and May, suggested that nominal outlays for plant and equipment would be roughly 9 percent above their 1984 average.

The index of industrial production edged down in April and May, after rising little over the first quarter. Production of defense and space equipment continued to advance and output of construction supplies also increased. Production of other products and materials generally remained sluggish: output of consumer goods had changed little from the level prevailing a year earlier, and production of business equipment—a source of strength throughout 1984—had declined thus far in 1985. The rate of capacity utilization for total industry fell 0.4 percentage point further in May to 80.3 percent, a cumulative drop of nearly 2½ percentage points since July 1984.

Nonfarm payroll employment rose 80,000 in June, after an advance in May that equaled the average monthly increase of 260,000 recorded in the first four months of the year. Manufacturing employment continued to fall in both May and June, however, bringing the cumulative loss in factory jobs to 220,000 so far this year. The civilian unemployment rate remained at 7.3 percent in June, unchanged since February.

The producer price index for finished goods and the consumer price index rose 0.2 percent in May. Over the first five months of the year, producer and consumer prices have risen at annual rates of about 1¾ percent and 4 percent respectively, the same as in 1984. The index of average hourly earnings also has continued to increase at its 1984 pace, rising at an annual rate of about 3 percent for the year through May.

Over the period since the Committee's meeting in May, the trade-weighted value of the dollar had generally moved within a relatively narrow range. But in days immediately preceding this meeting the value of the dollar declined about 2 percent, to a level below its recent low in April, bringing its decline over the intermeeting interval to around 3½ percent. The U.S. merchandise trade deficit widened in the April–May period from the rate in the first quarter, as both agricultural and nonagricultural exports fell while imports remained close to their high first-quarter rate.

At its meeting on May 21, 1985, the Committee had adopted a directive that, against the background of the reduction in the discount rate announced a few days before the meeting, called for maintaining the existing degree of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

pressure on reserve positions. The members expected that action to be consistent with growth in M1 at an annual rate of around 6 percent or a little higher during the period from March to June. Given the weakness in M2 and M3 in April, growth in these broader aggregates over the three-month period was expected to be slower than the respective annual rates of 7 and 8 percent anticipated at the time of the previous meeting in late March. The members agreed that somewhat lesser restrain would be acceptable in the event of substantially slower growth in the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially faster growth. It was understood that the need for lesser or greater restraint would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

In May and June, M1 expanded very rapidly, and its growth over the March-to-June interval was at an annual rate of about 13¼ percent, well above the rate expected at the time of the May meeting. The strength in M1 was evident in all its major components, particularly in demand deposits. That strength, coupled with an acceleration in the nontransaction component of M2 in June, brought growth in the broader aggregates to rates somewhat higher than expected in May for the three-month period. Nevertheless, for the period from the fourth quarter of 1984 through the second quarter of 1985, M2 and M3 expanded at rates within their long-term ranges, while M1 grew at a rate well above its range. Expansion in total domestic nonfinancial debt slowed a little in the second quarter, but remained high relative to the Committee's monitoring range for the year.

Total reserves grew rapidly in May and June, reflecting increases in required reserves associated with the growth in transaction accounts. The level of adjustment plus seasonal borrowing averaged around $550 million in the three complete maintenance periods between meetings and was running over $1.2 billion the week before this meeting, as seasonal strains associated with the midyear statement date and the holiday period, together with massive swings in Treasury balances, complicated reserve management at depository institutions and the Federal Reserve. Throughout the intermeeting interval, borrowing was boosted by occasional surges for a day or two near the end of a reserve maintenance period, apparently reflecting higher-than-expected demands for excess reserves, particularly around the mid-year statement date.

The federal funds rate centered on a trading range of 7½ to 7¾ percent during much of the intermeeting interval. The rate fell below 7 percent briefly after mid-June and rose above 8 percent for a time around the quarter-end statement date and July 4 holiday, when seasonal influences and sharply rising Treasury balances temporarily increased pressures on reserves. Other market rates fluctuated over relatively wide ranges in response to incoming economic data, changing expectations about the likelihood of a further cut in the discount rate, and at times, unanticipated money supply developments. On balance, rates on most Treasury securities fell about 35 to 60 basis points, while rates on commer-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

cial paper and certificates of deposit declined about 15 to 25 basis points, apparently reflecting emergence of slightly higher risk premiums in response to some concerns about the health of some financial institutions. Most commercial banks reduced their "prime" rate 1/2 percentage point to 9 1/2 percent. Corporate bond yields fell about 60 to 70 basis points and most broad stock price indexes reached record levels. The average rate on new commitments for fixed-rate conventional home mortgage loans declined about 80 basis points over the intermeeting period.

The staff projections presented at this meeting suggested that growth in real GNP would pick up somewhat in the second half of the year from the sluggish pace in the first half, and would continue at a modest pace through 1986. The unemployment rate was expected to fall only slightly over the projection period, and the rate of increase in prices was projected to remain close to that experienced in recent years.

In the Committee's discussion of current and prospective economic developments, the members agreed that some pickup in the rate of economic expansion from the slow growth of the first half of the year was a reasonable expectation for the second half. The outlook for 1986 was more uncertain, but the members generally saw continuing expansion, though possibly at a moderate pace, as the most likely prospect for the year. As they had at previous meetings, the members expressed concern about the uneven participation of various industries in the economic expansion, including the continuing and serious problems in the agricultural sector. They also remained concerned about the underlying imbalances in the economy, notably the massive deficits in the federal budget and in the balance of trade, that along with persisting strains in domestic and international financial markets threatened the sustainability of the expansion. In these circumstances the members recognized that their forecasts were subject to a great deal of uncertainty and several commented that the risks of any deviation appeared to be on the downside. Other members were more optimistic, at least with respect to the next few quarters, and in one view the rapid growth of M1 since the latter part of 1984 could presage significantly faster expansion than generally was anticipated currently.

In keeping with the usual practice for meetings when the Committee considers its long-run objectives for monetary growth, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared specific projections of economic activity, the rate of unemployment, and average prices. With regard to growth in real GNP, the projections had a central tendency of 2 3/4 to 3 percent for 1985 as a whole and 2 1/2 to 3 1/4 percent for 1986. The tendency for the rate of unemployment was an average rate of 7 to 7 1/4 percent for the fourth quarter of 1985 and about the same or a bit lower for the fourth quarter of 1986. The projections for the implicit GNP deflator centered on a rise of 3 3/4 to 4 percent for the year 1985 and 3 3/4 to 4 3/4 for the year 1986. These projections were considered to be consistent with the Committee's objectives for growth in money and credit established at this meeting. The projection also assumed that the Congress and the administration would achieve deficit reductions

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in the range of those contained in recent House and Senate budget actions. The projections were based on an assumption that the exchange value of the dollar would not deviate substantially from its recent trading range.

In support of their expectation that the rate of economic expansion would improve from the very sluggish pace experienced in the first half of the year, members referred to the favorable impact of reduced interest rates on interest-sensitive sectors of the economy, such as the construction and automobile industries, and they also noted the buildup of liquidity in the economy. Some members commented that consumer spending was likely to remain relatively robust, at least over the quarters immediately ahead, given generally favorable consumer attitudes and the sizeable gains expected in employment and earnings. A number of members also referred to favorable prospects for continuing growth in business capital spending against the background of reduced borrowing costs and strong competitive pressures—both domestic and foreign—on business firms to enhance their productivity. In the latter connection one member reported on the expectation of some businessmen that the lull in demands for high-technology equipment might prove to be temporary.

On the negative side, apart from the underlying imbalances that constituted an ongoing threat to the economy, the members cited a number of factors that would tend to limit, if not arrest, the expansion. The growth of private debt and rising delinquency rates could have an increasingly negative effect on consumer spending and perhaps on housing demand. In the investment area, the demand for high-technology equipment might not revive as some businessmen expected, and the high vacancy rates in many parts of the country for multifamily housing and office space suggested that a marked slowdown in that type of construction. More generally, relatively low rates of capacity utilization would limit the need for investments in many industries. Several members referred to the continuing drag on domestic production stemming from the high value of the dollar and the associated intense foreign competition in both domestic and export markets.

With regard to the outlook for inflation, the members noted that wage and price pressures were relatively subdued in domestic labor and product markets. Inflationary pressures were greater in some of the service industries, but against the background of generally low capacity utilization rates and relatively high unemployment the members did not expect much change in the overall rate of inflation during the year ahead, at least in the absence of any sizeable decline in the foreign exchange value of the dollar. Indeed, one member observed that the performance of prices might well prove to be better than was generally expected unless the exchange value of the dollar were to fall substantially. A number of members commented that a limited decline in the dollar might have little, if any, effect on domestic prices or in the extent of import penetration. Many foreign suppliers who enjoyed sizable profit margins would probably tend to absorb such a decline by maintaining current dollar prices in order to preserve their market shares. On the other hand, a substantial decline in the value of the dollar, if it were to occur, would pose a considerable risk of being reflected in higher domestic prices.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

At this meeting the Committee reviewed its ranges for growth of the monetary and credit aggregates in 1985 and established tentative ranges for 1986 within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).[1] At its meeting on February 12-13, 1985, the Committee had adopted monetary growth ranges of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9½ percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent. The Committee had agreed that growth in the monetary aggregates in the upper part of their ranges might be appropriate for the year, depending on developments with respect to velocity and provided that inflationary pressures remained subdued.

The Committee's review of its ranges for 1985 focused on the rapid growth of M1 during the first half of the year, the factors that may have influenced the demand for money, and the implications of M1 growth for the future course of economic activity and the rate of inflation. In their discussion the members took account of an analysis that suggested that the strength of M1 relative to the Committee's target range appeared to reflect in part a one-time response on a lagged basis to the sizeable declines in interest rates that had occurred over the past year. The available evidence suggested, not only on the basis of the recent experience but also that of earlier periods such as in 1982-83, that in periods characterized by large interest rate declines individuals and businesses tended to shift into transaction-type balances from other assets because they sacrificed less interest income in doing so. Moreover, it was possible that the availability of interest on certain types of checking accounts in recent years, together with the fact that the rates of interest on such accounts have tended to change more sluggishly than competing market-oriented rates, has increased the interest sensitivity of M1, particularly in the short run. It was also noted, however, that a part of the rapid growth of M1, notably in the past two months, did not appear to be related to the interest rate adjustments or to ongoing transaction demands, raising questions about whether there were special factors, such as changes in corporate cash management practices or transitory responses to sharp declines in Treasury balances, that also may have been influencing the demand for money.

While acknowledging that both the explanation and the implications of the bulge in M1 growth were subject to a great deal of uncertainty, the members generally concluded that faster-than-targeted expansion in M1 could be accepted for the first half of the year in light of the sluggish growth in economic activity, relatively well contained price pressures, and a high value of the dollar on foreign exchange markets. Moreover, growth in the broader aggregates for the year to date had been consistent with the Committee's easier expectations.

Looking ahead to the balance of the year, the members differed to some extent on an appropriate M1 target, but they generally concluded that it would not be desirable in the current economic and financial environment

1. The Midyear Monetary Policy Report pursuant to this legislation was transmitted to the Congress on July 16, 1985.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to offset the recent spurt in M1 by a slowing in the second half sufficient to bring M1 into the existing 4 to 7 percent long-run range. That would imply almost no growth month by month on average over the balance of the year. While the prospective behavior of M1 would remain subject to continuing uncertainties, the members believed that M1 velocity would probably move gradually toward a more usual or predictable pattern and that maintenance of the current degree of reserve pressure would be associated with a reduction in M1 growth during the second half of the year to a moderate pace. Such growth was likely to be consistent with a pickup in the rate of economic expansion and continued containment of inflationary pressures. Accordingly, most of the members favored either raising the M1 range that had been established in February for the year or rebasing the range from the fourth quarter of 1984 to the second quarter of 1985, with a smaller increase or no change in the actual numerical range.

Members who expressed a preference for a higher range over rebasing emphasized that the degree of uncertainty surrounding the future behavior of M1 remained considerable, and a higher range would not carry an implication that the velocity adjustment in M1 was concluded. Moreover, to the extent that changes in the composition of M1 toward interest-bearing accounts, shifts in cash management practices, and generally lower interest rates implied a more slowly rising trend in M1 velocity, M1 growth relative to GNP would be higher over time than the Committee had anticipated earlier and, in one view, should begin to be reflected in the Committee's M1 ranges. However, a majority of the members preferred to rebase M1 on the second quarter. While they did not disagree that there were considerable uncertainties about the prospective relationship between M1 and economic performance, these members felt that a rebased range would better reflect the current thrust of the Committee's policy and would be more consistent with a movement toward lower growth ranges over time, as needed to attain the long-run objective of sustained, noninflationary economic growth.

Because of the uncertainties surrounding the behavior of M1, one member proposed placing much less weight than usual on movements in that aggregate, possibly by relegating it to a monitoring status for some period of time. Other members opposed such a course because they felt that M1, together with the other monetary aggregates, would continue to provide a useful focus for the conduct of monetary policy even as their behavior had to be evaluated in the context of ongoing economic, financial, and exchange market developments.

With regard to the members' preferences for a specific M1 range, a majority supported a proposal to establish a range of 3 to 8 percent, rebased on the second quarter. Such a range implied a substantial slowing in growth from the pace in the first half. Other members indicated a preference for a rebased range of 4 to 7 percent, which they believed was likely to prove more consistent with the Committee's longer-run objectives. Given the uncertainties surrounding the behavior of M1, most of the members supported a relatively wide range for the second half, even though the prospects for expansion at the low end of the range were viewed as somewhat remote. It was recognized that because M1

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

growth had been strong during the latter part of the second quarter, its level was currently high in relation to the rebased range, and it was not likely to fall within that range until some time had elapsed. Relatively low growth with the range, should it occur, would be acceptable if the recent decline in M1 velocity were substantially reversed and economic performance proved to be satisfactory. In summary, the rebased range was based on expectations of a return of velocity growth over time toward more usual patterns, but because of the many uncertainties that were involved the members agreed on the desirability of continuing to judge M1 developments against the background of the other aggregates and evidence on the behavior of the economy, prices, and financial markets, both domestic and international.

With regard to M2, M3, and debt all of the members supported a proposal to reaffirm the current ranges for 1985, subject to the understanding that actual growth, as had been contemplated previously at the February meeting, might appropriately be high within the ranges depending on developments with respect to velocity and provided that inflationary pressures remained subdued.

At the conclusion of its review of the ranges for 1985, the Committee voted as follows to establish a rebased range for M1 and to reaffirm the ranges that were set at the February meeting for the broader aggregates and for total domestic nonfinancial debt:

> The Committee at this meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Forrestal, Keehn, Partee, Martin, Rice, Ms. Seger, and Mr. Wallich. Vote against this action: Mr. Black. (Absent and not voting: Mr. Gramley.)

Mr. Black dissented because he preferred a rebased range of 4 to 7 percent for M1, which he thought was more likely to be consistent with both sustained economic expansion and progress toward price stability. In particular, he was concerned that the higher 8 percent top of the rebased range adopted by the Committee might tend to prolong the process of reducing M1 growth to a noninflationary rate.

Turning to the establishment of tentative ranges for 1986, several members emphasized the desirability of taking further action, in line with previously stated Committee intentions, to reduce growth in money and credit over time to rates that would be consistent with sustainable economic expansion and reasonable price stability. In that context, a majority of the members favored an M1 range of 4 to 7 percent for 1986. However, with varying degrees of emphasis, a number of members questioned whether such a range would prove adequate to sustain the economic expan-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sion, particularly in light of the possibility that the trend in M1 velocity might be shifting lower. Reference was also made to the uncertainties associated with the lifting of remaining Regulation Q interest rate ceilings early in 1986, as provided for in current legislation. One member commented that the elimination of rate ceilings on savings accounts could result in rate adjustments that favored such accounts over M1-type deposits, thereby tending to restrain M1 growth in relation to that of M2. However, the removal of ceilings on regular NOW accounts would work in the other direction.

With regard to the broader aggregates, the members favored no change in the tentative range for M2 and a 1/2 percentage point reduction in the upper limit of the M3 range compared with the 1985 ranges for those aggregates. There was general agreement on the desirability of reducing the monitoring range for total domestic nonfinancial debt by 1 percentage point, partly reflecting an expectation that its expansion would be tempered by a drop-off in the net redemption of equity shares that had boosted corporate debt substantially over the past several quarters. Moreover, credit needs to finance the expansion would tend to grow less than in 1985 if, as a number of members anticipated, the current account deficit did not worsen further and the gap between the growth in domestic spending and domestic production narrowed or disappeared. All of these ranges were believed to be consistent with sustained growth in the economy so long as inflationary pressures remained subdued. However, the Committee recognized that uncertainties about interest rates and other factors that could affect the velocity of the various aggregates would require careful reappraisal of the ranges at the beginning of 1986. In addition, actual experience with institutional and depositor behavior after the completion of deposit rate deregulation would need to be taken into account in judging the ongoing appropriateness of the ranges.

At the conclusion of its discussion, the Committee took the following action to establish the tentative ranges for 1986:

> For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Keehn, Partee, Rice, and Wallich. Votes against this action: Mr. Martin and Ms. Seger. (Absent and not voting: Mr. Gramley.)

Mr. Martin dissented because he preferred a somewhat higher growth range for M1 to provide for greater flexibility if needed to accommodate sustained economic expansion, should velocity continue to decline or increase very sluggishly. Ms. Seger dissented because she believed that higher growth ranges were desirable to foster an acceptable rate of economic expansion and help reduce financial strains in the economy. Both Mr. Martin and Ms. Seger saw little risk under current conditions that inflation would intensify.

In the Committee's discussion of policy implementation, some divergence of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

views was expressed with regard to the appropriate operational approach for the weeks immediately ahead. A majority of the members were in favor of directing operations, at least initially, toward maintaining the existing degree of pressure on reserve positions, but others indicated preference for somewhat firmer or somewhat easier reserve conditions. The members agreed that current reserve conditions were likely to be associated with a marked slowing in the growth of M1 during the third quarter, partly because the recent unusual surge in demand deposits would appear to have satisfied transaction needs for some period ahead. Growth in the broader aggregates would also be expected to slow from the pace in May and June, partly because of the prospect of some moderation in the inflow of funds to money market mutual funds and to money market deposit accounts as the interest paid on such accounts was brought into better alignment with short-term market rates.

Despite the outlook for more moderate growth in the monetary aggregates, notably M1, compared with the second quarter, some members were concerned that such growth might not slow sufficiently, and they proposed some modest firming of reserve conditions to help assure that the expansion of M1 would moderate within the Committee's range for the second half of the year. A differing view, which placed less emphasis on the behavior of M1 because of the uncertainties that were involved, stressed the desirability of some easing of reserve conditions against the background of ongoing financial strains in some sectors and the sluggish performance of the economy.

In keeping with the Committee's usual practice, the members considered the question of possible intermeeting adjustments in the degree of reserve restraint. They agreed as they had previously that such adjustments should not be made automatically in response to the behavior of the monetary aggregates alone, but should take account of the strength of economic activity and inflationary pressures, domestic credit conditions, and the foreign exchange value of the dollar. In particular, the members agreed that some shortfall in the growth of M1 from expectations, should it occur for a month or two, should not be resisted and might indeed be desirable in the context of acceptable economic performance. Conversely, a tendency for M1 growth to exceed expectations should be countered more promptly, at least in the view of some members, in light of the rapid earlier growth in transaction balances. The members also felt that the behavior of the dollar in foreign exchange markets might well impose a significant constraint—potentially in either direction—with regard to possible adjustments in the degree of reserve restraint over the weeks ahead.

With regard to the intermeeting range for the federal funds rate, which calls for Committee consultation when its boundaries are exceeded for a period, it was suggested in the course of discussion that a rise in the average rate to around the upper end of the existing 6 to 10 percent monitoring range would imply reserve conditions that were inconsistent with the Committee's objectives for monetary growth, and that accordingly the upper end might be lowered to 9 percent. On the other hand, some members were concerned that a further decline in the average level of the federal funds rate to near the lower end of the present range might also prove inconsistent with monetary growth objectives and would therefore provide a misleading signal of policy easing. On balance,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

most of the members preferred to retain the current range, which bracketed fairly evenly with the existing federal funds rate.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve positions, keeping in mind the possibility of some increases in those pressures if growth of the monetary aggregates exceeded intentions. The members expected such an approach to policy implementation to be consistent with growth of both M2 and M3 at an annual rate of around 7½ percent for the period form June to September. Over the same period they expected the expansion of M1 to slow substantially to an annual rate of 5 to 6 percent. The members agreed that somewhat lesser restraint on reserve positions might be acceptable in the event of substantially slower-than-expected growth in the monetary aggregates, while somewhat greater restraint would be acceptable if monetary growth were substantially faster. It was understood that the need for lesser or greater restraint would be considered against the background of developments relating to the strength of the business expansion, inflationary pressures, and conditions in domestic credit and foreign exchange markets. The members agreed that the intermeeting range for the federal funds rate should be left at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests some pickup in the expansion of economic activity in recent months following virtually no growth in the first quarter. Total retail sales rose on balance in April and May to a level appreciably above the average for the first quarter, and housing starts held earlier gains after rising substantially in the first quarter. Information on business capital spending suggests further growth, though at a much less rapid pace than earlier in the economic expansion. Industrial production declined slightly in April and May after rising a little over the first quarter. Total nonfarm payroll employment increased at a somewhat reduced pace in May and June with employment in manufacturing registering further declines. The civilian unemployment rate remained at 7.3 percent in June, unchanged since February. Broad measures of prices and wages appear to be rising at rates close to those recorded in 1984.

Since the Committee's meeting in May, the trade-weighted value of the dollar against major foreign currencies has generally moved within a relatively narrow range but recently has declined to a level below its April low. The merchandise trade deficit in April–May widened from the first quarter rate as both agricultural and nonagricultural exports fell, while imports remained close to their high first-quarter level.

M1 expanded very rapidly in May and June after growing at a moderate pace in the preceding two months. The broader aggregates also grew more rapidly in May and June after slowing appreciably earlier. From the fourth quarter of 1984 through June, M1 grew at a rate well above the Committee's range for 1985; M2 increased at a rate around the upper end of its longer-run range; while M3 expanded at a rate in the upper half of its range. Expansion in total domestic nonfinancial debt slowed a little in the second quarter but remained high relative to the Committee's monitoring range for the year. Interest rates have declined somewhat further since the May meeting of the Committee.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee at this meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for the next year, the Committee also recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M2 and M3 at an annual rate of around 7½ percent during the period from June to September, and with a substantial slowing of M1 growth to an annual rate of 5 to 6 percent. Somewhat lesser reserve restraint might be acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint would be acceptable in the event of substantially higher growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for short-run operational paragraph: Messrs. Volcker, Corrigan, Balles, Forrestal, Keehn, Partee, Martin, Rice, and Wallich. Votes against this action: Mr. Black and Ms. Seger. (Absent and not voting: Mr. Gramley.)

Mr. Black dissented because he believed some increase in the degree of reserve pressure was needed to help assure an adequate slowing of M1 growth sented because she favored some easing of reserve conditions to help reduce current financial strains, moderate the strength of the dollar in foreign exchange markets, and promote faster economic expansion.

Meeting Held on August 20, 1985

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity was probably expanding in the current quarter at a moderately faster pace than in the first half of the year. Broad measures of prices and wages continued to indicate that inflation was running at about the same pace as in 1984.

The index of industrial production rose 0.2 percent in July, about the same increase as in each of the preceding two months. Output of consumer goods was relatively strong, reflecting gains in the production of automobiles and home goods. Production of construction supplies and of materials also increased in July; but production of business equipment fell, and output of defense and space equipment declined after several months of extraordinarily

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

rapid growth. Capacity utilization for total industry was 80.8 percent in July, unchanged since April and 1.2 percentage points below its year-earlier level.

Total nonfarm payroll employment rose 240,000 in July, a little above the average monthly increase during the first half of the year. Job gains remained uneven across industries, as employment in manufacturing declined slightly further while employment in service-producing industries continued to account for the bulk of the advance. The civilian unemployment rate remained at 7.3 percent in July, unchanged since February.

The nominal value of retail sales increased 0.4 percent in July after two months of decline. Sales of general merchandise recovered somewhat after falling in May and June, and sales of furniture and appliances rose at about the average pace of the preceding two months. In the automotive sector, however, sales of domestic automobiles dropped to an annual rate of 7½ million units—1 million below the average level earlier in the year when foreign cars were in short supply and financing incentive programs for domestic cars were prevalent. Sales slipped still further in early August to an annual rate of around 7 million units, with some of the slowing perhaps attributable to the recent strike by auto-haulers. The tentative settlement of that strike and the reintroduction of below-market-rate financing programs pointed to a likely rebound in sales of domestically produced autos.

Total private housing starts fell slightly in July to an annual rate of 1.65 million units. The lower pace reflected a drop in starts of multifamily units, as starts of single-family structures edged higher. Other indicators suggested some pickup in construction activity in the near term: newly issued permits for residential building remained at a high level relative to starts, consumer attitudes toward buying houses were quite positive, and informal trade reports from homebuilders indicated heightened buyer interest and sales activity.

Trends in business capital spending have been obscured lately by extreme volatility in monthly data, but available information suggested further growth over the period ahead, though probably at a relatively modest pace, following the extraordinarily rapid growth earlier in the economic expansion. In June, the latest month for which data on business investment were available, new orders and shipments of nondefense capital goods rebounded. On the other hand, outlays for nonresidential construction weakened.

The producer price index for finished goods rose 0.3 percent in July, after declining to 0.2 percent in June. The rise in July reflected in part a surge in prices of fresh vegetables that boosted the index for finished foods 1.3 percent; other food prices generally declined, however, and prices of crude foods fell in July for the seventh consecutive month. The consumer price index rose 0.2 percent in June, the same as in May. Food prices changed little over the two-month period and consumer commodity prices declined, but service prices continued to rise at a comparatively rapid rate. Thus far in 1985, producer and consumer prices and the index of average hourly earnings had risen at rates close to those recorded in 1984.

Since the Committee's meeting in July, the trade-weighted value of the dollar against major foreign currencies had fallen nearly 4¾ percent further, to a level about 17 percent below

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

its peak in late February. Most of the recent decline was in the early part of the intermeeting period; since late July the dollar's value had declined only slightly further on balance. The U.S. merchandise trade deficit widened in the second quarter to a record annual rate of nearly $134 billion. Both agricultural and nonagricultural exports fell substantially, while imports registered a small increase. The rise in imports was attributable to a substantial increase in the volume of oil imports after a sharp decline in the first quarter.

At its meeting on July 9–10, 1985, the Committee had adopted a directive that called for maintaining the existing degree of pressures on reserve positions, keeping in mind the possibility of some increase in those pressures if growth of the monetary aggregates exceeded intentions. That action was expected to be consistent with growth of both M2 and M3 at an annual rate of around 7½ percent for the period from June to September. Over the same period the expansion of M1 was expected to slow substantially to an annual rate of 5 to 6 percent. The members agreed that somewhat lesser restraint on reserve positions might be acceptable in the event of growth in the monetary aggregates that was substantially slower than expected while somewhat greater restraint would be acceptable if monetary growth were substantially faster. In either case, adjustments in the degree of reserve pressures would be considered against the background of developments relating to the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

Though slowing from the quite rapid May–June pace, M1 had shown relatively strong growth since midyear; it increased at an annual rate of about 9 percent in July and data for early August indicated the likelihood of stronger growth in the current month. Thus, its expansion appeared to be well above the Committee's expectations for the June-to-September period. The strength in M1 reflected an acceleration in other checkable deposits while demand deposits, though increasing a little on balance, remained at high levels as the extraordinary surge of late spring in such deposits showed no signs of unwinding. Expansion in the broader aggregates slowed in July from the average pace over the previous two months, to annual rates of about 8½ percent for M2 and 4½ percent for M3. For the period from the fourth quarter of 1984 through July, growth in M2 was around the upper end of its range for 1985, while the recent sluggish growth in M3 had brought its growth to around the midpoint of its range. Expansion in total domestic nonfinancial debt remained high relative to the Committee's monitoring range for the year.

Early in the intermeeting interval open market operations were directed at maintaining the existing degree of pressures on reserves. By early August, with M1 running well above the Committee's expectations at the time of the July meeting, and with M2 also on the high side, against the background of a weaker dollar and sustained economic activity, desk operations were conducted with a view toward more cautious provision of reserves. The level of adjustment plus seasonal borrowing, which had been artificially high around the time of the July meeting because of seasonal strains associated with the midyear

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

statement date and July 4 holiday period, averaged about $410 million in the two-week maintenance period ending July 31 and rose to $480 million in the first half of August.

The weekly average federal funds rate was generally in the 7¾ to 7⅞ percent area during the intermeeting interval, though average daily rates ranged from about 7⅜ percent to as high as 8¾ percent. Most other short-term interest rates rose about 20 to 45 basis points over the intermeeting interval, mainly reflecting a reassessment by market participants of the outlook for the economy and for monetary policy. Yields on intermediate- and long-term Treasury securities increased about 20 to 30 basis points, while yields on corporate bonds generally rose somewhat more. The average contract rate on new commitments for fixed-rate convetional home mortgage loans moved up slightly to around 12¼ percent.

The staff projections presented at this meeting suggested that growth in real GNP would pick up somewhat in the second half of the year from the sluggish pace in the first half, and would continue at a modest pace through 1986. Although domestic final demand was projected to rise less rapidly than earlier this year, a larger share of the increase was expected to be met out of domestic production rather than from imports or reduced inventory investment. The unemployment rate was projected to edge down only slightly over the forecast horizon and the rate of increase in prices was projected to remain close to that experienced in recent years.

In the Committee's discussion of the economic situation and outlook, the members focused on various uncertainties and risks inherent in current economic and financial conditions. They noted with some concern the absence of clear evidence that business activity might be strengthening, as they had expected earlier, following sluggish growth during the first half of 1985. Nonetheless, with domestic final demands remaining relatively buoyant, most of the members agreed that some pickup in the rate of economic expansion continued to be a reasonable expectation for the second half of the year. They recognized that various imbalances and financial strains in the economy constituted ongoing threats to the economic expansion and raised the danger that growth would be more sluggish than anticipated. Some members also observed that unexpected developments stemming from domestic or international financial problems or from other difficulties in specific sectors of the economy, if not contained, could interrupt the expansions itself. On the other hand, a few members remained relatively optimistic about the prospective performance of the economy; it was also suggested that the rapid growth in M1 in recent months might well lead with some lag to faster economic expansion than was currently anticipated.

Particular emphasis was given during the Committee's discussion to the prospect that domestic economic developments would depend importantly on international conditions, including the economic performance of industrialized countries, the ability and willingness of developing countries to manage their foreign debt problems, the global energy situation, and the foreign exchange value of the dollar. The members continued to stress, as they had at previous meetings, the strongly adverse impact that foreign

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

competition, fostered by a high value of the dollar in foreign exchange markets, was having on overall domestic economic activity and in particular on many manufacturing firms on agriculture. Some members commented that the prospects for near-term improvement in the balance of trade seemed to be relatively remote.

While a further decline in the dollar would tend with some lag to have a favorable impact on the balance of trade, a sense of "free fall" in the dollar would represent a major threat to progress toward price stability and to interest rates. In general, while a decline over time would not be disturbing, it was viewed as important to maintain a certain confidence in the dollar, given the large net inflows of funds from abroad needed to bridge the gap between the relatively limited availability of domestic saving and the funds required to finance the federal budget deficit and private capital outlays. Without provision of such funds relatively willingly from abroad, pressures on domestic interest rates would be greater than otherwise. The members agreed that the transition to a lower trade deficit and a more sustainable pattern of international transactions generally, presumably accompanied by a lower dollar, would be greatly facilitated by substantial progress in reducing future deficits in the federal budget and by the avoidance of protectionist legislation that could have a highly unfavorable effect on international trade, on the ability of developing countries to resolve their external debt problems, and on the overall performance of the domestic economy. Several members noted that the risks associated with the underlying distortions and problems in the domestic economy and the persisting strains in domestic and international financial markets posed dilemmas that were not amenable to a monetary policy solution.

As they had at earlier meetings, the members commented on the uneven pattern of developments in various sectors of the economy. They gave special emphasis to the problems in agriculture but also cited other problem or lagging areas of the economy. In most parts of the country, however, strength in a number of industries such as services and defense production currently tended to outweigh the economic weaknesses. In the construction area, one member called attention to recent indications of reduced nonresidential building activity and other members commented that vacancy rates in office structures were relatively high in several parts of the country. On the other hand, there were reports of growing buyer interest in housing, although recent data on housing starts were weaker than expected. With regard to financial conditions, a number of members referred to various financial practices and the buildup or incautious use of debt that had rendered many borrowers and their lenders more vulnerable to economic adversity. In the case of consumers, rising debt burdens together with the possibility of reduced income growth were viewed by at least some members as likely to restrain expansion in consumer expenditures.

At its meeting in July the Committee had reviewed the basic policy objectives that it had established in February for growth of the monetary and credit aggregates in 1985 and had set tentative objectives for expansion in 1986. For the period from the fourth quarter of 1984 to the fourth quarter of 1985, the Committee had reaffirmed

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the ranges for broader aggregates set in February of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was also reaffirmed at 9 to 12 percent for 1985. With respect to M1, the base was moved forward to the second quarter of 1985 and a range of 3 to 8 percent at an annual growth rate was established for the period to the fourth quarter of the year. For 1986 the Committee agreed on tentative monetary growth objectives that included reductions of 1 percentage point in the upper end of the M1 range and ½ percentage point in the upper end of the M3 range. The provisional range for total domestic nonfinancial debt was reduced by 1 percentage point for 1986.

In the Committee's discussion of policy implementation for the weeks immediately ahead, the members took particular account of the disparate behavior of M1 and the economy. Under the circumstances, a consensus emerged against making a substantial change for the time being in the degree of reserve restraint that had been sought recently. The members recognized that the behavior of M1 was subject to unpredictable fluctuations. Nonetheless, they continued to expect that the expansion in M1 would moderate appreciably over the months ahead, if something like the current degree of restraint on reserve positions was maintained.

In the course of the Committee's discussion, a number of members emphasized the uncertainties surrounding the behavior of M1 and the downside risks they saw in the economy. Under prevailing circumstances, the surge in M1 growth might not have the usual inflationary implications. The demand for assets in M1 appeared to have been influenced by the relatively low level of interest rates on market instruments and also on small time certificates of deposit, and the velocity of money seemed to be continuing to decline sharply. Moreover, there had been no signs of increasing price pressures in aggregate price indicators or in commodity markets. It was also argued that the objective of achieving M1 growth within the Committee's long-run range might receive somewhat reduced emphasis, at least for a time, pending evaluation of further developments including the performance of the broader aggregates.

Other members expressed more concern that further M1 growth at rates substantially above the Committee's long-run range would have inflationary consequences over time. They noted the persisting strength of M1 in recent weeks, and should that continue, they felt that added reserve restraint would probably be desirable to bring M1 closer to the upper end, or within, the Committee's long-run range by the fourth quarter. Continued strength in M1 could also raise questions about the Committee's commitment to an anti-inflationary policy, with potentially adverse implications for inflationary expectations. Some members also commented that the rapid growth in M1 had already built up considerable liquidity that would tend to sustain the expansion over the months ahead.

While there were shadings of opinion with regard to the appropriate degree of reserve pressure under the circumstances, on balance a majority of the members indicated their acceptance of a directive that called for maintaining the slightly firmer degree of reserve restraint that had been sought in recent weeks. The members

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

expected such an approach to policy implementation to be consistent with growth of M2 and M3 at annual rates of around 8½ and 6½ percent respectively for the period from June to September, not much changed from expectations at the time of the July meeting. Growth in M1 was expected to slow from its recent pace, but given the rapid expansion since June, M1 was now anticipated to grow at an annual rate of about 8 to 9 percent over the three-month period, considerably above earlier expectations. Two members argued for immediate adjustments in the degree of reserve pressures—although in opposing directions—based on their differing evaluations of the significance of recent monetary growth for inflation and economic activity as against the risks to sustained expansion stemming from the financial vulnerabilities and the underlying imbalances in the economy.

In keeping with the Committee's usual practice, the members contemplated the possible need for some intermeeting adjustment in the degree of reserve restraint. They agreed that somewhat greater restraint on reserve positions would be acceptable if growth in the monetary aggregates were substantially faster than expected, while somewhat lesser restraint would be acceptable if monetary growth were substantially slower. As in the past, any such adjustment should not be made automatically in response to the behavior of the monetary aggregates alone, but should take broader economic and financial developments into account, including conditions in domestic and international financial markets. For the period ahead, several members believed that policy implementation should be especially alert to developments in the foreign exchange markets. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The infomation reviewed at this meeting suggests that economic activity is probably expanding in the current quarter at a moderately faster rate than in the first half of the year. In July, industrial production continued to move somewhat higher and total retail sales rose modestly after two months of decline. On the other hand, housing starts fell somewhat in July. Information on business capital spending suggests further growth, though at a much less rapid pace than earlier in the economic expansion. Total nonfarm payroll employment continued to increase in July, although employment in manufacturing declined slightly further. The civilian unemployment rate remained at 7.3 percent in July, unchanged since February. Broad measures of prices and wages appear to be rising at rates close to those recorded in 1984.

Since the Committee's meeting in July, the trade-weighted value of the dollar against major foreign currencies has depreciated further. The merchandise trade deficit widened in the second quarter to the highest rate on record. Both agricultural and nonagricultural exports fell substantially, while imports registered a small increase.

Based on data for July and early August, M1 has been growing relatively rapidly. Demand deposits have shown little change on balance, but other checkable deposits have expanded substantially. Growth in M2 has continued at around the upper end of its 1985 range, while relatively sluggish growth in M3 recently has brought this aggregate to the midpoint of its range. Expansion in total domestic nonfinancial debt has remained high relative to the Committee's monitoring range for the year. Most interest rates have risen somewhat since the July meeting of the Committee.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth inputput on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee at the July meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remained subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks to maintain the degree of pressure on reserve positions sought in recent weeks. This action is expected to be consistent with growth in M2 and M3 at annual rates of around 8½ and 6½ percent, respectively, during the period from June to September. M1 growth is expected to slow from its recent pace, but given the rapid growth in recent weeks, expansion over the June-to-September period may be at an 8 to 9 percent annual rate. Somewhat greater restraint would be acceptable in the event of substantially higher growth in the monetary aggregates. Somewhat lesser restraint would be acceptable in the event of substantially slower growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations the pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Forrestal, Keehn, Martin, Partee, Rice, and Wallich. Votes against this action: Mr. Black and Ms. Seger. (Absent and not voting: Mr. Gramley.)

Mr. Black dissented because he preferred to direct open market operations promptly toward a somewhat greater degree of reserve restraint and thereby improve the prospects of moderating M1 growth to within the Committee's range for the second half of the year. Ms. Seger dissented because she favored some reduction in the degree of reserve restraint in light of the financial vulnerability of some sectors of the economy and in order to encourage sustained economic expansion.

At a telephone consultation on September 23, the Committee discussed the possible implications for intervention in foreign exchange markets of the deliberation during the weekend of the Ministers of Finance and Central Bank Governors of the G-5 countries. In the course of the discussion, it was indicated that the likely potential for U.S. sales of dollars and acquisitions of foreign currencies over the near term fell generally within existing Committee authorizations.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Meeting Held on October 1, 1985

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity expanded in the third quarter at an annual rate of about 3 percent, compared with a rate of about 1 percent in the first half of the year. While the increase in total spending by domestic sectors was a little weaker than in the first half, growth in domestic output was higher because the trade balance in the third quarter apparently did not deteriorate further. Broad measures of prices and wages appeared to be rising at rates close to or somewhat below those recorded earlier in the year.

The index of industrial production increased 0.3 percent in August. Production gains were particularly strong for consumer durable goods—mainly because of a spurt in assemblies of light trucks—and for defense and space equipment. Estimates for the preceding three months were revised down, however, and the level of output in August was about ½ percent above the average for the second quarter. Industrial capacity utilization edged up to 80½ percent, little changed since spring and about 1½ percentage points below its level a year earlier.

The nominal value of retail sales increased nearly 2 percent in August, mainly reflecting a surge in auto sales after the introduction of financing incentive programs in mid-August. Sales of new domestic automobiles rose to an annual rate of 9½ million units for the month and accelerated further to a rate of 12 million units during the first 20 days of September. Outlays for consumer goods other than autos also posted gains in August, but have shown little change on balance since early spring.

Total nonfarm payroll employment expanded by about 300,000 in August, well above the average gain in the preceding four months. Hiring continued to be brisk in service-producing industries and at finance and trade establishments. Moreover, employment in manufacturing rose for the first time since January, but the gains might have been overstated because of seasonal adjustment difficulties associated with a shift in timing of the model changeover period in the automotive industry. The civilian unemployment rate, which had held steady at 7.3 percent since February, fell to 7.0 percent in August.

Private housing starts picked up in August but, at an annual rate of 1¾ million units, were the same as the average recorded in the second quarter. Other indicators suggested an improved tone in the housing sector. Sales of new homes continued to trend up through July, and sales of existing homes registered a sizable advance in August. Moreover, newly issued permits for residential building remained at relatively high levels, and consumer attitudes toward buying homes apparently continued to be quite positive.

Incoming information suggested a leveling of business capital expenditures. Spending for nonresidential structures has slowed in recent months. Shipments of nondefense capital goods rebounded in August, about offsetting the previous month's decline. New orders also rose somewhat after a sharp drop in July, but that reflected a substantial rise in the volatile aircraft category; excluding such orders August showed an appreciable decline.

The U.S. merchandise trade deficit in July and August averaged somewhat less than that recorded in the second quarter of the year, as a drop in imports was partly offset by a slight de-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

cline in exports. The drop in imports was widespread across all major commodity categories, with especially large declines in oil, industrial supplies, capital goods, and consumer goods.

Recent data on prices and wages suggested that inflation has been holding steady at rates somewhat lower than those earlier in the year. The producer price index for finished goods fell 0.3 percent in August, as prices for consumer foods and energy-related items declined and overall prices of other consumer goods were unchanged. The consumer price index rose 0.2 percent in August for the fourth consecutive month, less than the average monthly change in the January-to-April period. During the first eight months of this year, producer and consumer prices and the index of average hourly earnings have risen at rates somewhat below those recorded in 1984.

Following the Committee's meeting in August, the trade-weighted value of the dollar against major foreign currencies appreciated more than 5 percent through mid-September. The dollar subsequently declined sharply, especially after the announcement on September 22 by the finance ministers and central bank governors of the G-5 countries that recent shifts in fundamental economic conditions had not been reflected fully in exchange markets. It was noted in the announcement by the G-5 countries that in view of the present and prospective changes in fundamentals, some further orderly appreciation of the main nondollar currencies against the dollar was desirable. By the time of this meeting the value of the dollar had declined about 3¼ percent on balance since the August meeting to a level nearly 20 percent below its peak in late February.

At its meeting on August 20, 1985, the Committee had adopted a directive that called for maintaining the slightly firmer degree of reserve restraint that had been sought in previous weeks. That action was expected to be consistent with growth of M2 and M3 at annual rates of around 8½ and 6½ percent respectively for the period from June to September. Growth of M1 was expected to slow from its recent pace, but given the rapid expansion since June, M1 was anticipated to grow at an annual rate of about 8 to 9 percent over the three-month period, considerably above earlier expectations. The members agreed that somewhat greater restraint on reserve positions would be acceptable if growth in the monetary aggregates were substantially faster than expected, while somewhat lesser restraint would be acceptable in the event of substantially slower monetary growth. In either case, adjustments in the degree of reserve pressures would be considered in the context of appraisals of the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

M1 growth surged in August to an annual rate just over 20 percent, reflecting exceptional strength in interest-bearing checkable deposits and relatively rapid expansion in other components. Data for the first half of September suggested slower but still substantial expansion in M1. Thus, for the period from June to September, M1 was expanding at a rate well above the Committee's expectations, and was at a level substantially higher than the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

path consistent with the Committee's range for the second half of the year. Reflecting the surge in M1, M2 accelerated in August to an annual rate of about 11¼ percent and M3 also strengthened to a rate of about 8½ percent; growth in these broader aggregates was running slightly above the rates anticipated for the June-to-September period. Relative to their long-run ranges for the year, M2 was close to the top of its range while M3 was near the middle of its range. Growth in total domestic nonfinancial debt remained relatively rapid in August, and thus far in 1985 was running somewhat above the upper end of its growth range for the year.

In the light of growth in the monetary aggregates—especially M1—continuing to exceed expectations, and with indications of a somewhat stronger tone in the economy as the intermeeting period progressed, open market operations during the period were directed toward maintaining or slightly increasing the degree of reserve restraint that had been sought shortly before the meeting on August 20. As a result, the level of adjustment plus seasonal borrowing rose somewhat on balance in the intermeeting interval, averaging about $515 million in the latest reserve maintenance period ending September 25. Borrowing had been running substantially higher in recent days, however, because of technical market conditions associated with a hurricane on the East Coast and the end-of-quarter statement date.

The small increase in reserve pressures, measured by the average level of borrowings, was not reflected in a significant change in money market interest rates, and the federal funds rate generally moved in a narrow range of 7¾ to 8 percent throughout the intermeeting period, averaging close to 8 percent in the week prior to this meeting. For Treasury securities, most short-term yields were unchanged to down slightly, influenced by a large paydown of Treasury bills because of debt ceiling problems, while long-term yields were up about 5 to 10 basis points. Most other market interest rates also showed small, mixed changes over the period. But yields on some federal agency securities advanced relatively sharply in the wake of reports about financial difficulties of the Farm Credit System.

The staff projections presented at this meeting were little changed from those prepared at the time of the August meeting. Growth in real GNP was projected to pick up somewhat in the second half of the year from the sluggish pace in the first half and to continue at a modest pace throughout 1986. The average unemployment rate was expected to change little over the period, and the rate of increase in prices was projected to remain close to that experienced in the past few years.

In the Committee's discussion of the economic situation, the members generally took the view that the latest information was consistent with some improvement in the rate of economic growth. They differed to some extent in their assessments of the prospects for the economy, however. Several thought that moderate growth in line with the staff projection, or perhaps a bit faster, was a reasonable expectation for the quarters ahead. Growth could pick up as domestic demands were maintained, given the large buildup in liquidity over recent months, the big federal deficit, and the possibility that the international trade position of the United States would stop worsening. On the other hand, a few members

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

stressed the downside risks in various sectors of the economy, such as potential restraint on consumer spending because of the large buildup in debt, the weak performance in manufacturing attributable in part to competitive pressures from abroad, and the continued signs of deterioration in the agricultural sector. They expressed the view that continued sluggish expansion was the more likely course for the economy. As had been the case at previous meetings, the members emphasized that a variety of problems and financial strains in some sectors of the economy, stemming to a substantial extent from the massive imbalances in the federal budget and in foreign trade, represented ongoing threats to the sustainability of the expansion.

Considerable attention was focused on the performance of the dollar in foreign exchange markets and the implications of possible changes in exchange rates for the balance of trade and the domestic economy. The members also reviewed developments relating to the foreign debt problems of less developed countries. In the course of discussion members recognized, as in previous meetings, that the extraordinary strength of the dollar earlier had contributed to the size of the trade deficit, but they also emphasized the importance of maintaining underlying confidence in the dollar, given the dependence of the United States for the time being on large capital inflows. It was noted that the possibility, while perhaps remote, of a precipitate continuing decline in the value of the dollar would present a threat to the financial system and the economy because of its potential implications for higher interest rates and inflationary pressures, particularly in the absence of stronger budgetary restraint than had yet been achieved. Protectionist legislation would aggravate the potential difficulties. Consequently, it would be important that shifts in the value of the dollar be orderly.

Several members referred to the generally favorable trends in wages and prices over the course of recent months. Some concern was expressed, however, that inflationary expectations for the longer term might be increasing in the context of the large increase in M1 and total debt, disappointment over the limited progress made thus far in reducing federal budget deficits, and against the background of recent and possible further declines in the foreign exchange value of the dollar. Some members also suggested that a view may be becoming more widespread—encouraged perhaps by the continued rapid expansion in M1—that an effective monetary policy directed at maintaining and reinforcing progress toward price stability might be inhibited by sensitive conditions in some business and financial sectors of the domestic economy and in international financial markets, particularly as long as the federal budget deficit remained so large.

At its meeting in July the Committee had reviewed the basic policy objectives that it had established in February for growth of the monetary and credit aggregates in 1985 and had set tentative objectives for expansion in 1986. For the period from the fourth quarter of 1984 to the fourth quarter of 1985, the Committee had reaffirmed the ranges for the broader aggregates set in February of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was also reaffirmed at 9 to 12 percent for 1985. With respect to M1, the base was moved forward to the second quarter of 1985 and a range of 3 to 8 percent at an annual

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

growth rate was established for the period to the fourth quarter of the year. For 1986 the Committee had agreed on tentative monetary growth objectives that included reductions of 1 percentage point in the upper end of the M1 range and 1/2 percentage point in the upper end of the M3 range. The provisional range for total domestic nonfinancial debt was reduced by 1 percentage point for 1986. At this meeting, there was some further discussion of the 1985 range for M1 and its role, but no change was made at this time.

In the Committee's discussion of policy implementation for the weeks immediately ahead, the continuing strength of M1 was assessed against the background of relatively modest expansion in economic activity and the absence of indications that inflation was increasing. According to an analysis prepared for this meeting, M1 growth could be expected to moderate substantially over the months ahead, even as the economy continued to expand, following its exceptionally rapid rate of growth since late spring and the resulting large buildup in liquidity. The most recent data on M1 lent some weight to the outlook for considerable slowing in this aggregate. Moreover, given the volatility of the M1 data and the difficulties of making seasonal adjustments, a decline in M1 for a time could not be ruled out. In general, however, growth in M1 could be expected to be sustained over the fourth quarter as a whole in part by the prospect that inflows of savings funds into NOW accounts were likely to continue, at least at a moderate rate, unless market interest rates rose quite substantially from current levels. In the circumstances, it appeared increasingly doubtful that the targeted rate of M1 growth for the second half of the year as a whole could be reached without an inappropriately abrupt increase in reserve pressures and in interest rates. Growth in M2 and M3 was expected to remain roughly consistent with the target ranges for 1985, and much slower growth in M1—consistent with the upper end of its target—would in the view of many members be acceptable and desirable, depending upon developments in the economy and financial markets.

As they had at the previous meeting, the members agreed that in prevailing circumstances, including a relatively strong dollar, the surge in M1 did not appear in itself to have inflationary implications for the time being. Nonetheless, while relatively rapid growth in M1 might be tolerated for a time, concern was expressed that the longer such growth persisted, the greater would be its potential for translation into inflationary demand pressures. A number of members also emphasized that the recent strength in M1 could not be explained fully by such factors as institutional changes and financial innovations or by shifts of funds to NOW accounts in response to earlier declines in market interest rates.

The members placed considerable emphasis on the need to judge the behavior of M1 in the context of the performance of the economy and the relatively moderate growth in the broader aggregates. Currently sensitive conditions in domestic and international financial markets and debt problems in some sectors of the economy such as agriculture were themselves a restraining force on the economy and argued against a policy course that might entail appreciably higher interest rates in the short run. On the other hand, significant easing under immediately prevailing market circumstances would

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

incur too much risk of prolonging undue growth in money and debt, possibly triggering an abrupt and exaggerated decline in the foreign exchange value of the dollar with disturbing implications for inflation and financial markets over time.

While individual members expressed some shadings of opinion regarding policy implementation over the weeks ahead, it was generally agreed that the balance of considerations bearing on the Committee's decision argued for little or no change from the recently prevailing degree of pressure on reserve positions. At the conclusion of the Committee's discussion, a directive that called for maintaining the degree of reserve pressure sought in recent weeks was favored by most members. They expected such an approach to policy implementation to be consistent with growth of both M2 and M3 at annual rates of around 6 to 7 percent for the period from September to December. Over the same period, growth in M1 was expected to slow markedly—also to an annual rate of 6 to 7 percent—and even slower growth would be acceptable in the context of satisfactory economic performance, given the very rapid expansion experienced in recent months. The members agreed that somewhat greater or lesser reserve restraint would be acceptable over the intermeeting period, depending on the behavior of the monetary aggregates and taking account of appraisals of the strength of the business expansion, the performance of the dollar in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. It was also understood that policy might be implemented with somewhat more flexibility than usual over the relatively short intermeeting period, given the uncertainties associated with particularly sensitive conditions in the foreign exchange and other markets. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity expanded in the third quarter at a moderately faster rate than in the first half of the year. In August, industrial production increased somewhat. Total retail sales rose considerably, boosted by a surge in auto sales. Housing starts, while increasing in August, were still no higher than their average level in the second quarter. Incoming information generally suggested a leveling of business capital spending. The merchandise trade deficit in July and August averaged somewhat less than in the second quarter as a drop in imports was partly offset by a slight decline in exports. Total nonfarm payroll employment rose somewhat more in August than in most other recent months. The civilian unemployment rate fell from 7.3 percent in July—its level since February—to 7.0 percent in August. Broad measures of prices and wages appear to be rising at rates close to or somewhat below those recorded earlier in the year.

Following the Committee's meeting on August 20, the trade-weighted value of the dollar against major foreign currencies appreciated through mid-September. The dollar subsequently declined sharply, especially after the announcement on September 22 by the Finance Ministers and Central Bank Governors of the G-5 countries that exchange rates have not fully reflected economic fundamentals.

M1 growth surged in August, reflecting exceptional strength in interest-bearing checkable deposits and relatively rapid expansion in other components; data for the first half of September suggest slower but still substantial expansion. Reflecting the surge in M1, M2 accelerated in August, and M3 also strengthened somewhat. Expansion in total domestic nonfinancial debt has remained relatively rapid. Most market inter-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

est rates have changed little on balance since the August meeting of the Committee.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee at the July meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks to maintain the degree of pressure on reserve positions sought in recent weeks. This action is expected to be consistent with growth in M2 and M3 over the period from September to December at annual rates of about 6 to 7 percent. A marked slowing of M1 growth over the period to an annual rate of around 6 to 7 percent is also anticipated; slower growth over the next three months would be acceptable in the context of satisfactory economic performance, given recent very rapid growth in M1. Somewhat greater or lesser reserve restraint would be acceptable depending on behavior of the aggregates, taking account of appraisals of the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Forrestal, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Vote against this action: Mr. Black.

Mr. Black dissented because he believed some increase in the degree of reserve pressure was needed at this time to ensure adequate slowing of M1 growth in the period ahead.

2. Authorization for Foreign Currency Operations

At this meeting the Committee also considered the need for adjustment in the limit on holdings of foreign currencies in the System Open Market Account. At present, Paragraph 1D of the Committee's authorization for foreign currency operations authorized the Federal Reserve Bank of New York, for the System Open Market Account, to maintain an overall open position in all foreign currencies not exceeding $8.0 billion. System holdings of foreign currencies currently totaled about $5½ billion, based on historical costs. In light of the potential for foreign exchange operations by the United States and other countries following the recent G-5 announcement, the Commit-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tee agreed to raise the limit in Paragraph 1D of the authorization to $10.0 billion, effective immediately.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None.

Meeting Held on November 4–5, 1985

1. Domestic Policy Directive

The information reviewed at this meeting indicated that growth in real GNP, which had picked up in the third quarter from the relatively slow pace in the first half, appeared to be continuing at a relatively modest rate. Broad measures of prices and wages appeared to be rising at rates close to or somewhat below those recorded earlier in the year.

Total retail sales increased considerably further in September, after a strong rise in August. But the gains in both months were attributable primarily to a surge in auto sales occasioned by financing incentive programs during the period. As expected, the surge proved temporary, and sales of domestic automobiles dropped to an annual rate of 6¼ million units in October from 11¼ million in the preceding month. Outlays for discretionary purchases other than autos were generally lackluster in recent months; spending at general merchandise and apparel stores and at furniture and appliance outlets, for example, changed little on balance in the third quarter. But with overall spending boosted by the transitory spurt in auto sales, the personal saving rate dropped to less than 3 percent in the third quarter—an extraordinarily low rate historically.

Total nonfarm payroll employment rose about 415,000 in October, substantially above the average monthly increase of 225,000 posted over preceding months of the year. To some extent, however, the October gain balanced out a weaker-than-usual advance in September; the average increase over the two months was 275,000. Service industries and finance and trade establishments continued to record job gains during the two-month period, while manufacturing employment edged down further. In October, the length of the factory workweek remained relatively high at 40.7 hours, and factory overtime rose slightly. The civilian unemployment rate was unchanged at 7.1 percent.

The index of industrial production edged down in September and increased at an annual rate of only 1.1 percent during the third quarter. Nearly two-thirds of that rise was attributable to production of motor vehicles. Output of defense and space equipment and of construction supplies remained strong while production of durable goods materials and energy materials declined over the period. The capacity utilization rate for total industry fell 0.3 percentage point in September, reversing the August increase. At 80.2 percent, the rate was about 1½ percentage points below its year-earlier level and its average for the 1967–84 period.

Total private housing starts fell in September and in the third quarter as a whole, with declines registered in both the multifamily and single-family sectors. But sales of new homes were higher during the quarter and sales of existing homes were up more than 10 percent on average. Moreover, newly issued permits for residential construction rose for the fourth consecutive quarter and a recent survey of consumer sentiment showed that favorable attitudes toward homebuying reached their highest level on record.

Incoming information generally

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

suggested a leveling of business capital spending. Shipments of nondefense capital goods fell in September and were essentially flat for the third quarter as a whole. However, business spending for motor vehicles advanced sharply in the quarter and, on balance, has accounted for virtually all of the rise in business equipment expenditures this year. New orders for nondefense capital goods, excluding the volatile components of aircraft and parts, rose about 1¾ percent in the quarter but on balance have shown little change thus far in 1985.

Over the first three quarters of 1985, most aggregate measures of inflation have evidenced some slowing from the rates posted in 1984, mainly reflecting downward pressures on prices of food and energy items. In September, the producer price index for finished goods fell 0.6 percent, leaving the index about unchanged on balance since the beginning of the year. The consumer price index rose 0.2 percent in September for the fifth consecutive month, down somewhat from the average monthly increase earlier this year and during 1984. On the wage side, the index of average hourly earnings rose at an annual rate of only 1 percent in the third quarter and 2½ percent over the first nine months of the year, compared with an increase of about 3 percent in 1984. However, the employment cost index, which takes account of nonwage benefits and salaries of white-collar workers as well as hourly wage earners, has risen at an annual rate of about 4¾ percent thus far this year, a little above last year's rate.

The trade-weighted value of the dollar against major foreign currencies had declined about 1½ percent further on balance since the Committee's meeting on October 1, bringing its net depreciation during the period after the G-5 announcement on September 22 to nearly 8 percent. Intervention sales of dollars by U.S. and foreign authorities were relatively large. With respect to individual currencies, the dollar's depreciation had been considerably greater against the Japanese yen than against major European currencies. Preliminary data on U.S. merchandise trade for the third quarter, which need to be interpreted with an extra amount of caution in light of uncertainties in the statistical reports, suggested that imports rose somewhat more than had been estimated earlier and that the trade deficit may have widened slightly in the quarter.

At its meeting on October 1, 1985, the Committee had adopted a directive that called for maintaining the degree of pressure on reserve positions sought in the weeks before the meeting. That action was expected to be consistent with growth of both M2 and M3 at annual rates of around 6 to 7 percent for the period from September to December. Over the same period, growth in M1 was expected to slow markedly—also to an annual rate of 6 to 7 percent—and even slower growth would be acceptable in the context of satisfactory economic performance, given the very rapid expansion in M1 in other recent months. The members agreed that somewhat greater or lesser reserve restraint would be acceptable over the intermeeting period, depending on the behavior of the monetary aggregates and taking account of appraisals of the strength of the business expansion, the performance of the dollar in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. It was understood that policy might be implemented with somewhat more flexibility than usual over the relatively short intermeeting period, given the uncertainties associated with

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

particularly sensitive conditions in the foreign exchange and other markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

M1 appeared to have changed little on balance in October and may have declined slightly after several months of rapid expansion; but it remained well above the range set by the Committee in July of 3 to 8 percent at an annual rate for the period from the second quarter to the fourth quarter of the year. M2 and M3 apparently grew sluggishly during the month, reflecting a moderation in their nontransactions components as well as the weakness in M1. As a result, by October M2 apparently had moved to a level a bit below the upper end of its annual range, while M3 was still near the middle of its long-run range. Expansion in total domestic nonfinancial debt had remained relatively rapid and continued to be somewhat above the upper end of its monitoring range for the year.

Growth of total reserves slowed in October to an annual rate of about 4½ percent, in association with the marked deceleration in transactions accounts. Nonborrowed reserves rose somewhat more rapidly than total reserves, however, as borrowing from the discount window fell from a temporarily inflated level at the end of September that was related to disruptions from the hurricane on the East Coast and to end-of-quarter statement date pressures. Over the full reserve maintenance period ending October 23, the level of adjustment plus seasonal borrowing averaged $470 million.

The weekly federal funds rate generally moved in a range of about 7⅞ to 8⅛ percent and averaged 8 percent for the five weeks preceding this meeting. Interest rates on short-term Treasury securities were up about 10 to 20 basis points over the period since the October 1 meeting of the Committee, while rates on private short-term market instruments were little changed to down somewhat. Most long-term rates fell about 25 to 35 basis points. The average rate on new commitments for fixed-rate conventional home mortgage loans declined about 15 basis points to around 12 percent.

The staff projections presented at this meeting suggested that growth in real GNP would continue at a relatively modest pace for the remainder of this year and throughout 1986. The staff continued to expect the average unemployment rate to change little over the projection horizon, and the rate of increase in prices to remain close to that experienced in the past few years.

During the Committee's discussion of the economic situation and outlook, members commented that, on the whole, the latest information suggested a more sluggish economic performance than had been indicated earlier. Nonetheless, several members felt that further economic expansion broadly in line with the staff forecast remained a reasonable expectation for the year ahead. In general, the members did not anticipate that any major sector of the economy would provide a strong fillip to the expansion, but they thought further growth was likely to be sustained by at least modest gains in several key sectors of the economy. At the same time, a number of members gave considerable emphasis to possible harbingers of a very sluggish economy. One member referred to the risk that the expansion itself might falter if persisting problems and financial strains in some sectors of the economy were not contained. The members recognized that under current circumstances their forecasts were subject to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

a great deal of uncertainty, and particular reference was made to the outlook for legislation to reduce the federal budget deficit and to the behavior of the dollar in foreign exchange markets.

In the course of the Committee's discussion, a number of members observed that consumer spending was likely to continue to expand but that its growth would be constrained by prospectively limited increases in real disposable income, relatively high consumer debt burdens, and a possible rise in the saving rate from its abnormally low third-quarter level. Views on the outlook for housing differed to some extent, with some members emphasizing the reduced levels of mortgage rates and current activity in resale markets while others stressed the negative implications of generally tighter lending standards. Growth in business fixed investment had already slowed markedly and the possibility of further weakening was suggested by a number of current indicators, including recent surveys of business spending plans and reports of deteriorating business sentiment in some parts of the country. With a ready availability of financing, commercial construction remained strong in many areas and might continue to hold up for a time. However, at least some types of construction such as office buildings appeared to be vulnerable to excess capacity and to possible changes in tax laws relating to real estate investments. Though agricultural conditions varied in different parts of the country, members commented that there were few, if any, signs of general improvement, and growth of income in agriculture and associated industries was considered likely to be weak over the next few quarters.

The outlook for foreign trade was viewed as especially difficult to discern. A reduced value of the dollar could be expected to foster improvement in the trade balance over time, with favorable repercussions on domestic economic activity and lessened incentives to close domestic production facilities or to relocate them abroad. The extent of progress in lowering the trade deficit over the year ahead was highly uncertain, however, and would depend not only on the performance of the dollar but importantly also on appropriate economic policies, including satisfactory progress in reducing federal budgetary deficits. Over time, stronger economic growth in other industrialized countries and more open markets abroad would also be needed.

While it was believed that the drop in the dollar since the G-5 meeting would tend to exert a positive effect on the economy by relieving pressures on export and on import-sensitive industries, it was also pointed out that an unduly large and rapid depreciation could have the potential for unsettling economic consequences under present circumstances. One member commented that rising prices were already being reported for a few imported materials, apparently as a consequence of earlier reductions in the value of the dollar. The members were also concerned that, at a time when the deficit in the U.S. current account continued to require large net inflows of funds from abroad, any considerable reduction in the willingness of investors to accumulate dollar assets could exert upward pressure on domestic interest rates as well, with damaging implications for interest-sensitive sectors of the domestic economy and for several developing countries burdened by international debt problems. Time was required to make, in an orderly way, the adjustments in domestic spending and production that would be needed if

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the balance of trade were to move toward a more sustainable level. Those adjustments would be greatly facilitated by a substantial reduction over time in the federal budget deficit and could be disruptive without it.

At its meeting in July the Committee had reviewed the basic policy objectives that it had established in February for growth of the monetary and credit aggregates in 1985 and had set tentative objectives for expansion in 1986. For the period from the fourth quarter of 1984 to the fourth quarter of 1985, the Committee had reaffirmed the ranges for the broader aggregates set in February of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was also reaffirmed at 9 to 12 percent for 1985. With respect to M1, the base was moved forward to the second quarter of 1985 and a range of 3 to 8 percent at an annual growth rate was established for the period to the fourth quarter of the year. For 1986 the Committee had agreed on tentative monetary growth objectives that included reductions of 1 percentage point in the upper end of the M1 range and ½ percentage point in the upper end of the M3 range. The provisional range for total domestic nonfinancial debt was reduced by 1 percentage point for 1986.

The Committee turned to a discussion of policy implementation for the forthcoming intermeeting period, and most of the members indicated that they were in favor of maintaining reserve conditions essentially unchanged, at least initially following today's meeting. The members took account, among other things, of an analysis, which suggested that, given the prospect of modest expansion in economic activity during the fourth quarter, a steady degree of reserve pressure was likely to be associated with some pickup in growth of all the monetary aggregates over the remainder of the quarter from the reduced October pace. For the three-month period as a whole, their rates of expansion would probably be close to, possibly a bit below, those anticipated at the time of the October meeting.

If these expectations for the fourth quarter were realized, they would represent less monetary growth than had occurred in the third quarter—substantially less in the case of M1. Even so, growth in M1 would remain well above the rebased range for the second half of 1985. The Committee had established that range at the July meeting on the presumption that the relationship between M1 and broad measures of economic activity would move toward a more normal pattern following the sizable and unusual decline in M1 velocity in the first and second quarters. But M1 velocity dropped even more in the third quarter. While the expansion of M1 was expected to slow considerably in the fourth quarter to a rate much closer to that of nominal GNP, even a substantial tightening of reserve conditions and a sharp rise in interest rates might not bring this aggregate within the Committee's range for the second half as a whole. As they had at previous meetings, the members agreed that the behavior of M1 needed to be judged in the context of the performance of the economy and the fact that the broader aggregates were growing at rates within their ranges. Under prevailing circumstances, and unless the dollar declined sharply further, the strength of M1 thus far did not appear to suggest strong inflationary consequences. Thus, aggressive efforts to reduce its growth beyond the slower pace that was already expected were deemed to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

be unwarranted, especially in light of the financial strains and other problems in some sectors of the economy and the attendant risks to the expansion itself. Accordingly, the members concluded that growth of M1 above its target range would be acceptable for the second half of the year. Growth of M2 and M3 within their long-run ranges continued to be appropriate.

In the Committee's discussion of possible intermeeting adjustments in the degree of reserve restraint, members could foresee conditions that would call for either some easing or some tightening. Most of the members felt that policy implementation should be particularly alert to opportunities for some easing in light of the relatively sluggish growth in domestic economic activity and the favorable price performance, subject to the constraint imposed by a desire to minimize the risk of inducing unacceptably faster growth in money and credit. It was also emphasized that account needed to be taken of the behavior of the dollar on foreign exchange markets in any policy adjustments. One member urged giving considerable weight to the behavior of M1 in relation to expectations, with no presumptions regarding the direction of any intermeeting adjustment in the degree of reserve restraint.

At the conclusion of the Committee's discussion, most of the members indicated their acceptance of a directive that called for maintaining about the current degree of reserve restraint. Given the sensitivity of economic and financial conditions and exchange market developments, it was understood that policy would be implemented with some added degree of day-to-day flexibility. The members expected such an approach to policy implementation to be consistent with growth of both M2 and M3 at an annual rate of about 6 percent for the period from September to December. Over the same period, M1 was also expected to expand at an annual rate of around 6 percent, but in light of its very rapid growth in the third quarter, slower growth in this aggregate would be acceptable. Somewhat greater reserve restraint might, and somewhat lesser restraint would, be acceptable depending on the behavior of the monetary aggregates over the intermeeting period and taking account of appraisals of the strength of the business expansion, the performance of the dollar on foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity is continuing to expand at a relatively modest pace. In September, total retail sales rose considerably further, but the gain was boosted by a temporary surge in auto sales that was reversed in October. Total nonfarm payroll employment increased considerably in October, following a much slower advance in September, and the civilian unemployment rate was unchanged at 7.1 percent. In recent months industrial production has increased only slightly on balance. Housing starts fell in September, but sales of new and existing homes remained at a relatively high level on average. Incoming information generally suggests a leveling of business capital spending. Merchandise trade data for the third quarter indicate that the deficit widened slightly, as imports continued to increase. Broad measures of prices and wages appear

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to be rising at rates close to or somewhat below those recorded earlier in the year.

M1 appears to have shown little net change in October following several months of rapid expansion. Largely reflecting the weakness in M1, growth in M2 and M3 apparently was quite moderate in October. Expansion in total domestic nonfinancial debt has remained relatively rapid. Most short-term market interest rates have changed little on balance since the October 1 meeting of the Committee, while long-term rates have declined somewhat. The trade-weighted value of the dollar against major foreign currencies has dropped slightly further on balance since October 1, following a substantial decline after the September 22 meeting of the Finance Ministers and Central Bank Governors of the G-5 countries.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee at the July meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depository behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks generally to maintain about the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M2 and M3 over the period from September to December at annual rates of about 6 percent. M1 growth over the period at an annual rate of around 6 percent is also anticipated; slower growth for that aggregate would be acceptable in the context of satisfactory economic performance, given the very rapid growth in M1 over the summer. Somewhat greater reserve restraint might, and somewhat lesser reserve restraint would, be acceptable depending on behavior of the aggregates, taking account of appraisals of the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Keehn, Partee, Martin, and Rice. Vote against this action: Ms. Seger. Absent and not voting: Mr. Wallich.

Ms. Seger dissented because she believed that some reduction in the degree of reserve restraint was needed to help relieve financial strains in the economy, and to promote a more acceptable rate of economic expansion closer to the faster growth expected by Committee members early this year.

2. Authorization for Domestic Open Market Operations

On December 9, 1985, the Committee approved a temporary increase of $1 billion, to $7 billion, in the limit be-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tween Committee meetings on changes in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations. The increase was effective immediately for the intermeeting period ending with the close of business on December 17, 1985.

Votes for this action: Messrs. Volcker, Balles, Black, Forrestal, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Timlen. Votes against this action: None. Absent and not voting: Messrs. Corrigan and Wallich. (Mr. Timlen voted as alternate for Mr. Corrigan.)

This action was taken on the recommendation of the Manager for Domestic Operations. On December 9, the Manager had advised that outright purchases of securities thus far in the intermeeting interval had reduced the leeway under the usual $6 billion limit to slightly over $1.2 billion. Additional purchases of securities in excess of that leeway were likely to be necessary over the remainder of the intermeeting period, largely to offset reserve drains associated with seasonal increases in currency in circulation.

Meeting Held on December 16–17, 1985

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity was expanding at a relatively modest pace. The underlying trend in inflation appeared to have changed little, as broad measures of prices and wages were rising at rates close to those recorded earlier in the year.

Total nonfarm payroll employment increased further in November, though less than in October, and the civilian unemployment rate edged down to 7.0 percent. Over the two-month period employment gains averaged 270,000, about equal to the average monthly increase in the third quarter. Most of the growth in employment continued to be in service industries and at finance and trade establishments. But manufacturing employment, after contracting during the first three quarters of the year, rose substantially in October and moved up further in November. Moreover, the length of the factory workweek remained at a relatively high level.

The index of industrial production rose an estimated 0.4 percent in November, reversing the drop in October. Output of defense and space equipment continued at a brisk pace over the two-month period. For most other broad categories of products and equipment, gains in November roughly retraced the declines posted in October.

Total retail sales rose in November and gains were recorded at most major types of stores, with particularly large increases registered at general merchandise outlets. But sales had dropped sharply in October—attributable largely to a reduction of more than 17 percent in sales at automotive outlets that was associated with the ending of financing and price concessions on 1985 automobiles—and the November increase only partially offset that decline. For the two-month period sales were 1 percent below the average for the third quarter. Sales of domestic automobiles remained relatively sluggish in November, and manufacturers reintroduced some limited financing incentives. In early December domestic auto sales picked up to an annual rate of nearly 7½ million units, about 1 million units above the sales pace in October and November but still below recent and planned production levels.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In November, total private housing starts fell substantially, more than reversing the appreciable gain in the previous month. An especially sharp drop in starts of single-family homes accounted for most of the decline. Over the two-month period total starts were at an average annual rate of 1.65 million units, about the same as in the third quarter. Newly issued permits for residential construction averaged somewhat below the rate recorded for the third quarter. Sales of existing homes picked up in October (the latest month for which data were available) from their third-quarter pace, but sales of new homes dropped. Interest rates at savings and loan associations on new commitments for fixed-rate conventional home mortgage loans had stabilized in the 12⅛ to 12¼ percent range from August through most of October, but declined considerably in recent weeks: the average contract rate fell from about 12 percent in early November to a bit above 11¼ percent by mid-December.

Incoming information generally suggested sluggishness in business capital spending. In October shipments of nondefense capital goods picked up after changing little in the third quarter, but new orders for such goods fell appreciably. Outlays for nonresidential construction have been essentially flat over recent months. Moreover, recent surveys of business capital spending plans suggested little real growth in that sector for next year.

Recent monthly data on prices have shown higher rates of increase than those recorded in the spring and summer, reflecting what was expected to be a temporary spurt in prices of food and energy-related items. The producer price index for finished goods rose 0.9 and 0.8 percent in October and November respectively, after falling in three of the preceding four months. Thus far in 1985, the index had increased at an annual rate of about 1½ percent, slightly below the rate in 1984. The consumer price index rose 0.3 percent in October, slightly above the 0.2 percent monthly increase recorded from May through September. Over the first 10 months of the year, consumer prices increased at an annual rate of about 3¼ percent, compared with a rise of 4 percent in 1984. The rate of increase in the index of average hourly earnings through November of this year remained close to the 3 percent pace posted over the course of 1984.

The trade-weighted value of the dollar against major foreign currencies had declined about 2½ percent on balance since the Committee's meeting on November 4–5, though in recent weeks the dollar's value had tended to stabilize. Revised data on merchandise trade for the third quarter confirmed that the deficit had widened further, to an estimated annual rate of $133 billion, as non-oil imports rose and exports fell somewhat.

At its meeting on November 4–5, 1985, the Committee had adopted a directive that called for maintaining generally the existing degree of pressure on reserve positions. That action was expected to be consistent with growth of both M2 and M3 at an annual rate of about 6 percent for the period from September to December. Over the same period, M1 also was expected to expand at an annual rate of around 6 percent, but in light of its very rapid growth in the third quarter, the members indicated that slower growth in that aggregate would be acceptable. The members agreed that somewhat greater reserve restraint might, and somewhat lesser restraint would, be acceptable depending on the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

behavior of the monetary aggregates over the intermeeting period and taking account of appraisals of the strength of the business expansion, the performance of the dollar on foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. It was understood that policy might be implemented with somewhat more flexibility than usual, given the sensitivity of economic and financial conditions and exchange market developments. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

After declining slightly in October, M1 expanded at an annual rate of about 13 percent in November. Growth in M2 and M3 continued quite moderate in November, at annual rates of about 6½ and 5 percent respectively. Through November, M1 expanded at a pace well above the range set by the Committee in July of 3 to 8 percent at an annual rate over the period from the second quarter to the fourth quarter of the year; M2 grew at a rate a bit below the upper limit of its range of 6 to 9 percent for the year and M3 expanded at a rate near the midpoint of its range of 6 to 9½ percent for 1985. Expansion in total domestic nonfinancial debt apparently was quite rapid in November, and growth in that aggregate remained somewhat above the upper end of its 9 to 12 percent monitoring range for the year.

Given expansion in the broader monetary aggregates at a pace close to the Committee's expectations for the September-to-December period and within their longer-run ranges as well, and with account taken of economic and financial developments, open market operations during the intermeeting interval were directed toward maintaining approximately unchanged conditions of reserve availability. Reserve management was complicated by the concentrated settlement of large Treasury security issues delayed by debt ceiling problems and by a computer breakdown at a major bank that led to an overnight loan from the Federal Reserve discount window in excess of $22 billion—an unprecedented amount. Excluding that borrowing, seasonal plus adjustment credit from the discount window averaged around $725 million during the two complete reserve maintenance periods after the Committee's meeting in early November. During that period, excess reserves were unusually large, affected for a time by a maldistribution of reserves in the wake of the $22 billion borrowing. Thus far in the current maintenance period, borrowing was running about $175 million.

The federal funds rate averaged around 8 percent during the intermeeting period, but exhibited considerable day-to-day and week-to-week volatility associated with the extraordinary level of borrowing noted above and pressures related to the need to finance a very large volume of Treasury issues. Rates on Treasury bills generally fell about 20 to 35 basis points over the intermeeting interval, while other short-term rates typically moved down about 10 to 15 basis points. Long-term interest rates dropped appreciably further over the period, falling about ½ to ¾ percentage point.

In the Committee's discussion of the economic situation and outlook, individual members expressed somewhat differing views regarding prospects for economic growth in 1986. The staff projections presented at this meeting had suggested that growth in real GNP would continue at a relatively modest pace in 1986, with the average unemployment rate and the rate of increase

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in prices during the coming year expected to change little from the rates in 1985. While the staff projection was seen as a plausible assessment of the outlook, several members emphasized that any current forecast was subject to a great deal of uncertainty. They referred, for example, to the difficulty of evaluating the potential impact of deficit reduction and tax reform legislation, and to the uncertainties surrounding the outlook for the U.S. trade balance. Some members concluded that the economy might prove to be somewhat stronger than the staff was projecting, but several stressed the possibility of appreciably slower growth. In this connection, one member cautioned that a sluggish expansion would be vulnerable to an actual downturn in the event of adverse developments in particular sectors of the economy.

In the course of the discussion, some members commented that a sector-by-sector review of the economy tended to suggest a relatively weak expansion in 1986, and one clearly subject to downside risks, but several members also cited a number of broad factors that they felt would tend to sustain overall economic growth. These factors included the appreciable fall in longer-term interest rates, including mortgage rates, and the rise in stock market prices over the course of recent weeks, the decline in the foreign exchange value of the dollar, and the substantial growth in money. On the negative side, members referred to the rapid rise in debt burdens, the exposure of financial institutions to domestic and international debt problems, and the difficulties in some sectors of the economy. Also mentioned was the possibility that as legislation to reduce future federal deficits became effective it would tend to exert a dampening influence on economic activity, although such legislation was urgently needed to foster the longer-run health of financial markets and the economy.

Turning to particular sectors of the economy, the members again underscored the variation in conditions among industries and their uneven contribution to current and prospective economic activity. Moderate growth was considered to be a reasonable expectation for many sectors of the economy. At the same time, the members expressed concern about the persisting problems and financial strains in some industries such as agriculture and a number of manufacturing and extractive businesses, notably those that competed actively with foreign producers. In agriculture, prices remained generally depressed despite recent increases in some crop and especially in livestock prices, and many producers and lenders continued under severe financial pressure. Reference was also made to the loss of momentum in investment spending, associated in part with the aging of the business expansion but also reflecting uncertainties about still pending tax reform legislation. Consumer spending was thought likely to expand further, but its growth would probably be inhibited by the buildup in consumer debt that had already taken place. In the housing market, starts had been lower than many expected, given the reductions in mortgage interest rates.

The reduced value of the dollar could be expected to foster some improvement in the trade balance over time, with favorable implications for domestic economic activity, though with the potential for adding to upward price pressures. Export demand might also be enhanced by somewhat faster growth in some major European economies. Some members suggested,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

however, that the prospective improvement in the trade balance might be restrained in the event of foreign retaliation to any new protectionist measures adopted by the United States. The dollar had tended to stabilize in recent weeks, but members remained concerned that a renewed decline, particularly if it should be precipitate, would have disruptive repercussions.

With regard to the outlook for inflation, the members saw little reason at this time to expect significant changes from the rates of increase experienced in 1985. The reduced value of the dollar in foreign exchange markets would tend to exert some upward pressure on prices, but continued softness in world commodity prices, especially oil, could have offsetting effects. Inflationary sentiment appeared to have diminished, as evidenced by the recent performance of the stock and bond markets, and with continuing competition from abroad, price competition could be expected to remain intense in many markets. Moreover, the general pattern of labor settlements so far did not suggest any substantial acceleration of cost pressures during the year ahead.

At its meeting in July the Committee had agreed on tentative growth ranges of 4 to 7 percent for M1 and 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1985 to the fourth quarter of 1986. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1986. At this meeting the Committee reviewed background technical factors bearing on the ranges for 1986, including the implications of the final phase of deposit deregulation early in the year. It was anticipated that at its next meeting the Committee would reassess the tentative ranges and establish definite ranges as required by the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).

In the Committee's discussion of policy implementation for the period ahead, the members differed to some extent in their views concerning an appropriate degree of pressure on reserve positions. Some favored directing open market operations, at least initially, toward maintaining approximately unchanged conditions of reserve availability. A majority, however, indicated a preference for moving toward implementing some slight easing of reserve conditions. Several also commented that decisions about the precise degree of reserve pressure should depend in part on whether the discount rate was reduced, and if so by how much.

Members who leaned toward maintaining prevailing reserve conditions expressed particular concern about the rate of growth in money and credit and the inflationary implications of further rapid growth. They agreed that the outlook for economic expansion remained uncertain, but in their view business activity was likely to be satisfactory, given current reserve conditions, especially in view of recent developments in financial markets, the lower dollar, and the buildup in money and liquidity. Other members, while recognizing the risks of unduly rapid monetary growth, were more concerned that the rate of economic expansion might remain inadequate. In that context, some thought that the recent declines in longer-term interest rates, which would help sustain the economy, were premised to an extent on expectations of an easier monetary policy. One member commented that real interest rates were still relatively high in any event and were exerting a restraining influence on economic ac-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tivity. It was also noted that reduced interest rates would lessen, though by no means eliminate, the financial strains in some sectors of the economy and the external debt problems of several developing countries.

The members agreed that the extent of any easing was constrained by a number of considerations, including the need to avoid unduly rapid expansion in money and credit and the potential vulnerability of the dollar to a relative decline in U.S. interest rates. It was also suggested that a sharp move toward ease under present circumstances might well foster a resurgence of inflationary expectations, with adverse repercussions over time on financial markets and the sustainability of the economic expansion.

According to an analysis prepared for this meeting, the degree of pressures on reserve positions being considered by the members was likely to be associated with some slowing in M1 growth during the early months of 1986, while the broader aggregates might continue to expand at moderate rates. While the final phase of deposit deregulation was expected to have little net impact on monetary growth during the first quarter, the members recognized that the relationship between money and GNP remained subject to a great deal of uncertainty. They noted that the demand for M1 had deviated considerably from historical experience and that it was very difficult to predict when the unusual weakness in M1 velocity, which had been evident for several quarters, would be reversed and a more normal pattern would emerge. In the circumstances, some sentiment was expressed for further reducing the emphasis on M1, but a majority of the members agreed that it should be retained as one guide among others for the conduct of monetary policy.

In keeping with past practice, the members considered the question of possible intermeeting adjustments in the degree of pressure on reserve positions. While no member wanted to rule out possible adjustments in either direction, most believed that policy implementation should be especially alert to the potential need for some further easing in light of the relatively sluggish performance of the economy and the generally favorable outlook for prices and wages. Policy implementation also needed to take account of the behavior of the monetary aggregates, conditions in domestic and international financial markets, and developments in foreign exchange markets, as well as the impact of a reduction in the discount rate, should one take place. It was also suggested that the Committee's expectations with regard to the short-run growth of the aggregates be stated with less precision than in the past and that the behavior of M1, in particular, be evaluated in the context of other economic and financial developments, including the growth of the broader aggregates. In one view, however, any substantial deviation of M1 growth from expectations should be resisted—in either direction—by an appropriate adjustment in the degree of reserve pressure.

At the conclusion of the Committee's discussion, most of the members indicated that they favored or could accept a directive that called for some limited decrease in the degree of pressure on reserve positions. The members expected such an approach to policy implementation to be consistent with growth of M2 and M3 at annual rates of 6 to 8 percent for the four-month period from November to March. Over the same period they expected the expansion of M1 to slow to an annual rate of 7 to 9 percent, though the outlook for M1 growth

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

continued to be subject to unusual uncertainty. Somewhat greater reserve restraint might, and somewhat lesser restraint would, be acceptable over the intermeeting period depending on the growth of the monetary aggregates, the strength of the business expansion, the performance of the dollar on foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity is expanding at a relatively modest pace in the current quarter. Total nonfarm payroll employment increased further in November, though less than in October, and the civilian unemployment rate edged down to 7.0 percent. Retail sales and industrial production picked up in November after declining in October. After strengthening in October, housing starts fell appreciably in November. Incoming information generally suggests relatively sluggish business capital spending. Revised merchandise trade data for the third quarter confirm that the deficit widened further, as non-oil imports continued to increase and exports fell somewhat. Broad measures of prices and wages appear to be rising at rates close to those recorded earlier in the year.

After declining in October, M1 grew substantially in November while growth in M2 and M3 continued quite moderate. Expansion in total domestic nonfinancial debt has remained rapid. Through November, M1 expanded at a rate well above the long-run range set by the Committee, M2 grew at a rate a bit below the upper end of its range for the year, and M3 expanded at a rate near the mid-point of its range for 1985. Treasury bill rates have fallen somewhat while other short-term market interest rates have changed little on balance since the November meeting of the Committee; long-term rates have moved appreciably lower over the period. The trade-weighted value of the dollar against major foreign currencies has declined on balance since the Committee's meeting in early November, though the dollar has tended to stabilize more recently.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee at the July meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9½ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depository behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks to decrease somewhat the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M2

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and M3 over the period from November to March at annual rates of about 6 to 8 percent; while the behavior of M1 continues to be subject to unusual uncertainty, growth at an annual rate of 7 to 9 percent over the period is anticipated. Somewhat greater reserve restraint might, and somewhat lesser reserve restraint would, be acceptable depending on behavior of the aggregates, the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Forrestal, Guffey, Keehn, Martin, Partee, Rice, and Ms. Seger. Vote against this action: Mr. Black. Absent and not voting: Messrs. Balles and Wallich. (Mr. Guffey voted as alternate for Mr. Balles.)

Mr. Black dissented because he was concerned about the rapid growth of M1 and he did not think a decrease in the degree of pressure on reserve positions was desirable under present circumstances.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Consumer and Community Affairs

Through its rulewriting and enforcement responsibilities, the Board in 1985 sought to maintain the intended level of protection for consumers in their financial affairs while easing regulatory burdens. Following similar action by the Federal Trade Commission applying to nonbank lenders, the Board amended Regulation AA (Unfair or Deceptive Acts or Practices) to implement the Credit Practices Rule for banks. The Board also amended Regulation J (Collection of Checks and Other Items and Wire Transfers of Funds) to encourage banks to speed the availability to consumers of funds deposited by check. The Board proposed an amendment to Regulation Z (Truth in Lending) to require creditors to make available to consumers additional information about mortgages with adjustable rates; and it proposed to amend the provisions of Regulation Q (Interest on Deposits) concerning advertising of interest on deposits. The Board amended Regulation B (Equal Credit Opportunity) to simplify it and reduce the burdens of compliance on creditors while maintaining protection for credit applicants; Regulation B was reviewed under the Board's Regulatory Improvement Project, which involves a periodic review of all the Board's regulations.

The Board continued to maintain official staff commentaries for Regulation Z and Regulation E (Electronic Fund Transfers). For the first time, it issued a commentary for Regulation B and published staff guidelines to assist creditors in complying with the new Credit Practices Rule.

In addition to describing the above regulatory changes, this report summarizes the data on consumer complaints handled by the Board and describes the way the Board monitors practices by banks that may be unfair or deceptive. Also discussed are increased activities by the Federal Reserve System in the area of community affairs; compliance with Regulations B, E, and Z; the economic impact of Regulation E; the System's implementation of the Community Reinvestment Act; the activities of the Consumer Advisory Council; and legislative recommendations from the Board and other agencies with enforcement responsibility under the Truth in Lending, Equal Credit Opportunity, and Electronic Fund Transfer acts.

Regulatory Actions

The Board addressed several regulatory issues in 1985. It considered whether to adopt banking versions of the Used Car Rule and the Credit Practices Rule corresponding to those the Federal Trade Commission applies to nonbank lenders. In addition, the Board amended Regulation B (Equal Credit Opportunity) and Regulation J (Collection of Checks and Other Items and Wire Transfer of Funds) and proposed amendments to Regulation Q (Interest on Deposits) and Regulation Z (Truth in Lending).

NOTE. This section fulfills the statutory requirements for annual reports under the Truth in Lending Act, the Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Community Reinvestment Act, and the Federal Trade Commission Improvement Act.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Used Car Rule

In 1985 the Board considered whether to adopt a rule for banks on the sale of used motor vehicles following adoption by the Federal Trade Commission of the Used Car Rule for nonbank lenders. The Federal Trade Commission Improvement Act requires the Board to adopt a rule substantially similar to that of the FTC unless the Board finds that the governed practices as engaged in by banks are not unfair or deceptive or that a similar rule for banks would seriously conflict with essential monetary or payments policies of the Federal Reserve. In March, after careful review of the issues involved, the Board decided not to adopt a Used Car Rule. The rule adopted by the FTC includes a list of acts or practices that the commission views as unfair or deceptive; requires dealers to prepare and display a sticker (referred to as the "Buyer's Guide") on used vehicles; prohibits dealers from making any statements or taking any actions that alter or contradict the Buyer's Guide; and requires dealers conducting sales in Spanish to make the required disclosures in that language. In adopting the Used Car Rule, the commission specifically excluded banks and other financial institutions from the rule's definition of a dealer; it did so on the grounds that banks and other financial institutions do not sell used motor vehicles in the usual retail environment, and thus the risk of banks using the deceptive practices found to be characteristic of used car sales presentations was small. When the Board's investigation supported the commission's conclusion, it found that a companion rule applicable to banks was not necessary.

Credit Practices Rule

In April the Board adopted amendments to Regulation AA (Unfair or Deceptive Acts or Practices), effective January 1, 1986, to include the Credit Practices Rule previously adopted by the FTC for nonbank creditors. (The Federal Home Loan Bank Board did the same for its member institutions.) As adopted by the Board, the rule prohibits banks from entering into a consumer credit obligation that contains any of the following items:

- A "confession of judgment" clause, by which the consumer agrees to permit the creditor to obtain a judgment in the event of default without giving the debtor notice or an opportunity to be heard in court.
- A "waiver of exemption," by which the consumer waives or limits state law exemptions sheltering the consumer's home or other necessities from attachment, unless the waiver relates to property specifically given as security for the obligation.
- The debtor's assignment of future wages to the creditor in the event of default.
- Permission for the creditor to take a security interest in any of the consumer's household goods beyond those for which the credit in question is being extended.

The amendment also bans the "pyramiding of late charges." Under this practice, a charge arising from the delay of one payment is taken out of a subsequent timely payment, causing a series of subsequent payments to be incomplete and therefore subject to late charges. Finally, the amendment prohibits a creditor from misrepresenting a cosigner's liability and requires the creditor to give the cosigner a notice, either in the contract extending credit or in a separate document, that explains the cosigner's obligation and potential liability.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Adjustable-Rate Mortgages

In May the Board issued for public comment proposed amendments to Regulation Z (Truth in Lending) that would require creditors to provide more information to consumers if the interest rate on their mortgage is adjustable. The amendments were also designed to make uniform the disclosure rules of several federal agencies. Under the proposal, creditors would be required to make available to consumers certain information about adjustable-rate mortgages; a pamphlet, the "Consumer Handbook to Adjustable Rate Mortgages," which was published jointly in January by the Federal Reserve Board and the Federal Home Loan Bank Board, could be used to fulfill this requirement. Furthermore, creditors would be required to give consumers, at the time disclosures are made, more details about rate and payment caps, negative amortization, margins, discount rates, and the like. The proposal also would eliminate a provision that permits creditors to substitute the disclosure required by other federal agencies for the variable-rate disclosure required by the Board's Regulation Z. In light of the comments on the proposal, additional review is under way to improve uniform requirements for disclosure.

Availability of Funds

As part of its effort to encourage banks to speed the availability of funds that consumers deposit by check, the Board in February amended Regulation J (Collection of Checks and Other Items and Wire Transfer of Funds). The amendment, effective October 1, 1985, requires a depository institution upon which a check of $2,500 or more is drawn to provide prompt notification of nonpayment to the institution at which the check was first deposited. A depository institution that fails to provide timely and accurate notification may be held liable for the loss incurred by the institution of first deposit. This procedure should reduce the risk of loss to depository institutions and their customers and permit earlier availability of funds. It applies, however, only to checks collected through the Federal Reserve System; legislation would be necessary to apply it to all checks.

Revised Regulation B

In November the Board issued revisions to Regulation B (Equal Credit Opportunity) and published an official staff commentary to assist creditors in complying with the regulation. This action was taken as part of the Regulatory Improvement Project, under which the Board is reviewing and revising all of its regulations to update and simplify their language and eliminate unneeded provisions. The revisions are designed to assist creditors in complying with the regulation while maintaining the protection for credit applicants envisioned by the underlying statute. The revisions include new procedures for dealing with incomplete applications; a broader selection of sample forms for informing applicants of the reasons for credit denial, requirements for data notation designed to reveal illegal discrimination against applicants for mortgage loans, and a change in the definition of "applicant" to give guarantors legal standing in the courts when they allege that a creditor improperly required their signatures.

Business Credit and Regulation B

In its review of Regulation B, the Board also considered the regulation's treatment of business credit transactions. The regulation continues to afford business applicants the basic pro-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tections against illegal discrimination under the Equal Credit Opportunity Act while also continuing certain modifications of the technical requirements of Regulation B for business lenders. The Board believes that the personal contact involved in applications for business credit obviates the need for some of the mechanical requirements that ensure compliance in the relatively nonpersonal arrangements for consumer credit. For example, a written notice of the right to receive a statement of the reasons for a credit denial would be redundant because lenders commonly tell business applicants why their requests for credit were denied.

Business Credit Pamphlet
The Board is preparing a pamphlet about the Equal Credit Opportunity Act and business credit transactions for distribution through government agencies, women's groups, and other organizations. The pamphlet is designed to increase public awareness, particularly among women and minority entrepreneurs, of the rights of business credit applicants and of the responsibilities of business credit lenders. It should prove to be a cost-effective means of informing business persons of their rights to equal credit opportunity.

Regulation B and Leasing
The Board considered whether to extend the coverage of Regulation B to lease transactions. A 1984 judicial decision, which is binding in California and other states in the Ninth Circuit, holds that the Equal Credit Opportunity Act applies to consumer leases. The Board noted that the Congress has consistently viewed lease and credit transactions as distinct and mutually exclusive financial transactions and has treated them separately under the Consumer Credit Protection Act. In addition, there is little evidence to suggest that lessors discriminate on the basis of the lessee's personal characteristics. Consequently the Board decided not to extend coverage of the regulation to lease transactions but to monitor industry practices and make rules or recommend legislation to remedy any problems.

Regulation Q

In December the Board proposed revisions to Regulation Q (Interest on Deposits) designed to clarify, simplify, and update its requirements applicable to advertising interest on deposits. The Board asked for comment on whether member banks should be required to state the annual percentage yield, the annual rate of simple interest, or both, in advertisements for deposits. In addition, the proposals would require that advertisements by member banks for accounts subject to service charges must state that the charges are imposed.

Interpretations

In 1985 the Board continued to offer legal interpretations and guidance through the official staff commentaries on Regulation E and Regulation Z. In addition the Board published in November the first official staff commentary on Regulation B along with its final revisions to the regulation. These commentaries guide financial institutions in applying the regulations to specific situations; updates to them are generally published by April 1 each year.

In November the Board issued staff guidelines to help banks comply with the Credit Practices Rule. The guidelines, which are in the form of questions and answers, will also be updated annually.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Determination of Preemption

In June the Board determined that a disclosure provision of the law of Arizona is preempted by the Truth in Lending Act and Regulation Z. The Truth in Lending Act provides that the federal law preempts a state law when they are inconsistent. In the case of the Arizona law, the Board preempted a portion of a disclosure notice informing consumers of their total debt because the state law requires the use of a term different from that used in federal law to describe the same item. As of October 1, 1986, creditors in Arizona are prohibited from using that disclosure; they also have the option of complying with the federal, rather than the state, law before that date.

Community Affairs

During 1985 the Board and the Reserve Banks increased their activities in community affairs. The Board had reaffirmed its support early in 1984 for the community affairs function in the Federal Reserve System and asked the Federal Reserve Banks to provide the necessary resources to implement an effective program.

With support from the Board, the Community Affairs Officers (CAOs) and staffs of the Reserve Banks carry out educational activities furthering public–private partnerships and private sector initiatives for community development. They are responsible for gathering information about the development needs of communities served by state member banks and bank holding companies in the CAO's district; for offering information to state member banks and bank holding companies about government and other programs designed to assist community development; and for promoting the goals of the Community Reinvestment Act (CRA) by fostering communication among borrowers, local governments, development organizations, and financial institutions in communities served by state member banks. The CAOs also give community and neighborhood organizations general information about the CRA and the procedures of the Federal Reserve System for handling bank and holding company applications and protests of those applications. Finally, the CAOs inform and assist bank holding companies interested in forming community development corporations.

CAOs in 1985 sponsored 43 meetings and conferences in 20 states on various development topics ranging from the use of the secondary market in small business lending programs to community development corporations. Bankers, other lenders, state and local government representatives, community groups, and examiners attended. In addition, CAOs have distributed literature on reinvestment and have responded to individual requests for information and assistance.

In many of the 17 formal CRA protests received by the System in 1985, the CAOs assisted in bringing about negotiated settlements. In 5 other cases, the CAOs brought the parties together to avert formal protests.

The CAOs continued to educate consumer examiners about community contacts and community development programs and strategies. They also assisted banks by providing information through the examiners and counseled banks with CRA problems. Some CAOs have begun to visit community organizations and economic development groups in their districts to ascertain housing and economic needs.

The community affairs staff at the Board supports the efforts of the Reserve Banks by helping to train consumer and commercial examiners in

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

community development. The Board's staff also attends and speaks at meetings and conferences on community development. During the year, the Board prepared a pamphlet, "Community Development Corporations and the Federal Reserve," surveyed the activities of the various community development corporations approved by the Board, and assisted in planning a national conference for community development corporations.

A major topic for banks, consumer groups, and regulators in 1985 was basic banking. Basic, or "lifeline," banking refers to a minimum level of financial services offered by banks at low or no cost to individuals with limited funds. The Board and the CAOs sponsored four meetings and seminars on basic banking for both bankers and consumer organizations. These meetings also considered issues such as branch closings, fees, delayed availability of funds, and truth in savings.

Compliance with Consumer Regulations

Data from the five federal agencies that supervise financial institutions and other supervisory agencies indicate that compliance with the Truth in Lending Act, the Equal Credit Opportunity Act, and the Electronic Fund Transfer Act improved in 1985. This section summarizes the data on compliance with these acts in the period from July 1, 1984, to June 30, 1985.[1]

Truth in Lending (Regulation Z)

The Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank Board (FHLBB), and the National Credit Union Administration (NCUA) reported that 63 percent of the institutions they examined were in full compliance with Regulation Z, a substantial improvement over the 1984 figure of 40 percent. This improvement is probably a function of experience with the revised Regulation Z the Board adopted in 1980. The agencies that were able to supply data on the frequency of violations (the Board, the OCC, and the NCUA) reported that 81 percent of the institutions that were not in full compliance had no more than five violations per institution. This statistic indicates that even those institutions that were not in full compliance were making a satisfactory effort toward compliance in general.

Summaries of examination findings compiled by the Board, the OCC, the FDIC, the FHLBB, and the NCUA show the following items to be the most frequent violations of Regulation Z:

- Failure to disclose the number, amounts, and timing of payments scheduled to repay the obligation.
- Failure to disclose accurately the annual percentage rate.
- Failure to disclose accurately the finance charge.
- Failure to disclose the fact that the creditor has or will acquire a security interest in the property purchased.
- Failure to make the disclosures clearly and conspicuously, in writing, and in a form that the consumer may keep.

The FDIC, the OCC, and the FHLBB issued 13 cease-and-desist orders for violations of Regulation Z. The Board assessed civil money penalties against one bank for failing to comply with an outstanding cease-

1. Not all the federal agencies that regulate financial institutions use the same method to compile information on compliance; however, the data support the general conclusions presented here.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and-desist order with provisions that addressed Regulation Z. There were 235 institutions that reimbursed approximately $2 million to 29,823 accounts as a result of understated annual percentage rates or finance charges. This amount is approximately the same as it was in both 1984 and 1983.

The Federal Trade Commission continued its program to increase voluntary compliance with the Truth in Lending Act as it applies to advertisers of credit for real estate and automobiles. In advertising of real estate credit, the FTC monitored more than 4,000 companies in 42 cities and found an overall compliance rate of 90 percent. The commission took enforcement actions against one real estate developer, who agreed to pay $300,000 in civil penalties. The FTC made a similar effort in 1985 to monitor the credit programs of more than 850 automobile dealers in 16 cities. Its staff also pursued several nonpublic investigations of compliance with the Fair Credit Billing Act. The commission continued to receive numerous inquiries concerning proper disclosures for variable-rate mortgages and other types of mortgage financing. It reported that such questions may suggest further staff inquiry to see whether additional consumer education or other actions are necessary. The FTC published a consumer brochure entitled "Solving Credit Problems" and reprinted "How to Advertise Consumer Credit," its manual for businesses.

The other agencies with responsibility for enforcing the Truth in Lending Act—the Packers and Stockyards Administration of the Department of Agriculture, the Department of Transportation (DOT), and the Farm Credit Administration—report no difficulties with enforcement. The DOT has had an enforcement proceeding against an air carrier since 1983 for repeated violations of the rules governing credit refunds; the agency filed a suit against the carrier in 1985 through the Department of Justice.

Equal Credit Opportunity (Regulation B)

The five federal agencies that supervise financial institutions reported that 81 percent of all institutions examined were in full compliance with the Equal Credit Opportunity Act (ECOA) in 1985, compared with 76 percent reported in both 1983 and 1984. The following items were the most frequent violations of Regulation B by the federally supervised financial institutions:

• Failure to provide on each statement in an identifiable fashion the amount, date, and type of the transfer, the type of account to or from which funds were transferred, or the name of any third party to or from whom funds were transferred.
sons for the adverse action.

• Failure to notify the applicant of action taken within 30 days after receiving a completed application.

• Illegally requiring the signature of an applicant's spouse or other person.

• Illegally requesting the sex of an applicant.

The FDIC, the OCC, and the FHLBB issued four cease-and-desist orders that included provisions relating to the requirements of Regulation B.

The FTC reported that most creditors subject to its supervision appear to comply with the act. It took enforcement action against three creditors during the reporting period. Two of these actions arose from a project in which auditors posed as applicants for credit; among other things, these cases resulted in the assessment of $360,000

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in civil penalties. The FTC also entered into a consent agreement with a retail creditor for the correction of alleged violations of the ECOA's requirements regarding notification of an adverse action; the agreement resulted in a civil penalty of $65,000, injunctive relief, and renotification to consumers. In addition, the FTC is conducting investigations that address discriminatory practices such as discouraging applicants who rely on protected income, like public assistance; discriminating on the basis of sex or marital status by discounting income earned by married women; and requiring the signature of an applicant's spouse.

The FTC currently has two ECOA cases in litigation. In the first, dealing with age discrimination, the court upheld the FTC's authority to obtain civil penalties for violations of the ECOA. The second case, which is being appealed through the Department of Justice, involves requiring the signature of an applicant's spouse when the applicant relied on community property.

Other agencies with enforcement responsibility for the ECOA—the Interstate Commerce Commission, the Small Business Administration, the Department of Transportation, and the Packers and Stockyards Administration of the Department of Agriculture —report no significant problems with compliance. The Farm Credit Administration and the Securities and Exchange Commission reported minor violations that did not require formal enforcement action.

Electronic Fund Transfer Act (Regulation E)

The regulatory agencies responsible for enforcing the Electronic Fund Transfer Act reported that 93 percent of the institutions examined were in full compliance in 1985. This ratio compares with 87 percent in 1984 and 84 percent in 1983. The following were the most frequent violations of Regulation E:

- Failure to provide to the consumer, at the time of contract or before the first transfer is made, a written statement outlining the terms and conditions of the electronic fund transfer service.
- Failure to provide a notice annually on procedures for resolving disputes or to mail a notice with each statement.
- Failure to provide on each statement the location or identification of the electronic terminal involved in each transfer.
- Failure to provide on each statement in an identifiable fashion the amount, date, and type of the transfer, the type of account to or from which funds were transferred, or the name of any third party to or from whom funds were transferred.
- Failure to provide a statement of the consumer's liability for unauthorized transfers.

Other agencies responsible for enforcement of the Electronic Fund Transfer Act report satisfactory compliance.

Economic Impact of Regulation E

The Electronic Fund Transfer Act requires the Board to monitor the costs and benefits of the act to financial institutions and consumers. The economic impact of the act increased during 1985 as more financial institutions offered electronic fund transfers (EFTs) and more consumers used them. Approximately two thirds of the nation's depository financial institutions now provide EFT services that are covered by the act. A large per-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

centage of depository institutions in each size class offer services to which the act applies; these include automated clearinghouse transfers, preauthorized electronic transfers, and access to automated teller machines (ATMs). Approximately 65,000 ATMs are in use throughout the nation. Larger institutions are more likely to operate ATMs and offer a full range of consumer EFT services than are smaller ones; smaller institutions are able to offer most kinds of EFT services to consumers through shared networks and other joint ventures.

Consumer demand for EFT services continued to grow during 1985. The evidence indicates that at least 70 percent of households have a savings or transactions account with an EFT feature that is used at least occasionally. The number of transactions conducted through ATMs has increased, and so has the number of consumers electing to receive payroll or government transfer payments by electronic direct deposit. The development of point-of-sale EFT systems accelerated in 1985.

The benefits to consumers from the Electronic Fund Transfer Act are difficult to measure because they cannot be isolated from consumer protections that would have been provided otherwise. Examination reports do not suggest any widespread violations of the consumer rights established by the act.

Data from the Board's Consumer Complaint Control System offer further evidence that consumers have no serious problems with EFTs. Of the 2,138 complaints processed in 1985, 97 involved EFTs. The Federal Reserve System forwarded 36 of these complaints to other agencies for resolution; of the remaining 61, none involved a possible violation of the regulation.

Costs associated with the act are also difficult to quantify because the costs of industry practices that would have evolved in the absence of statutory requirements are unknown. The cost of compliance for an EFT transaction is probably not high enough to compromise the cost advantage EFT transactions may otherwise have over check transactions. As EFT systems mature, as transaction volume builds, and as start-up costs for compliance are amortized, the costs of compliance imposed by the act per transaction and per dollar of transferred funds are likely to decline.

Consumer Complaints

The Board and the Federal Reserve Banks investigate and resolve complaints against state member banks and forward to appropriate enforcement agencies any complaints received that involve other creditors or businesses. In 1985 the System received 2,138 complaints against state member banks, nonmember banks, and

Consumer Complaints Received by the Federal Reserve System, by Subject, 1985

Subject	Number
Regulation B (Equal Credit Opportunity)	128
Regulation C (Home Mortgage Disclosure)	7
Regulation E (Electronic Fund Transfers)	97
Regulation M (Consumer Leasing)	4
Regulation Q (Interest on Deposits)	95
Regulation Z (Truth in Lending)	428
Regulation BB (Community Reinvestment)	3
Fair Credit Reporting Act	51
Fair Debt Collection Practices Act	7
Fair Housing Act	1
Real Estate Settlement Procedures Act	1
Transfer Agents	5
Unregulated bank practices	1,261
Other[1]	50
Total	**2,138**

1. Primarily miscellaneous complaints against business entities.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Consumer Complaints Received by the Federal Reserve System, by Function and Resolution, 1985

Type of resolution	Total complaints	Type of complaint: Loan functions: Discrimination	Loan functions: Other	Deposit function	Electronic fund transfers	Trust services	Other
Total complaints	**2,138**	**139**	**877**	**549**	**97**	**15**	**461**
Total concerning state member banks	863	84	351	200	56	15	157
Insufficient information[1]	30	2	12	7	0	0	9
Information furnished to complainant[2]	112	15	44	22	5	2	24
Bank legally correct							
No accommodation	317	33	127	67	34	7	49
Accommodation made[3]	107	11	46	27	3	2	18
Clerical error, corrected	115	4	50	27	6	1	27
Factual dispute[4]	37	0	13	14	1	1	8
Bank violation, resolved[5]	17	2	9	5	0	0	1
Possible bank violation, unresolved[6]	2	0	1	1	0	0	0
Customer error	10	2	3	4	0	0	1
Pending, December 31	116	15	46	26	7	2	20

1. The staff has been unable, after follow-up correspondence with the consumer, to obtain sufficient information to process the complaint.
2. When it appears that the complainant does not understand the law and that there has been no violation on the part of the bank, the Federal Reserve System explains the law in question and provides the complainant with other pertinent information.
3. The bank appears to be legally correct but chooses to make an accommodation.
4. Factual disputes not resolvable by the Federal Reserve System and contractual disputes that can be resolved only by the courts. Consumers wishing to pursue the matter may be advised to seek legal counsel or legal aid, or to use small claims court.
5. The bank appears to have violated a law or regulation and has taken corrective measures voluntarily or as requested by the Federal Reserve System.
6. Customers are advised to seek civil remedy through the courts. Cases that appear to involve criminal irregularity are referred to the appropriate law enforcement agency.

creditors and businesses: 1,744 by mail, 369 by telephone, and 25 in person (see the accompanying table). The Board also received 152 written inquiries requesting specific explanations about consumer credit laws, regulations, and banking policies and practices. In responding to both the complaints and the inquiries, members of the Board's staff provided consumers with specific explanations of laws, regulations, and banking practices, and with printed explanatory material. The Board's Division of Consumer and Community Affairs reviews regularly a sample of the complaints resolved by the Reserve Banks to evaluate their actions for compliance with System procedures and guidelines.

The Board sends follow-up questionnaires to complainants to assess their perceptions of how well the System handled their cases. In 1985, consumers returned 49 percent of these questionnaires. Approximately 82 percent reported that the explanations received were clear and understandable; 84 percent reported that they were satisfied with the promptness in handling; 95 percent reported that they were treated courteously by Federal Reserve staff; 92 percent reported that they would contact the Federal Reserve again if they had another problem with a bank; and 63 percent reported that the resolutions of their complaints were acceptable. The proportion of those satisfied with the outcome is relatively lower than the proportion of those satisfied with the System's handling of complaints because many of the complaints involved

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

practices that, although of concern to consumers, are permissible banking practices that cannot be changed unless the bank agrees.

The accompanying table summarizes the nature and resolution of complaints against state member banks in 1985. Of the 863 complaints concerning state member banks, about 50 percent involved loan functions: 10 percent alleged discrimination on a prohibited basis and 41 percent concerned a credit denial on a nonprohibited basis (such as length of residency), disclosures of credit costs, and other unregulated lending practices (such as the release or use of credit information). Approximately 23 percent of the complaints filed against state member banks involved disputes concerning interest on deposits and general practices concerning deposit accounts.

Unregulated Practices

The Board continued to monitor complaints about banking practices that are not subject to existing regulation to focus on those that may be unfair or deceptive. As in the past, the Board identified the unregulated practices that were the subject of 15 or more complaints per quarter or 50 for the year as a whole.

Of the 1,261 complaints about unregulated banking practices, 318 fell into one of the following five biggest categories: complaints about credit denial based on credit history (100, or 8 percent of the complaints about unregulated practices); discrepancies in accounts (58, or 5 percent); excessive time to clear checks, including delayed availability of funds (55, or 4 percent); improper crediting of deposits to accounts (53 or 4 percent); and credit denial based on other nonprohibited factors, such as the lack of sufficient assets (52, or 4 percent).

Many of the complaints about credit denials based on credit history indicated that the applicant for credit underestimated the importance lenders give to a poor credit history or a lack of borrowing experience when considering the applicant's creditworthiness. Complaints about discrepancies in accounts, the second largest category, generally involved factual disputes regarding the amount or the timing of a deposit. Each of these categories represent 5 percent or less of all consumer complaints received by the System.

Community Reinvestment Act

The Board is required by the Community Reinvestment Act (CRA) to encourage institutions under its jurisdiction to help meet the credit needs in their communities—including low- and moderate-income neighborhoods—in a manner consistent with the safety and soundness of the institutions. The CRA requires the Board to assess the record of state member banks in meeting such needs as part of its examinations and to take the institution's record into account in deciding certain applications.

During the 1985 reporting period (July 1, 1984, through June 30, 1985), Federal Reserve System personnel examined 669 state member banks for compliance with the CRA, ranking them on a scale of 1 through 5. A score of 1 represents the highest level of compliance; a score of 3 is less than satisfactory. No bank fell into the lowest category, and less than 1.6 percent failed to achieve at least a satisfactory performance.

In 1985, 17 of the applications received by the Federal Reserve were

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

protested under the CRA. Of the 14 protests that were carried to a decision by year-end, 10 were withdrawn after agreements were reached as a result of meetings facilitated by the Federal Reserve Banks. One application was withdrawn for reasons not related to the CRA, and 1 was pending at year-end.

Consumer Advisory Council

The Consumer Advisory Council met in March, June, and October of 1985 to advise the Board on System responsibilities under the consumer credit protection laws and to discuss other issues relating to financial services to consumers. The council has 30 members, some representing consumers and financial institutions and others from the academic and governmental sectors. The council's meetings are open to the public.

At its March meeting the Board's staff briefed the council on the highlights of a staff study it had requested on service charges and fees (issued in January 1985). In general, the study showed that although service charges imposed on checking accounts had risen in recent years, bank costs for providing checking accounts had increased even more rapidly.

Council members were concerned in 1985 about basic banking services. The council's Committee on Service Charges formed in 1984 to study the issue of rising fees for consumer financial services was also asked to focus on this issue. At its October meeting the council recommended that the Board issue a policy statement to encourage state member banks to offer a program of basic banking services accessible to low- and moderate-income consumers, and it suggested that the Board encourage other federal financial regulatory agencies to issue comparable policy statements. In addition, the council recommended that the Board develop education programs and examination procedures to determine whether state member banks are offering basic banking services and encourage the other agencies to do likewise. (The Board's staff has been monitoring developments in the area of basic banking services for some time. To discuss the issue the Board sponsored a conference of bankers in November 1984 and a similar conference of consumer representatives in April 1985.)

The council considered issues related to the Home Mortgage Disclosure Act at its March and June meetings. In June the council adopted a resolution urging the Board to consider a recommendation for the permanent extension of the act, which was scheduled to expire on October 1, 1985.

In 1985 the council also considered the following issues:

- Proposed revisions to the Board's Regulation Z (Truth in Lending) that would establish uniform requirements for all lenders in disclosing the terms on adjustable-rate mortgages.
- The Board's review of Regulation B, (Equal Credit Opportunity).
- Tie-ins between credit insurance and extensions of credit.
- The Board's proposed revisions of the advertising rules of Regulation Q (Interest on Deposits).

The closing of branch offices and the Community Reinvestment Act.

- Deregulation of financial services.
- Potential effects of interstate banking on the delivery of financial services to consumers.

Finally, in a year-end assessment of their council experience, members expressed strong support for the wider

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

use by other regulatory agencies of advisory groups such as the council.

Legislative Recommendations

In September the Board recommended that the Congress extend the Home Mortgage Disclosure Act of 1975 for four years. The Board believes that the data required by the act are useful in monitoring compliance with the Community Reinvestment, Equal Credit Opportunity, and Fair Housing acts. Moreover, although the public does not appear to use the data extensively, community groups rely heavily upon it to monitor the response of financial institutions to community needs for mortgage credit.

The Board also recommended that the asset size below which banks are exempt from the act be increased from $10 million to perhaps $25 million, and it recommended that the Congress enable the Board to make future adjustments to the asset size exemption if the act is extended permanently. Largely because of the effects of inflation, the percentage of the commercial banks in metropolitan areas covered by the act has increased from 78 percent in 1976 to 94 percent in 1985. Increasing the asset size would reduce the percentage of banks covered to a level closer to that when the law was first adopted.

Finally, the Board recommended the experimental use of city and county data on title-lien transfers as an alternative source of information about mortgage lending. The advantages of this alternative source are that data can be collected on a more timely basis, the information is more reliable, and the overall cost may be lower than under the present system.

In October the Board testified before the House Committee on Banking, Finance and Urban Affairs in opposition to a proposed federal ceiling on the interest rate charged on credit card debt. The Board believes that financial markets distribute credit most efficiently and productively when interest rates are determined in markets that are as free as possible from artificial restraints. Evidence suggests that the credit card business is reasonably competitive, notwithstanding the lack of much variation in interest rates. Furthermore, credit card rates have tended to decline recently. Efforts to constrain rates through federal regulation are likely to reduce the availability of credit or generate less efficient means of recapturing credit costs.

Also in October the Board told the House Committee on Banking, Finance and Urban Affairs that it would support legislation on disclosure and on expediting return items in order to increase the speed with which check deposits are made available. The Board does not, however, favor legislation that would set schedules of availability.

Each year, the Board asks the agencies with enforcement responsibilities under Regulations B, E, and Z for recommendations concerning the underlying acts. The Office of the Comptroller of the Currency reiterated its support for certain changes to the Electronic Fund Transfer Act that were described in the Board's ANNUAL REPORT of 1983 and of 1984. The OCC recommends a review of section 909 of the act, which governs consumer liability for unauthorized electronic fund transfers, and clarification of congressional intent with regard to this section of the act.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Legislative Recommendations

The Board of Governors has made the following recommendations for legislation to the Congress of the United States.

Bank Holding Company Legislation

The Federal Reserve believes that reform of the existing statutory framework is urgent to accommodate the constructive evolution of the banking system and to channel the forces of change in a manner consistent with continuing public policy objectives.

The Federal Reserve has recommended that the framework for legislative action should include the following essential elements:

- New statutory definitions to clarify what is a bank, what is a thrift institution, and what is the proper scope of powers for state-chartered banks.
- Expansion of the powers of bank holding companies.
- Streamlining of the procedures of the Bank Holding Company Act.

Definitions

New definitions of the terms "bank" and "thrift institution" are urgent to assure an orderly framework for the development of the financial system, to promote competitive equity, and to establish clearly the competitive rules for the various segments of the financial service industry. The Board takes as its point of departure the basic proposition that banks, and depository institutions generally, continue to perform a unique and critical role in the financial system and the economy—as operators of the payments system, as custodians of the bulk of liquid savings, as key and impartial suppliers of short-term credit, and as the link between monetary policy and the economy.

The Board believes that all institutions having the unique character of banks should be subject to the rules applicable to banking institutions—that is, the limitations on the range of activities and ownership, as well as the protections against conflict of interest, concentration of resources, and excessive risk. To achieve that end and to close the so-called "nonbank bank" loophole, the Board has recommended clarifying the definition of "bank" in the Bank Holding Company Act by, among other changes, extending the definition to cover all institutions that are insured by the Federal Deposit Insurance Corporation.

The Board has also recommended that thrift institutions meet a minimum residential mortgage test to remain eligible for the special benefits provided by law for such institutions. The holding companies of thrift institutions not meeting the test would be limited so that the scope of their permissible nonbanking activities would be similar to those of bank holding companies.

The Board has also recommended that the Congress establish limits with respect to the ability of states to authorize state-chartered institutions to engage in certain activities that may affect the safety and soundness of the financial system.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Powers

The Board has supported proposed legislation that would permit bank holding companies to engage in a broader range of activities including securities underwriting and brokerage activities, operation of thrift institutions, and other activities of a financial nature.

Procedures

The Board favors streamlining the procedures for dealing with bank holding company applications. By recent changes in the regulation governing holding company activities, the Board has gone as far as it believes it can, consistent with present law, to speed up procedures and lessen regulatory burdens. The Board has recommended legislation eliminating the "benefits and burdens" test of present law, limiting bank holding company examinations and reports, providing for expedited notice procedures for approval of new activities, and setting out new and simplified criteria for determining the permissibility of new activities generally.

Increasing the Number of Class C Directors

The Board has recommended that the Federal Reserve Act be amended to increase the number of Class C directors at each Federal Reserve Bank from three to five. The proposal aims to diversify further the backgrounds and interests represented on the boards of directors of the Reserve Banks as a way of accomplishing one of the objectives of the Federal Reserve Reform Act of 1977. That act provides for the representation of the interests of consumers, labor, and services, in addition to agriculture, commerce, and industry, on the boards of the Reserve Banks.

The Board also has recommended that thrift institutions be added to the groups that should be considered in selecting Class C directors in view of the changes made by the Monetary Control Act of 1980. That act applied reserve requirements to such institutions and made Federal Reserve credit and services available to them.

Federal Reserve Bank Branches

The Board has recommended that the Federal Reserve Act be amended with respect to the limit on the cumulative dollar amount that may be spent on construction of Federal Reserve Bank branch buildings. The System incurs expenses for branch construction principally for additions to, or replacements for, existing branch facilities. The current limitation, set in 1974, will be exhausted by projects that are under way or that are currently at an advanced planning stage. Branches of Federal Reserve Banks provide important services to the financial system and the public, including the distribution of coin and currency, the clearing of checks, and the processing of electronic payments. The current statutory limitation will prevent needed renovation and new construction at branch buildings.

Return Check Notification

The Board has recommended that the Federal Reserve Act be amended to establish a procedure that would help reduce the risk associated with return checks and help shorten holding periods on checks. The procedure would

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

require that when a check of $2,500 or more is returned unpaid, the institution upon which the check is drawn must provide timely notice to the institution at which the check was originally deposited. The Board adopted the procedure as an amendment to Regulation J (Collection of Checks and Other Items and Wire Transfers of Funds). The proposed legislative recommendation is that the procedure be extended beyond checks covered under Regulation J to those not originally collected through the Federal Reserve.

The Board believes that the notification procedure for returned checks will reduce the risk to depository institutions and their customers because the institutions will receive notice more rapidly that a large-denomination check is being returned. Also, the procedure should make it easier for depository institutions to make funds available sooner to their customers because the institutions will not need to impose extended holds on all checks to protect themselves from loss.

Interstate Banking

The Board believes that the time has come for the Congress to review and clarify national policy toward interstate banking. A legislative resolution should recognize the desirability of transitional arrangements before moving to more general interstate banking, the need to avoid undue concentration of banking resources and to maintain a climate in which small institutions can flourish, and the desirability of retaining a role for the states in the evolution of the banking structure within a state. Interstate acquisitions generally should take the form of a holding company affiliate rather than interstate branching.

The Board recognizes that regional arrangements provide a possible transitional approach to full interstate banking. Viewed as a permanent solution, however, regional compacts would tend to balkanize banking, with a tendency toward regional concentrations. The potential weaknesses of regional compacts could be substantially ameliorated if states entering into such regional arrangements were also required after a period of a few years to permit reciprocal entry by banks in any state that has enacted a regional arrangement or otherwise provides for entry of banks of any other states.

To forestall large concentrations of domestic banking resources, the Board has recommended that certain safeguards be included in legislation liberalizing interstate banking. The Board has suggested the following approaches: the very largest holding companies might be prohibited from merging with one another; institutions could be prohibited from obtaining by acquisition more than some fixed share of banking assets, although de novo or small acquisitions could still be permitted; and states could set limits on the percentage of banking assets within their own boarders that could be acquired through acquisitions or mergers.

The Board has also recommended that Congress authorize interstate branching within metropolitan areas and within neighboring areas of contiguous states.

Emergency Acquisition Authority

Congress has temporarily extended the provisions contained in Title I of the Garn–St Germain Depository Institutions Act that permit the FDIC and the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FSLIC to arrange for emergency interstate mergers and acquisitions of financially troubled thrift institutions and failed insured commercial banks with assets of $500 million or more.

In light of the continuing strains evident in some sectors of the thrift and banking industries, including difficulties experienced by some banks engaged in lending to the agricultural and energy sectors, the Board has recommended that the emergency arrangements for failing institutions in the Garn–St Germain Act be extended and liberalized in the following ways: (1) reduce or eliminate the $500 million asset size cutoff for insured commercial banks, (2) permit the use of the emergency procedures not only for a failed bank but for a bank in danger of failing, and (3) authorize the interstate acquisition of a bank holding company in which a subsidiary bank is in danger of failing.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Litigation

During 1985 the Board of Governors was named in 55 pending lawsuits, compared with 40 in 1984. Of the 25 new lawsuits filed in 1985, 4 raised questions under the Bank Holding Company Act, compared with 17 in 1984. As of December 31, 1985, 31 cases were pending, 7 of which involve questions under the Bank Holding Company Act. The sections below briefly describe each of these cases.

Bank Holding Companies—Antitrust Action

In 1985 no bank holding company acquisitions or mergers that had been approved by the Board were challenged by the U.S. Department of Justice under antitrust laws, and no such cases were pending from previous years.

Bank Holding Company Act—Review of Board Actions

In *Oklahoma Bankers Association* v. *Federal Reserve Board*, No. 83-2591 (10th Circuit, filed December 13, 1983), plaintiff sought judicial review of a Board order dated November 17, 1983, approving the application of Citicorp, New York, New York, to acquire de novo Citicorp Savings and Trust Company, Tulsa and Oklahoma City, Oklahoma, a limited-purpose trust company that will engage in industrial bank activities. On July 9, 1985, the court affirmed the Board's order (766 F.2d 1446).

In *Dimension Financial Corporation et al.* v. *Board of Governors*, No. 83-2696 (10th Circuit, filed December 30, 1983); *First Bancorporation* v. *Board of Governors*, No. 84-1011 (10th Circuit, filed January 5, 1984); *Colorado Industrial Bankers Association et al.* v. *Board of Governors*, No. 84-1122 (10th Circuit, filed January 27, 1984); *Financial Institutions Assurance Corporation* v. *Board of Governors*, No. 84-1407 (10th Circuit, filed January 27, 1984); *Ohio Deposit Guarantee Fund* v. *Board of Governors*, No. 84-1257 (10th Circuit, filed January 28, 1984); and *State of Ohio et al.* v. *Board of Governors*, No. 84-1270 (10th Circuit, filed January 30, 1984), petitioners challenge the definition of "commercial loan" and "demand deposit" in a revision of the Board's Regulation Y that was approved by the Board on December 14, 1983 (*Federal Reserve Bulletin*, vol. 70, February 1984, p. 121). The court of appeals set aside the definitions challenged in Regulation Y on September 24, 1984 (744 F.2d 1402). A petition for writ of certiorari (No. 84-1274, filed February 6, 1985) was granted by the Supreme Court on April 29, 1985 (105 S. Ct. 2137). By letters in 1985 dated June 25, June 28, and July 10 respectively, the Financial Institutions Assurance Corporation, the Ohio Deposit Guarantee Fund, and the State of Ohio withdrew from the case. The case is pending.

In *Huston* v. *Board of Governors*, No. 84-1084 (8th Circuit, filed January 17, 1984), petitioner sought review of a Board order dated November 8, 1983, approving an application by KSAD, Inc., Council Bluffs, Iowa, to become a bank holding company (*Federal Reserve Bulletin*, vol. 70, January 1984, p. 44). On March 26, 1985 the court upheld the Board's action (758 F.2d 275).

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In *Huston* v. *Board of Governors*, No. 84-1361 (8th Circuit, filed March 20, 1984), petitioner sought review of a Board letter issued on February 21, 1984, in which the Board declined to issue control proceedings with respect to a nonvoting investment by First Bank System, Minneapolis, Minnesota, in Banks of Iowa, Des Moines, Iowa. On March 26, 1985, the court upheld the Board's action (758 F.2d 275).

In *Northeast Bancorp, Inc., et al.* v. *Board of Governors*, Nos. 84-4047, 84-4051, and 84-4053 (2d Circuit, filed March 27, 1984), petitioners sought review of the Board orders dated March 26, 1984, approving the merger of Bank of New England Corporation, Boston, Massachusetts, and CBT Corporation, Hartford, Connecticut, and the acquisition by Hartford National Corporation, Hartford, Connecticut, of Arltru Bancorporation, Lawrence, Massachusetts (*Federal Reserve Bulletin*, vol. 70, April 1984, pp. 374 and 353 respectively). On August 1, 1984, the court of appeals upheld the Board's orders (740 F.2d 203). A petition for writ of certiorari (No. 84-363, filed September 6, 1984) was granted by the Supreme Court on January 7, 1985 (53 U.S.L.W. 3367). By order dated June 10, 1985, the Court affirmed the Board's orders (105 S. Ct. 2545).

In *Florida Bankers Association et al.* v. *Board of Governors*, Nos. 84-3269 and 84-3270 (11th Circuit, filed April 20, 1984), petitioners seek review of a Board order dated March 23, 1984, approving an application by U.S. Trust Corporation, New York, New York, to expand the activities of its subsidiary, U.S. Trust Company of Florida, N.A., Palm Beach, Florida, to include the acceptance of time and demand deposits and the making of consumer loans (*Federal Reserve Bulletin*, vol. 70, April 1984, p. 371). On May 20, 1985, the court reversed the Board's order of approval (760 F.2d 1135). Intervenor U.S. Trust Company's petition for certiorari (No. 85-193) was filed with the Supreme Court on August 5, 1985.

In *Citicorp* v. *Board of Governors*, No. 84-4081 (2d Circuit, filed May 22, 1984), petitioner challenged the constitutionality of the Connecticut Interstate Banking Act and the Board's approval of the application of Bank of Boston Corporation, Boston, Massachusetts, to acquire Colonial Bancorp. Inc., Waterbury, Connecticut (*Federal Reserve Bulletin*, vol. 70, June 1984, p. 524). On June 18, 1984, the court consolidated the case with *Northeast Bancorp, Inc., et al.* v. *Board of Governors*. By order dated July 11, 1984, the court upheld the Board's order. The decision was affirmed by the Supreme Court on July 10, 1985 (105 S. Ct. 2545).

In *Bank of New York Company, Inc.* v. *Board of Governors*, No. 84-4091 (2d Circuit, filed June 14, 1984), petitioner sought review of a Board order denying the interstate acquisition of Northeast Bancorp, Inc., New Haven, Connecticut, by Bank of New York Company, Inc., New York, New York. The case was dismissed with prejudice, pursuant to stipulation, for failure to reactivate the case within 30 days of the Supreme Court's decision in *Northeast Bancorp*.

In *Seattle Bancorporation et al.* v. *Board of Governors*, No. 84-7535 (9th Circuit, filed August 15, 1984), petitioner sought review of a Board order dated July 16, 1984, denying petitioners' application to acquire Alaska Pacific Bancorporation, Anchorage, Alaska (*Federal Reserve Bulletin*, vol. 70, August 1984, p. 667). On September 27, 1985, the case was dismissed as moot.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In *Citicorp* v. *Board of Governors*, No. 84-4121 (2d Circuit, filed August 27, 1984); No. 84-4145 (2d Circuit, filed October 12, 1984); No. 84-4173 (2d Circuit, filed December 31, 1984); No. 85-4009 (2d Circuit, filed January 15, 1985); and *David Bolger Revocable Trust* v. *Board of Governors*, No. 84-3550 (3d Circuit, filed August 31, 1984), petitioners sought review of several Board orders approving the interstate acquisition of banks by bank holding companies (*Federal Reserve Bulletin*, vol. 70, September 1984, p. 737, and November, p. 834; vol. 71, January 1985, p. 43, and March, p. 176). The cases were dismissed by stipulation of the parties on the basis of the decision of the Supreme Court in *Northeast Bancorp, Inc.* v. *Board of Governors*.

In *Florida Department of Banking* v. *Board of Governors*, Nos. 84-3831 and 84-3832 (11th Circuit, filed November 30, 1984), and *Florida Bankers Association* v. *Board of Governors*, Nos. 84-3883 and 84-3884 (11th Circuit, filed December 21, 1984), petitioners seek review of Board orders dated November 1, 1984, approving the applications by Bank of Boston Corporation, Boston, Massachusetts, and Bankers Trust New York Corporation, New York, New York, to expand the activities of their subsidiaries—Bank of Boston Trust Company of Southeast Florida, N.A., Dearfield Beach, Florida; Bank of Boston Trust Company of Southwest Florida, N.A., Sarasota, Florida; and Bankers Trust Company of Florida, N.A., Palm Beach, Florida—to include the acceptance of time and demand deposits and the making of consumer loans (*Federal Reserve Bulletin*, vol. 71, January 1985, pp. 55 and 51 respectively). Proceedings in the cases have been stayed pending a determination by the Supreme Court of a petition for certiorari in *Florida Bankers Association* v. *Board of Governors*.

In *The Broad Street National Bank of Trenton* v. *Board of Governors*, No. 85-3387 (3d Circuit, filed July 17, 1985), petitioner sought review of the Board's order dated June 17, 1985, approving the application by First Jersey National Corp., Jersey City, New Jersey, to acquire 8.8 percent of the voting shares of The Broad Street National Bank of Trenton (*Federal Reserve Bulletin*, vol. 71, August 1985, p. 638). The case was dismissed on November 14, 1985, by stipulation of the parties.

In *Independent Community Bankers Association of South Dakota* v. *Board of Governors*, No. 85-1496 (D.C. Circuit, filed August 7, 1985), petitioner seeks review of the Board's order dated July 12, 1985, approving the application of First City Bancorporation of Texas, Inc., Houston, Texas, to acquire First City Bank-Sioux Falls, N.A., Sioux Falls, South Dakota (*Federal Reserve Bulletin*, vol. 71, September 1985, p. 716). The case is pending.

In *First National Bancshares Corp. II* v. *Board of Governors*, No. 85-3702 (6th Circuit, filed September 4, 1985), petitioner seeks review of the Board's order dated August 5, 1985, denying the application of First National Bancshares Corporation II, Lexington, Tennessee, to become a bank holding company by acquiring First National Bancshares Corporation, Lexington, Tennessee, and, indirectly, its subsidiary, First National Bank of Lexington, Lexington, Tennessee (*Federal Reserve Bulletin*, vol. 71, October 1985, p. 793). The case is pending.

In *First National Bank of Blue Island Employee Stock Ownership Plan* v. *Board of Governors*, No. 85-2615 (7th Circuit, filed September 23,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1985), petitioner seeks review of the Board's order dated August 22, 1985, denying the application of First National Bank of Blue Island Employee Stock Ownership Plan, Blue Island, Illinois, to become a bank holding company by acquiring Great Lakes Financial Resources, Inc., Blue Island, Illinois (*Federal Reserve Bulletin*, vol. 71, October 1985, p. 804). The case is pending.

Other Litigation Involving Challenges to Board Procedures and Regulations

The Glass-Steagall Act

In *A. G. Becker Inc.* v. *Board of Governors et al.*, No. 80-2614 (D.D.C., filed October 14, 1980), and *Securities Industry Association* v. *Board of Governors et al.*, No. 80-2732 (D.D.C., filed October 24, 1980), plaintiffs sought review of a Board statement dated September 26, 1980, denying in part plaintiffs' petition that the Board prohibit Bankers Trust Company, a state member bank, from selling third-party commercial paper as an agent of the issuer, pursuant to the Glass-Steagall Act. On June 28, 1984, the Supreme Court overruled the Board's decision and remanded the case to the court of appeals (104 S. Ct. 2979), which remanded it to the district court. On October 19, 1984, the district court remanded the case to the Board to determine whether the methods that Bankers Trust uses to place commercial paper constitute underwriting or similar activities within the meaning of the act. On June 4, 1985, the Board determined that the current placement methods of Bankers Trust are consistent with the act. On June 28, 1985, A.G. Becker was dismissed as a plaintiff by stipulation of the parties. The parties' cross-motions for summary judgment are pending.

Freedom of Information Act

In *9 to 5 Organization for Women Office Workers* v. *Board of Governors*, No. 80-2905-C (D. Mass., filed December 30, 1980), plaintiff sought disclosure under the Freedom of Information Act of records containing information regarding a wage survey conducted by a consortium of employers in Massachusetts and used by the Board in approving salaries of the Federal Reserve Bank of Boston. On November 2, 1983, the U.S. Court of Appeals for the First Circuit vacated the decision of the district court that certain of the requested data was not exempt from disclosure under the act and remanded the case to the district court (721 F.2d 1). The parties entered into a stipulation settling the case. On February 28, 1985, the court entered a dismissal order consistent with the stipulation.

Financial Institutions Supervisory Act

In *Calhoun et al.* v. *Board of Governors*, No. 85-1750 (D.D.C., filed May 30, 1985), plaintiffs sought to enjoin certain temporary cease-and-desist orders and removal orders entered against them by the Board of Governors. On September 3, 1985, the case was dismissed by stipulation of the parties.

In *Carter* v. *Board of Governors et al.*, No. 85-4021 (6th Circuit, filed December 9, 1985), plaintiff seeks review of the Board's order dated November 18, 1985, removing him as an officer of First National Bank of Clinton, Clinton, Kentucky. The case is pending.

In a case filed in the U.S. District Court for the District of Minnesota,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

No. 4-83-995 (filed November 16, 1983), which was placed under seal by court order, plaintiff alleges that the Board reviewed and copied his records at a national bank in violation of the Right to Financial Privacy Act. The case is pending.

Farm Credit Act

Several cases have been filed in various district courts seeking injunctive relief and damages relating to loans made to plaintiff farmers by commercial banks and the Farm Credit System. A motion by the federal defendants to dismiss will be filed in each of the following cases: *Populist Party of Iowa* v. *Federal Reserve Board*, No. 85-626-B (S.D. Iowa, filed August 2, 1985); *Silkman* v. *Volcker et al.*, No. 85-2083 (D. Colo., filed September 10, 1985) and related cases; *Alfson* v. *Wilkinson et al.*, No. A1-85-267 (D.N.D., filed October 8, 1985); *Jensen* v. *Wilkinson et al.*, No. 85-4436-S (D. Kan., filed October 10, 1985), and related cases; *Kurkowski* v. *Wilkinson et al.*, No. CV-85-0-916 (D. Neb., filed October 16, 1985); *Farmer* v. *Wilkinson et al.*, No. 4-85-CIVIL-1448 (D. Minn., filed October 21, 1985); *Kalb* v. *Wilkinson et al.*, No. 085-4184 (N.D. Iowa, filed October 22, 1985); *Podolak* v. *Volcker et al.*, No. C85-0456 (D. Wyo., filed October 28, 1985), and related cases; *Myers et al.* v. *Federal Reserve Board*, No. 85-1427 (D. Ida., filed November 18, 1985).

Other Actions

In *The Committee for Monetary Reform et al.* v. *Board of Governors*, No. 83-1730 (D.D.C., filed June 16, 1983), plaintiffs challenged the constitutionality of the Federal Open Market Committee and the Board's regulation of the nation's money supply. The court granted the defendant's motion to dismiss for lack of standing on October 26, 1983. By an opinion dated June 28, 1985, the court of appeals affirmed the dismissal by the district court (766 F.2d 538).

In *Melcher* v. *Federal Open Market Committee*, No. 84-1335 (D.D.C., filed April 30, 1984), plaintiff challenges the constitutionality of the Federal Open Market Committee. Plaintiff filed a motion for summary judgment, and the Federal Open Market Committee filed a motion to dismiss. The case is pending.

In *Lamb* v. *Pioneer First Federal Savings and Loan*, No. 84-2-01551-7 (Snohomish County Superior Court, Washington, filed May 8, 1984), plaintiff challenges the issuance of U.S. currency in the form of Federal Reserve notes. On February 20, 1985, the case was dismissed as to the Federal Reserve for lack of jurisdiction.

In *Brown* v. *United States Congress et al.* No. 84-2887-6 (IG) (S.D. Cal., filed December 7, 1984), plaintiff seeks damages resulting from discrimination in home financing and mandatory injunctions regarding the Board's monetary policy. The court dismissed the case on September 17, 1985. Plaintiff filed a notice of appeal on September 20, 1985, No. 85-6313 (9th Circuit), then voluntarily dismissed the appeal on November 12, 1985. On September 27, 1985, plaintiff filed a motion for reconsideration with the district court. The case is pending.

In *Harvey* v. *President of the United States et al.*, No. C-84-20797-RPA (N.D. Cal., filed December 20, 1984), plaintiff sought dissolution of the Federal Reserve System, alleging that the Congress acted in an arbitrary and capricious manner in enacting the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Reserve Act. The case was dismissed by memorandum order of the court.

In *Lewis* v. *Volcker et al.*, No. C-1-85-0099 (S.D. Ohio, filed January 14, 1985), plaintiff seeks damages resulting from alleged violations of federal monetary credit and bankruptcy statutes by the Board and BancOhio National Bank. On November 20, 1985, the U.S. magistrate recommended dismissal of the action.

In *White* v. *State of California, United States of America, et al.* No. 85-5624 (9th Circuit, filed February 12, 1985), plaintiff alleges that defendants are in error in their valuation of Federal Reserve notes and of coins as currency of the United States and that plaintiff was wrongfully penalized for nonpayment of taxes. The Board's motion to dismiss was granted by the district court on December 26, 1984. Plaintiff's motion for reconsideration was denied on February 8, 1985, and a notice of appeal was filed. The Board is awaiting a decision on its motion to dismiss.

In *Cook* v. *Spillman et al.*, No. CIV-S-85-0953 EJG (E.D. Cal., filed July 10, 1985), *Wight et al.* v. *Internal Revenue Service et al.*, No. CIV-S-85-0012 MLS (E.D. Cal., filed July 12, 1985), and *Urwyler et al.* v. *Internal Revenue Service et al.*, No. CV-F-85-402 REC (E.D. Cal., filed July 18, 1985), plaintiffs allege that the sixteenth amendment to the Constitution was not properly ratified and that the use of Federal Reserve notes constitutes illegal gambling. The Board's motions to dismiss the cases were granted by the district court. The cases have been appealed to the U.S. Court of Appeals for the Ninth Circuit and are pending.

In *Johnson* v. *Federal Reserve System et al.*, Nos. S85-0958(R) and S85-1269(N) (S.D. Miss., filed July 16, and October 21, 1985), plaintiff seeks injunctive relief and damages against defendants relating to foreclosure on plaintiff's property. The cases are pending.

In *McHuin* v. *Volcker et al.*, No. 85-2170 WARB (W.D. Okla., filed August 29, 1985), plaintiff seeks reinstatement as an employee at the Federal Reserve Bank of Kansas City. The case is pending.

In *Cannon* v. *Bank of America et al.*, No. 85-1481 (E.D. Cal., filed October 17, 1985), and *Ouper* v. *First Interstate Bank et al.*, No. 85-2109 (D. Oregon, filed December 13, 1985), plaintiffs seek damages against defendants, alleging check kiting, mail fraud, antitrust violations, and racketeering. The cases are pending.

In *Howe* v. *United States et al.*, No. 85-4504-C (D. Mass., filed December 6, 1985), plaintiff challenges the constitutionality of the current monetary system. The case is pending.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Banking Supervision and Regulation

The Board of Governors in 1985 began a major new program to strengthen supervision of state member banks and bank holding companies. The Board's action, which was taken in light of developments and trends within the banking system over the past several years, was aimed at two broad areas of Reserve Bank supervision: (1) the early identification of problems in banking organizations through more frequent and thorough on-site examinations and inspections, and (2) more frequent and clearer communications of findings to bank management and boards of directors. As part of this overall effort, the Board has also taken steps to prevent supervisory problems through tighter prudential standards and improved coordination and cooperation with other federal and state banking departments.

The Board also put in place a number of supervisory guidelines. Principal among these was a revision of the Board's capital adequacy guidelines, which specify capital ratios that banks and bank holding companies are generally expected to exceed. The Board also issued for comment a proposal for a supplemental adjusted measure of capital. The Board also adopted guidelines on the payment of dividends by troubled banking organizations. These measures are described below under "Program to Strengthen Supervision of Banks and Bank Holding Companies."

Supervision for Safety and Soundness

The Federal Reserve conducts the following activities to ensure the safety and soundness of financial institutions: on-site examinations and inspections, surveillance and monitoring activities, and enforcement and other supervisory actions.

Examinations and Inspections

The on-site review of operations is the primary means for ensuring the safety and soundness of financial institutions. Examinations or inspections of these operations entail (1) an appraisal of the quality of the institution's assets; (2) an evaluation of management, along with internal policies, operations, and procedures; (3) an assessment of the key financial factors of capital, earnings, asset and liability management, and liquidity; and (4) a review for compliance with applicable laws and regulations.[1]

State Member Banks

The Federal Reserve is the primary federal supervisor and regulator of state-chartered commercial banks that are members of the System. At the end of 1985 there were 1,080 state member banks, accounting for about 7 per cent of all insured commercial banks.

1. The Board's Division of Consumer and Community Affairs is responsible for reviewing compliance with consumer and civil rights laws. The responsibility is accomplished mainly through examinations by specially trained Reserve Bank examiners. These regulatory responsibilities are described in the "Consumer and Community Affairs" section of this Report. Compliance with other statutes and regulations, which is treated in this secion, is the responsibility of the Board's Division of Banking Supervision and Regulation and of the Reserve Banks, whose examiners check for safety and soundness.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Because these banks typically were larger than the average, they held about 20 percent of total assets of insured commercial banks.

As stated above and detailed in the section on the program to strengthen the supervision of banks and bank holding companies, the Board has increased the frequency of examinations and inspections of state member banks and bank holding companies. In general, banking organizations for which the Federal Reserve is primary supervisor will be examined or inspected at least annually. In 1985, System examiners conducted 744 examinations, many jointly or concurrently with examiners from state regulatory agencies.

Bank Holding Companies

During 1985, the number of bank holding companies increased by 307 to a total of 6,453. These organizations control commercial banks that hold about 92 percent of the total assets of insured commercial banks in the United States.

Most large bank holding companies, as well as small companies with significant nonbank assets, will be inspected annually under the new inspection policy. Others are inspected at least every three years or in the case of the smallest companies that do not have nonbank assets, on a sample basis. The inspection focuses on the operations of the parent holding company and its non-bank subsidiaries; the subsidiary banks are examined by the appropriate federal banking regulatory agency. During 1985, System examiners conducted 1,779 inspections of bank holding companies.

Enforcement Actions and Civil Money Penalties

Under the Financial Institutions Supervisory Act of 1966, the Board of Governors has the authority to enter into written agreements with, or issue cease-and-desist orders against, state member banks, bank holding companies, and persons associated with such organizations that engage in unsafe or unsound practices or that violate applicable laws or regulations. The Board may also assess civil money penalties for violations of a cease-and-desist order, of the Bank Holding Company Act, or of certain provisions of the Federal Reserve Act.

In 1985, the Reserve Banks recommended and the Board's staff initiated and worked on 261 enforcement actions, most dealing with unsafe or unsound banking practices; 144 were completed by year-end. Also, the Board assessed or collected 15 civil money penalties, which totaled $96,000; 1 was paid by a company and 14 by individuals.

The Board made available to the public a description of all formal supervisory actions during the year and the reasons for them. This step was taken to achieve the fullest public disclosure of information consistent with confidentiality.

International Activities

The Federal Reserve oversees several international banking activities.

Edge and agreement corporations. Edge corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international trade, exports in particular. An agreement corporation is a company that enters into an agreements with the Board not to exercise any power that is impermissible for an Edge corporation. During 1985 the Federal Reserve conducted examinations of 136 Edge and agreement corporations and their branches.

Foreign office operations of U.S.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

banking organizations. Examinations of the international operations of state member banks, Edge corporations, and bank holding companies are conducted principally at the banking organizations' head offices in the United States, where the ultimate responsibility for foreign offices lies. To verify and supplement the results of the head-office examinations, on-site reviews of important foreign offices are performed at least every three years. In 1985 the Federal Reserve examined 11 foreign branches of state member banks and 16 foreign subsidiaries of Edge corporations and bank holding companies. All the examinations abroad were coordinated with the foreign supervisory authorities of the countries in which the examinations took place.

U.S. activities of foreign banks. Foreign banks continue to expand their operations in the United States and are significant participants in the U.S. banking system. As of December 31, 1985, 255 foreign banks operated 420 state-licensed branches and agencies, of which 48 are insured by the Federal Deposit Insurance Corporation, and 82 branches and agencies licensed by the Office of the Comptroller of the Currency, of which 3 have FDIC insurance. Foreign banks also directly owned 22 Edge corporations and 10 commercial lending companies. In addition, foreign banks held a majority interest in 71 U.S. commercial banks. Together, these foreign banks controlled approximately 17 percent of U.S. banking assets as of June 30, 1985.

The Federal Reserve has broad residual and oversight authority for the supervision and regulation of foreign banks that engage in banking in the United States through branches, agencies, commercial lending companies, Edge corporations, or banks. In exercising this authority, the Federal Reserve relies on examinations conducted by the appropriate regulatory agency, whether on the federal or state level. Although the states have primary authority for examining state-licensed, uninsured branches and agencies, the Federal Reserve participated in the examination of 101 such offices during the past year.

During 1985 several new reporting requirements for branches and agencies of foreign banks were developed, including a revised quarterly call report that will collect data on past-due and nonaccrual loans. Another new report will require branches and agencies to report quarterly on exposure to their home country—percentage of bank loans to their home country relative to bank capital—and the next five largest exposures to foreign countries.

Specialized Examinations

The Federal Reserve conducts specialized examinations in the following areas of bank activity.

Electronic Data Processing

Under the Interagency EDP Examination Program, the Federal Reserve examines the electronic data processing (EDP) activities of state member banks, Edge and agreement corporations, and independent centers that provide EDP services to these institutions. During the year, System examiners conducted 311 on-site EDP reviews. In addition, the Federal Reserve reviews EDP examination reports issued by other bank regulatory agencies on organizations that provide data processing services to state member banks.

Trust Activities

The Federal Reserve examines trust departments of state members banks,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

trust companies that are members of the Federal Reserve System, and certain foreign and domestic trust company subsidiaries of bank holding companies. These examinations review the trust functions to ensure that they are conducted in accordance with law, regulations, and applicable fiduciary principles. During the year, the Federal Reserve conducted 279 such examinations.

Municipal Securities Dealers and Clearing Agents
Under the Securities Act Amendments of 1975, the Board is responsible for supervising state member banks and bank holding companies that act as municipal securities dealers or as clearing agencies. In 1985 the Board examined 30 of the 51 state member banks registered with the Board that deal in municipal securities for their trading accounts.

A clearing agency acts as a custodian of securities for the settlement of security transactions by bookkeeping entries. The four agencies registered with the Board were examined in 1985.

Transfer Agents
System examiners conduct separate reviews of state member banks and bank holding companies that act as transfer agents. Transfer agents countersign and monitor the issuance of securities, register the transfer of securities, and exchange or convert securities. During 1985 the Board examined 102 such banks and bank holding companies.

Surveillance and Monitoring Program

In line with the overall supervisory objective of maintaining a safe and sound banking system, the Federal Reserve monitors the financial condition of member banks quarterly and that of bank holding companies semiannually. This program supplements the examination process through computerized screening systems that trigger financial analyses of institutions judged to have poor or deteriorating financial profiles. It further aids in the allocation of the System's examination resources by focusing on banking institutions that have serious financial problems and that may be subject to accelerated examinations or warrant closer supervision. During 1985 the System strengthened its surveillance program by adopting a new computer screening program and implementing the electronic transmission of surveillance results between the Reserve Banks and the Federal Reserve Board.

The Board adopted changes to the reporting requirements for large bank holding companies and a new report form for smaller bank holding companies. These changes enhanced the system for evaluating the financial condition of these institutions by expanding coverage to all bank holding companies and by increasing the frequency of monitoring smaller organizations to twice a year. Under way is the development of a new surveillance screening system and a new performance report for small bank holding companies.

Staff Training

System staff training emphasizes analytical and supervisory themes common to the four areas of supervision and regulation—examinations, inspections, applications, and surveillance—and stresses the interdependence among these areas. During 1985 the Federal Reserve conducted nineteen schools, ten of which offered core banking courses—three introductory, four intermediate, and three advanced.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Other programs included two schools dealing with credit analysis, two with bank holding company applications, three with consumer compliance examinations (two introductory and one advanced), and one seminar for senior examiners on early detection and prevention of criminal activity. A workshop on the use of microcomputers in supervisory work was conducted as well. In addition to the two sessions of the credit analysis school held in Washington, regional sessions were conducted at two Reserve Banks.

Courses in specialized areas, including lending on income property, trust activities, international banking, electronic data processing, payment system risks, activities of municipal securities dealers, management, conducting meetings with management, and instructor training, were conducted by the Federal Financial Institutions Examination Council.[2] In addition, staff attended two schools conducted by the Federal Bureau of Investigation on white-collar crime and bank failures.

In 1985 the Federal Reserve trained 590 persons, including 36 from state banking departments and foreign central banks, and trained 373 persons in FFIEC schools.

Federal Financial Institutions Examination Council

During 1985 the Federal Financial Institutions Examination Council made several policy recommendations to its constituent agencies, which were then adopted by the Federal Reserve. As discussed in greater detail below, the council formulated policy statements on repurchase agreements of depository institutions with securities dealers and others and on securities lending. In adopting these policies, the Federal Reserve said it did so to assure that financial institutions sufficiently collateralize their exposure and that their collateral is secure.

The council also approved new and revised reporting requirements. The report "Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks" was revised to make it comparable to the report filed by U.S. banks. The "Country Exposure Report for U.S. Agencies and Branches of Foreign Banks" was introduced and is to be implemented early in 1986, and revisions were made to the "Country Exposure Report" filed by U.S. banks.

During 1985 the Federal Reserve tested and then adopted the uniform "Commercial Bank Report of Examination." The report had been approved by the council in 1984 for use by the three federal bank regulatory agencies.

Program to Strengthen Supervision of Banks and Bank Holding Companies

During 1985 the Federal Reserve initiated a program to strengthen its overall supervision of state member banks and bank holding companies. The program includes greater frequency in examinations and inspections; enhanced communications with boards of directors; increased surveillance and monitoring through the use of expanded reporting requirements; and guidelines on capital adequacy, cash dividends, and large-dollar transfers. The Re-

2. The Federal Financial Institutions Examination Council consists of representatives of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

serve Banks are expected to add to their examination and supervision staffs to carry out this program.

Examinations and Inspections
To aid in the early identification of problems in banking organizations, the Board in October 1985 announced an increase in the frequency of examinations of state member banks and inspections of all but certain relatively small bank holding companies. The policy requires that, in general, banking organizations for which the Federal Reserve is the primary supervisor are to be examined or inspected at least annually; the largest of such organizations and those with significant problems are to be examined or inspected semiannually. The Federal Reserve will place greater reliance on state banking agencies for the examination of smaller, healthy organizations, to the extent the states are willing to assume these responsibilities and have the resources to take them on. The greater frequency of examinations is intended to help prevent the development or intensification of problems at banking organizations.

Communication with Directors
The Federal Reserve has had a longstanding practice of communicating examination or inspection findings regarding organizations with significant problems to the bank management and boards of directors of those organizations. As part of its intensified supervisory initiatives announced in October, the Board approved the formalization and intensification of such communications. The new policy requires Reserve Bank officials to meet with the management and directors of organizations with significant problems and to provide each member of the board of directors with a summary report of examination findings. Directors must sign the report as evidence that they have read it.

Senior Reserve Bank officials are to become more involved in communicating and presenting adverse findings to the boards of directors. The policy is intended to give each director of a state member bank or bank holding company considered to be a "problem" a clear understanding of their organization's weaknesses and the responsibilities of its board of directors to correct them. The summary report will specifically emphasize matters requiring the attention of the board of directors and its obligation to ensure that corrective actions are taken to address all the deficiencies noted.

Other Supervisory Guidelines

Also in 1985 the Board put in place several additional supervisory guidelines to improve the safety and soundness of banking organizations.

Supervisory Reporting Requirements

During 1985 the Federal Reserve approved major revisions to the supervisory reporting requirements for bank holding companies. Over the past year, the Federal Reserve has made considerable efforts to strengthen procedures for monitoring risk-taking between on-site examinations and for identifying supervisory problems at an earlier stage. An important aspect of these efforts has been the development of proposals to revise the supervisory reports filed by bank holding companies with the Federal Reserve.

Bank holding companies with total consolidated assets of $150 million or more (large bank holding companies) will report quarterly standardized consolidated and parent-company-only fi-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

nancial statements. Multibank holding companies, regardless of size, will be required to submit consolidated and parent-company-only financial statements. Beginning in June 1986, the consolidated and parent-only financial statements will be submitted on the "Consolidated Financial Statements for Bank Holding Companies with Total Consolidated Assets of $150 Million or More, or with More Than One Subsidiary Bank" (FR Y-9C) and on the "Parent-Company-Only Financial Statements for Bank Holding Companies with Total Consolidated Assets of $150 Million or More, or with More Than One Subsidiary Bank" (FR Y-9LP).

Beginning in June 1986, one-bank holding companies with total consolidated assets of less than $150 million will submit semiannual financial statements in a standard format on the report "Parent-Company-Only Financial Statements for Bank Holding Companies with Total Consolidated Assets of Less Than $150 Million" (FR Y-9SP).

The "Annual Report of Domestic Bank Holding Companies" (FR Y-6) was divided into separate reports: (1) "Annual Report of Bank Holding Companies" (FR Y-6), implemented in December 1985; (2) "Bank Holding Company Report of Changes in Investments Activities" (FR Y-6A), to be implemented in June 1986; and (3) "Annual Report of Selected Financial Data for Nonbank Subsidiaries of Bank Holding Companies" (FR Y-11I), implemented in December 1985. These divisions in the current annual report were made to simplify and reduce the burden of the reporting now required because only changes in bank holding company investments or activities will be reported instead of all investments.

The new combined nonbank financial statements (FR Y-11Q) will be collected quarterly from all bank holding companies with total consolidated assets of $1 billion or more and from bank holding companies with total consolidated assets of at least $150 million but less than $1 billion that have significant nonbank subsidiary activities. An annual supplement (FR Y-11AS), which requires the reporting of nonbank financial information by the primary type of business activity of the nonbank subsidiary, will also be collected from these bank holding companies, beginning in December 1986.

Revisions to Capital Adequacy Guidelines

In April 1985 the Federal Reserve revised its capital adequacy guidelines for state member banks and bank holding companies, guidelines that were originally adopted in 1981. The principal revisions raise the minimum capital levels for multinational and regional banking organizations and eliminate the disparity in minimum capital requirements between larger and smaller institutions. In particular, the revised guidelines establish a uniform minimum primary capital ratio of 5.5 percent and a minimum total capital ratio of 6 percent for all state member banks and bank holding companies, regardless of size. These revisions parallel actions taken by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, thereby establishing uniform minimum capital ratios for all federally supervised banking organizations.

Banking organizations are generally expected to maintain at least the minimum capital ratios. However, institu-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tions with excessive amounts of on- or off-balance-sheet risks are expected to support their activities with capital that substantially exceeds the minimum requirements. To enforce these expectations, the Board adopted a regulation under which it may require a banking organization to maintain minimum or higher capital levels as defined by the revised guidelines.

The Board has also considered a proposal that relates primary capital more closely to the on- or off-balance-sheet risk profiles of banking organizations. This risk-based measure would aid in setting above-minimum capital ratios for high-risk banks.

Policy on Cash Dividends

As part of its ongoing program to improve the capital adequacy of banking organizations, the Federal Reserve Board in November 1985 issued a policy statement on the payment of cash dividends by state member banks and bank holding companies. The statement addresses the payment of dividends that are not covered by earnings, that are funded by borrowings, or that come from unusual or nonrecurring gains such as the sale of property or other assets.

The statement expresses the Federal Reserve's view that an organization with weak earnings or under other financial pressures should not pay cash dividends that exceed its net income, that are inconsistent with the organization's capital position, or that can be funded only in ways that may weaken the organization's financial health. In some instances involving extreme financial pressures or constraints upon subsidiaries, a banking organization should give serious consideration to reducing or eliminating dividends to conserve its capital base and improve its financial condition.

Policy on Repurchase Agreement Transactions

Events in 1985 demonstrated the importance to financial institutions of monitoring the value of, and exercising appropriate control over, collateral involved in repurchase transactions. For this reason, the Federal Reserve adopted a policy statement on repurchase transactions recommended by the Federal Financial Institutions Examination Council. The statement provides financial institutions with guidelines for prudently managing credit risk exposure and provides guidance on the possession or control of securities involved in repurchase agreements. In addition, the policy points out the need for full collateralization, maintenance of agreed collateral margins, and frequent mark-to-market procedures (changing the valuations of securities as their market value changes).

Depository institutions doing business with unregulated government securities dealers are urged to verify compliance by these dealers with the minimum capital guidelines of the Federal Reserve Bank of New York. Depository institutions are advised to consult their counsel about state law governing control of securities and custodial agreements, and to ask their District Federal Reserve Banks about the procedures for obtaining control of repurchase agreement securities through the Federal Reserve's book-entry system.

Policy on Securities Lending

In May 1985 the Board adopted a supervisory policy on securities lending to guide financial institutions engaging in securities lending activities. The policy, also recommended by the Federal Financial Institutions Examina-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tion Council, covers the securities lending of a bank or trust company for its own account, as well as the lending of customers' securities held in custody or trust accounts. Matters addressed included the need for full collateralization and daily mark-to-market procedures, formal approvals and credit analyses in selecting borrowers, written agreements with borrowing and lending customers, and written internal safeguards and review procedures. Also provided are guidelines for recordkeeping and regulatory reporting.

Policy on Reducing Risks on Large-Dollar Electronic Fund Transfer Systems

Over the past several years the Board has become increasingly concerned about the risks that participation in large-dollar payment networks present to depository institutions, the banking system, and other sectors of the economy. Because private wire networks transmit payment messages throughout the day, with settlement of net positions at the close of business, the network faces the possibility that a participant will be unwilling or unable to settle a large net debit position. A failure to settle by one participant could seriously jeopardize the financial positions of its net creditors on that network, with serious repercussions for other depository institutions and their customers. Failures of depository institutions while in net debit on Fedwire during the day would result in a loss to the Federal Reserve.

In May 1985 the Board issued a policy statement to control and reduce the risks to depository institutions participating in large-dollar wire transfer systems—both on private systems and on Fedwire. In part the policy relies on the efforts of depository institutions to reduce their own exposures through the use of bilateral net credit limits on private wire systems and the use of sender net debit caps—a ceiling on the value of all "sends" in excess of the value of all "receives" in a given interval—across all wire systems; the policy also relies on examination, monitoring, and counseling by the Federal Reserve and other supervisors of financial institutions.

Effective March 27, 1986, no private large-dollar payment network will be eligible for Federal Reserve net settlement services unless it (1) requires each participant to establish bilateral net credit limits with each other participant on that network, (2) establishes a sender net debit cap that is reasonably designed to reduce risks to participants in that network, (3) rejects or holds any payment that would breach bilateral net credit limits or the network's sender net debit cap, and (4) agrees to provide transaction data to its Reserve Bank on request.

The policy statement also strongly encourages each institution that incurs daylight overdrafts on Fedwire or that participates on a private large-dollar wire network to adopt voluntarily a sender net debit cap across all wire systems. Examiners will review caps to see whether they are consistent with the established guidelines. Adherence to these caps will be monitored and institutions with overdrafts in excess of their caps will be counseled.

Under the policy, the Board's regulatory options are (1) to contact an institution whose level of aggregate daylight credit exposure is deemed by the institution's examiner to be unsafe or unsound, (2) to eliminate access to daylight overdrafts on Fedwire by institutions not engaging in the self-evaluation process, and (3) to control Fedwire overdrafts of an individual in-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

stitution that are determined by a Reserve Bank to expose that institution to excessive risk. If events demonstrate that the senior management and the boards of directors of depository institutions are not taking seriously the proposed guidelines and procedures, the Board will consider other options, including the imposition of explicit limits on daylight credit exposure.

Regulation of the U.S. Banking Structure

The Board of Governors administers the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act for state member banks and bank holding companies. In doing so, the Federal Reserve acts on a variety of proposals that directly or indirectly affect U.S. banking structure at the local, regional, and national levels. The Board also has primary responsibility for regulating the international operations of domestic banking organizations and the U.S. operations of foreign banks that engage in banking in the United States, either directly through a branch or agency or indirectly through a subsidiary commercial lending company. In addition, the Board has established regulations for the interstate banking activities of these foreign banks and for foreign banks that control a U.S. subsidiary commercial bank.

Bank Holding Company Act

By law, a company must obtain the Board's approval to form a bank holding company through securing control of one or more banks. Moreover, once formed, a bank holding company must receive the Board's approval before acquiring additional banks or nonbanking companies.

In reviewing an application filed by a bank holding company, the Board considers the convenience and needs of the community, the applicant's financial and managerial resources, the prospects of both the applicant and the

Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1985

Proposal	Direct action by the Board of Governors		Action under delegated authority					Total
			Director of the Division of Banking Supervision and Regulation		Office of the Secretary	Federal Reserve Banks		
	Approved	Denied	Approved	Denied	Approved	Approved	Permitted	
Formation of holding company	61	7	...	...	4	583	...	655
Merger of holding company	18	...	...	...	5	29	...	52
Retention of bank	...	...	...	...	...	...	...	...
Acquisition								
Bank	81	13	...	...	37	360	...	491
Nonbank	115	3	...	...	13	141	305	577
Acquisition of bank service corporation[1]	...	...	...	...	...	2	1	3
Other	2	1	3	...	...	4	...	10
Total	**277**	**24**	**3**	**...**	**59**	**1,119**	**306**	**1,788**

1. Approved under the Bank Service Corporation Act, which contains standards patterned after those of the Bank Holding Company Act.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

firm to be acquired, and the competitive effects of the proposal.

In 1985 the Board—and, under delegated authority, the Federal Reserve Banks, the Director of the Board's Division of Banking Supervision and Regulation, and the Board's Office of the Secretary—acted on 1,788 bank holding company applications. The System approved 648 proposals to organize holding companies and denied 7, approved 478 bank acquisitions by existing bank holding companies and denied 13, and approved 574 requests to acquire nonbank companies that are closely related to banking and denied 3. Data on holding company decisions are shown in the accompanying table.

Bank Merger Act

The Bank Merger Act requires that all proposed bank mergers receive the prior approval of the appropriate federal bank regulatory agency. If the bank surviving the merger is a state member bank, the Federal Reserve has primary jurisdiction. Before approving a bank merger, the Federal Reserve considers the community's convenience and needs, the financial and managerial resources and prospects of the existing and proposed institutions, and the competitive effects of the proposal. The Board must also consider the views of certain other agencies on the competitive factors involved in the transaction.

During 1985 the Federal Reserve approved 77 merger applications: 5 were approved by the Board, 4 by the Secretary of the Board under delegated authority, and 68 by the Reserve Banks under delegated authority. One application was denied. As required by law, each merger is described in table 19 in the Statistical Tables section of this REPORT.

When the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC) has jurisdiction over a merger, the Board is asked to comment on the competitive factors to assure comparable enforcement of the antimonopoly provisions of the act. On behalf of the Board, the Reserve Banks submitted 627 reports on competitive factors to the OCC and the FDIC in 1985. The Board and those agencies have adopted standard terminology for assessing competitive factors in bank merger cases to assure consistency in administering the Bank Merger Act.

Change in Bank Control Act

The Change in Bank Control Act of 1978 gave the federal banking agencies the authority to disapprove changes in the control of banks and bank holding companies. The Federal Reserve is the agency responsible for changes in the control of state member banks and of bank holding companies. Factors to be considered in determining whether a transfer of control should be disapproved include the financial condition, competence, experience, and integrity of the acquiring person, and the effect on competition. In 1985, 188 changes in ownership of the stock of state member banks and holding companies were reported; 16 were processed by the Board and 172 by the Reserve Banks. There was one disapproval.

International Activities of U.S. Banking Organizations

The Board has four principal statutory responsibilities in supervising the international operations of U.S. banking organizations: to approve the establishment of foreign branches of member banks and regulate the scope of their activities; to charter and regulate

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Edge corporations and their investments; to authorize and regulate overseas investments by member banks, Edge corporations, and bank holding companies; and to authorize and regulate investments by bank holding companies in export trading companies.

In September 1985 the Board revised its Regulation K, which governs the international activities of U.S. banking operations. The revision was made under the directive in the International Banking Act of 1978 that the Board review and revise its regulations regarding the international operations of U.S. banks every five years. The most significant changes allowed Edge corporations to provide full banking services to a limited class of customers that are restricted by their charters or licenses to international business; required any party purchasing 25 percent or more of the voting shares of an Edge corporation to give the Board 60 days notice before the acquisition; and increased the limitation on general consent investments from $2 million to $15 million.

Foreign Branches of Member Banks

Under provisions of the Federal Reserve Act and Regulation K, member banks may establish branches in foreign countries subject, in most cases, to the Board's review. In reviewing proposed foreign branches, the Board considers the requirements of the governing statute, the condition of the bank, and the bank's experience in international business. In 1985 the Board approved the opening of 15 foreign branches.

By the end of 1985, 163 member banks were operating 967 branches in foreign countries and overseas areas of the United States. One hundred thirty-two national banks were operating 834 of these branches, while 31 state member banks were operating the remaining 133 branches.

International Banking Facilities

The Board amended its Regulations D and Q to permit the establishment of international banking facilities (IBFs) in the United States as of December 3, 1981. An IBF is essentially a set of asset and liability accounts that is segregated from other accounts of the establishing office. In general, deposits from and credit extended to foreign residents or other IBFs can be booked at these facilities free from domestic reserve requirements and interest rate limitations. Subject to conditions specified by the Board, IBFs may be established by U.S. depository institutions, by Edge and agreement corporations, and by U.S. branches and agencies of foreign banks. By the end of 1985, 540 IBFs had been established.

Edge and Agreement Corporations

Under sections 25 and 25(a) of the Federal Reserve Act, Edge and agreement corporations may engage in international banking and foreign financial transactions. These corporations, which are usually subsidiaries of member banks, provide their owner organizations with additional powers in two areas: (1) they may conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions; and (2) they have broader powers to make foreign investments than member banks do because they can invest in foreign financial organizations, such as finance companies and leasing companies, as well as in foreign banks. By the end of 1985 there were 140 Edge corporations, which had 124 branches. The Board requires each Edge corporation

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

that is engaged in banking to maintain a ratio of equity to risk assets of at least 7 percent. At midyear, two-thirds of the banking corporations had ratios that were more than twice this minimum.

Foreign Investments
Under authority of the Federal Reserve Act and the Bank Holding Company Act, in 1985 the Board authorized 83 foreign investments by member banks, Edge and agreement corporations, and bank holding companies. In most cases, the applicant requested permission to increase an existing investment.

Export Trading Companies
In 1982 the Bank Export Services Act amended section 4 of the Bank Holding Company Act to permit bank holding companies, their subsidiary Edge or agreement corporations, and bankers' banks to invest in export trading companies, subject to certain limitations and after Board review. The purpose was to allow effective participation by bank holding companies in the financing and development of export trading companies. On June 2, 1983, the Board adopted regulations to achieve the objectives set forth in the law: to facilitate the export of goods and services produced in the United States and to minimize potential adverse effects on the subsidiary banks of the bank holding companies involved. In 1985 the Board acted affirmatively on the 7 notifications received for the establishment of export trading companies. At year-end, 35 bank holding companies had investments in export trading companies.

Delegation of Applications

In exercising its responsibility to formulate policies and procedures in the applications area, the Board has delegated certain regulatory functions—including the authority to approve, but not the authority to deny, certain types of applications—to the Reserve Banks, and to the Director of the Board's Division of Banking Supervision and Regulation and the Secretary of the Board.

The delegation of responsibility for applications permits a more efficient use of staff resources at both the Board and the Reserve Banks by removing routine cases from the Board's agenda. During 1985, 85 percent of the applications were acted upon under delegated authority. This proportion was similar to that for 1984 but still somewhat smaller than that for earlier years, reflecting the continuing complexity of applications.

Timely Processing of Applications

On January 1, 1984, the System implemented revised procedures and schedules for applications, which reduced internal processing targets by one-third. The processing time was shortened from 90 days to 60 days for applications decided by the Board and from 45 days to 30 days for applications handled under delegated authority. These changes served to reduce the burden on applicants and to make more efficient use of the staff at the Board and the Reserve Banks. In addition, the number of nonbanking proposals declined 25 percent during 1985, largely as a result of the elimination of filing requirements for many de novo notifications. This decline followed one of 24 percent in 1984. Of the applications in 1985, the System acted on 96 percent within the time allowed for processing.

In 1985, 74 of the 78 applications for bank mergers were processed

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

within 60 days. The System also prepared 627 reports on the competitive factors of proposed mergers for the other two banking agencies; all but a few were completed within 30 days. Of the 188 change-of-control notices, 161 were handled within 60 days.

The System also measures its performance in processing international applications against a 60-day standard. During 1985, 93 percent of the 165 international applications on which the Federal Reserve acted were handled within the time allowed.

Board Policy Decisions and Developments in Bank-Related Activities

During 1985 the Board for the first time approved the following activities for individual bank holding companies: tax preparation services performed in a nonfiduciary capacity; execution and clearance of futures contracts on stock indexes and of options on the futures contracts; authorization services on credit cards and reporting services for lost or stolen credit cards; consulting activities on employee benefits; expanded servicing of student loans; and the issuance and sale of official checks with no limitation on the maximum face amount, subject to certain limitations. The Board denied an application by a bank holding company to act as specialist in foreign currency options traded on a securities exchange.

At year-end the Board also had under consideration applications to engage in the following new nonbank activities: underwriting and dealing in certain securities, subject to limitations; acting as issuer's agent in the placement of commercial paper; acting as advisor in the placement of municipal debt securities; and offering investment advice in connection with securities brokerage activities.

In addition, during 1985 the Board published for comment a proposal to allow bank holding companies to invest directly in real estate to a limited extent. Among the issues presented was the riskiness of the activity and the role of such investments in the crises of certain thrift institutions in Ohio and Maryland.

The Federal Reserve approved during 1985 several applications by out-of-state banking organizations to acquire financially distressed, uninsured thrift institutions that had lost capital and the confidence of depositors. These acquisitions helped restore financial stability to the affected communities and provided depositors with better access to their funds. Because of the significant public interest involved, the Board approved the acquisitions despite its general prohibition on affiliations between bank holding companies and thrift institutions.

In other matters, the Board upheld several interstate bank holding company applications based on state laws that permit interstate banking on a regional basis. The U.S. Supreme Court upheld the constitutionality of such laws. The Court also agreed with the Board that these laws satisfied the requirements of the Douglas amendment. The Board approved subsequent proposals for interstate acquisitions by holding companies in New England and in the Southeast and Midwest.

A federal court ruled that nonbank banks are not permitted to be acquired by out-of-state banking institutions because the resulting organizations constitute an interstate banking presence in violation of the Bank Holding Company Act. The Supreme Court vacated and remanded the decision in January 1986 following its ruling that nonbank banks are not "banks" for purposes of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the Bank Holding Company Act. After another federal court enjoined the Comptroller of the Currency from chartering nonbank banks, the Board suspended the processing of applications by bank holding companies to acquire de novo nationally chartered nonbank banks. Before these court rulings, the Board had reluctantly approved several nonbank bank proposals after they received chartering approval and after a congressionally imposed moratorium had expired.

The Board turned down a request by a banking organization to conduct insurance activities in a large geographic area through a bank subsidiary. The bank's chartering authority had approved the proposal for implementation outside the bank's home state, but this activity would have represented a circumvention of the Bank Holding Company Act. Proposals by applicants to engage in similar activities within their home states were approved.

Public Notice of Board Decisions

Each action by the Board that involves a bank holding company, bank merger, change in control, or international banking proposal is effected by an order or announcement. Orders state the decision along with the essential facts of the application and the basis for the decision. Announcements state only the decision. All orders and announcements are released immediately to the public and are reported in the Board's weekly H.2 statistical release, "Actions of the Board; Applications and Reports," and in the monthly *Federal Reserve Bulletin*. Actions taken by the Reserve Banks are also reported in the H.2 statistical release and in the *Bulletin*. Announcements of applications and notices received by the System but not yet acted on are also made in the H.2 release.

Enforcement of Other Laws and Regulations

The preceding sections have discussed the Board's activities in carrying out its statutory responsibilities for the supervision of bank safety and soundness and the regulation of banking structure. This section describes the enforcement of other laws, rules, and regulations.

Compliance with the Bank Secrecy Act

Through the examination process, the Federal Reserve monitors whether the institutions it supervises are complying with the Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act). To deter unlawful activities, the act, among other things, requires financial institutions and couriers to report to the Internal Revenue Service cash transactions and shipments of more than $10,000.

In order to strengthen its monitoring under the act, the Board in 1985 supplemented examination procedures and emphasized the importance of the act in its training courses. In addition, the Board staff participated in an interagency task force intended to improve compliance with the act.

Securities Regulation

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchase or carrying of securities. In fulfilling its responsibility under the act, the Board limits the amount of credit that may be provided by securities brokers and dealers (Regulation T), by banks

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(Regulation U), and by other lenders (Regulation G). Regulation X extends these credit limitations, or margin requirements, to certain borrowers and certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

The Securities and Exchange Commission, the National Association of Securities Dealers, and the national securities exchanges examine brokers and dealers for compliance with Regulation T. The three bank supervisory agencies examine banks for compliance with Regulation U, with the Board being responsible for state member banks that extend margin credit secured by margin stock.

The Board, the National Credit Union Administration, the Farm Credit Administration, and the Federal Home Loan Bank Board examine other lenders under their respective jurisdictions for compliance with Regulation G. At the end of 1985 there were 537 such lenders, of which 291 were subject to the Board's supervision. Of these 291, 184 are subject to regular inspection by the Federal Reserve System. During the year Federal Reserve examiners inspected 64 G-lenders for compliance with the Federal Reserve's margin requirements (these lenders are inspected on either a biennial or triennial basis, according to the type of credit extended).

Regulations U and G, in general, impose credit limitations on banks and other lenders on loans whose purpose is purchasing or carrying publicly held equity securities and that are secured by such securities.

Regulation T limits the amount of credit that brokers and dealers may extend when securities serve as collateral for credit that is used to purchase or carry securities. This collateral must consist of stocks and bonds traded on national securities exchanges, of certain over-the-counter (OTC) stocks that the Board designates as having characteristics similar to those of stocks listed on national exchanges, or of bonds meeting certain requirements.

The Board published revised lists of over-the-counter stocks subject to its margin regulations on February 12, May 14, August 13, and November 12, 1985. The current "List of Marginable OTC Stocks" consists of 2,520 stocks. The Board's Division of Banking Supervision and Regulation monitors the market activity of all over-the-counter stocks to determine what stocks to place on this list. In 1986 the Board will publish the list in the same months.

In 1985 the Board amended Regulation G to permit extensions of credit to trusts for employee stock ownership plans (ESOPs). The amendment allows savings and loan associations, insurance companies, and finance companies to extend credit on margin stock on the same basis as banks. At the same time the Board amended Regulation T to permit broker–dealers to extend and arrange credit for ESOPs. Regulation T was also amended to permit a uniform, premium-based system of margin requirements for all types of option contracts. The system will incorporate the maintenance margin required by the national securities exchanges or associations under rules approved by the Securities and Exchange Commission.

The Board also adopted technical amendments to Regulations G and U to exclude face-amount certificates from the definition of margin security. A face-amount certificate is a security, issued by an investment company registered under the Investment Company Act of 1940, that promises to pay an

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

investor a fixed sum of money at a fixed future date in return for a designated payment. As permitted by the Investment Company Act, face-amount certificates have built-in credit features. In addition, the Board amended Regulation T to allow broker–dealers to sell these instruments without being considered in violation of the margin regulations.

Under section 8 of the Securities Exchange Act, a broker or dealer may not borrow from a bank on the collateral of registered securities unless the bank is either a member of the Federal Reserve System or has filed an agreement with the Board undertaking to comply with all the statutes, rules, and regulations applicable to member banks with respect to credit on securities. Domestic and foreign nonmember banks must file these agreements, designated T-1 and T-2 respectively, before they can lend to brokers or dealers on the collateral of registered securities. During the year the Board processed three T-1 and T-2 agreements.

In 1985 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued 51 interpretations of the margin regulations. Those that presented sufficiently important or novel issues were published in the "Securities Credit Transactions Handbook," which is part of the *Federal Reserve Regulatory Service*. These interpretations serve as a guide to the margin regulations.

Financial Disclosure by State Member Banks

The Board's Regulation F deals with the disclosure requirements for state member banks that have securities registered under the Securities Exchange Act of 1934. Thirty-one state member banks, most of which are of small or medium size, were registered with the Board under this regulation. These institutions must file certain materials, such as financial reports and proxy statements, that are of interest to investors. The Board's staff reviews these filings for compliance with the regulation.

The disclosure rules under Regulation F are similar to those issued by the Securities and Exchange Commission.

Loans to Executive Officers

Under section 22(g) of the Federal Reserve Act, each state member bank must include with each quarterly report of condition a report of all extensions of credit made by the bank to its executive officers since the date of the bank's previous report of condition. The accompanying table summarizes these data for the last quarter of 1984 and the first three quarters of 1985.

Applications by State Member Banks

The Board's authority over state member banks covers permission to open new domestic branches, to make investments in bank premises that exceed 100 percent of capital stock, and to add to the capital base from sales of subordinated debt; it also covers the waiver of six months' notice of intention to withdraw from membership in the System. The Federal Reserve employs the application or notification process to administer these statutory provisions.

With few exceptions, these matters are handled under delegated authority by the Federal Reserve Banks or, in the case of proposed sales of subordi-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

State Member Bank Loans to Executive Officers, 1984-85

Period	Loans to executive officers		
	Number	Amount (dollars)	Range of interest rates charged (percent)
October 1-December 31, 1984	1,153	14,500,258	7-23
January 1-March 31, 1985	1,361	16,437,020	6-21
April 1-June 30, 1985	1,322	21,051,810	7-21
July 1-September 30, 1985	1,284	19,211,668	7-22

nated debt, by the Director of the Board's Division of Banking Supervision and Regulation.

Stock Repurchases by Bank Holding Companies

A bank holding company sometimes purchases its own shares from its shareholders. Often such stock repurchases are financed through borrowings, so that the net effect of the transaction is to increase the debt of the bank holding company at the very time that its equity decreases. Because relatively large repurchases may adversely affect the financial condition of a bank holding company and its bank subsidiary, the Board, by regulation, requires holding companies to give advance notice of repurchases that retire 10 percent or more of their consolidated equity capital. The Board may object to stock repurchases if the holding company that files the notice fails to meet the standards that the Board applies in the applications process, including the Board's capital guidelines.

The Federal Reserve reviewed 119 such notifications during 1985, all but 6 of which were acted on by the Reserve Banks on the Board's behalf.

Federal Reserve Membership

At the end of 1985, 6,050 banks were members of the Federal Reserve System, a net increase of 68 from the previous year. Member banks operated 27,595 branches on December 31, 1985, a net increase of 1,557 for the year.

Members banks accounted for 40 percent of all commercial banks in the United States, and for 60 percent of commercial banking offices.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Regulatory Simplification

The Board of Governors established the Regulatory Improvement Project to minimize the burdens imposed by regulation; to ensure that consideration is given to minimizing the economic impact of regulation on small business; to see that interested parties have the opportunity to participate in the design of proposed regulations and to comment on them; and to ensure that regulations are written in simple language. In addition to monitoring the creation of new regulations, the program periodically reviews all existing regulations for adherence to these objectives.

To improve its regulatory process and increase the effectiveness of the Regulatory Improvement Program, the Board took preliminary steps this year toward establishing a regulatory policy and planning committee. Chaired by a member of the Board and comprising senior staff, the committee is to determine priorities and schedule and coordinate regulatory actions.

Periodic Review

The following section reports actions resulting from the periodic review of existing regulations under the Regulatory Improvement Program.

International Banking Operations

In 1985 the Board revised its regulation governing the international operations of U.S. banking organizations (Regulation K). Because of a statutory requirement, the review had been undertaken to determine whether changes were desirable to ensure or improve the competitive position of Edge corporations. Four alternative proposals had been offered in 1984 for expanding the ability of an Edge corporation to provide a broad range of services in the United States. In 1985 the Board adopted an alternative that will allow Edge corporations to provide full banking services to a limited class of companies, such as foreign airlines and shipping companies, whose charters or licenses restrict them to international business. The revised regulation also increases the lending limit of Edge corporations and relaxes the limits on their investments in foreign companies. The language of the revised regulation has been simplified and its organization improved.

Equal Credit Opportunity

In 1983 the Board announced that it intended to review its regulation implementing the Equal Credit Opportunity Act (Regulation B), and in 1985 it proposed and adopted a revised Regulation B. The Board's review considered ways to simplify the regulation so as to ease the burdens imposed on creditors and to carry out more effectively the purposes of the Equal Credit Opportunity Act. To improve the data for monitoring compliance, the revised regulation requires that applications be in writing for loans secured by an applicant's principal dwelling and that creditors provide the race or national origin and sex of an applicant from visual observation or from surname when the applicant does not provide that information. The revised regulation also sets forth new procedures for dealing with incomplete applications and offers a broader selection of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sample forms for informing applicants of the reasons for denials of credit. Some provisions were rewritten to improve clarity. In addition the Board adopted an official staff commentary on Regulation B, similar to those on other consumer regulations; these commentaries provide regulated entities with official guidance and interpretation on the regulations.

Interest on Deposits

In preparation for the end of the Depository Institutions Deregulation Committee and of the authority for interest rate ceilings on March 31, 1986, the Board in 1985 issued for comment a revised and greatly simplified regulation for interest on deposits (Regulation Q). Most of the existing provisions of Regulation Q have been deleted, including those governing withdrawals and early withdrawal penalties, various account characteristics, all interest rate ceilings, and the $150,000 limit on business savings accounts. The revised regulation continues to prohibit the payment of interest on demand deposits and specifies that any money market deposit account of a business will be considered to be a demand deposit if it permits more than six withdrawals per month.

The review consolidated the regulation on the advertising of interest on deposit accounts with the miscellaneous interpretations, rulings, and policy statements on the subject, simplified them, and rewrote them as one clear and comprehensive section. Public comment was requested on whether to require a bank that advertises interest rates to continue to state rates for simple interest, or to substitute a statement of the annual percentage yield, or to require both. When the final regulation is adopted, current Board rulings, interpretations, and staff opinions in conflict with any amendments would be rescinded, and the remaining interpretations and opinions would be consolidated and keyed to regulatory provisions. The Board deferred the consideration of regulating disclosure of account information pending discussion with other agencies and further study of the issue.

New Regulatory Actions

This section reports on significant final regulatory actions taken by the Board in 1985, and on related proposed actions.

Reserve Requirements

Statutory authority mandating money market deposit accounts (MMDAs) ends on March 31, 1986. In order to ensure that MMDAs continue to be subject to a 3 percent reserve requirement after that date, rather than the 12 percent imposed on transaction accounts, the Board proposed amending its regulation on reserve requirements (Regulation D). The amendment explicitly treats the MMDA as a nonpersonal savings deposit, which will be permitted six withdrawals per month, of which no more than three may be by check, draft, or similar order. In addition, the Board proposed eliminating the current $150,000 limit on business savings accounts to permit consistent treatment of such accounts with MMDAs.

Collection of Checks

To reduce uncertainty about whether certain checks would be honored, the Board amended its regulation on collection of checks (Regulation J) to require payor institutions to provide direct notification to the bank of first deposit when the payor institution plans to return a check of $2,500 or

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

more that has been collected through the Federal Reserve System. Previously, payor institutions were required to notify the immediately preceding endorser, which meant many institutions may have been involved in the chain of notification, with the frequent result that returned checks would arrive before the notice. Direct notification was adopted in part to enable depository institutions to reduce their holding period on check deposits without incurring substantial new risk of losses. The new procedures are expected to reduce the number of required notifications by half and to decrease processing costs for both payor and intermediary institutions. A payor institution will have to provide notice only when it expects the notice to arrive at the bank of first deposit before the check; and the intermediary institutions will no longer be involved in the notification chain. To assist depository institutions in complying with the new requirement, the Federal Reserve enhanced the notification service it provides to payor banks and extended the service to other depository institutions for checks that are collected outside the Federal Reserve System.

Margin Regulations

The Board amended two of its margin regulations (Regulations G and T) to permit broker-dealers and G-lenders to extend credit to trusts for employee stock option plans that are qualified under section 401 of the Internal Revenue Code. The amount of such credit would not be subject to the limitations normally applicable under these regulations. These amendments will permit broker-dealers, savings and loan institutions, and other G-lenders to extend such credit on margin stock on the same basis currently allowed banks under a special exemption in Regulation U. Thus, as employers, all lenders subject to the margin regulations will be treated equally.

The Board also amended Regulation T to change the structure of the initial margin requirements for the writing of options on equity securities and to consolidate many provisions covering different option products into a single rule. The amended regulation provides a uniform premium-based system of margin requirements for all types of option contracts. An initial margin now will be the amount specified by the rules of the national securities exchange or of the association authorized to trade the option if the Securities and Exchange Commission has approved such rules. Previously, the Board specified the actual amount of the initial margin.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Reserve Banks

Developments in the Pricing of Federal Reserve Services and in the Payment Mechanism

In 1985 the Reserve Banks fully recovered their costs of providing priced services, as required by the Monetary Control Act of 1980. The System as a whole recovered 105.6 percent of its operating expenses and imputed costs, compared with 103.9 percent in 1984. Table 10, in the Statistical Tables section of this REPORT, presents revenue and expenses by major category of service for 1985 and 1984.

Total revenue at Reserve Banks from all priced services was $733.0 million and total cost was $699.4 million. These figures include the income and expenses related to clearing balances, the private sector adjustment factor (the taxes and costs of capital the Federal Reserve would incur if it were a private firm), and the value of priced float. With allowance for a temporary support program for the automated clearinghouse service, the Federal Reserve had a net revenue of $38.6 million.

The Federal Reserve made significant strides toward stabilizing the pricing of services in 1985. Except for a midyear lowering of check fees, prices were held constant for the year. The System installed better operating systems for the electronic payment services at many of the Reserve Banks and also improved the process of handling return items—checks not honored by the institution on which they are drawn.

Check Collection

Check operations by Federal Reserve Banks cost the System $526.2 million in 1985. This amount includes the cost of float and of the private sector adjustment factor. The check operations generated $555.8 million in revenue, for a surplus of $29.6 million. The fees implemented in January 1985 were lowered at midyear in an attempt to reduce this surplus. The number of checks processed by Federal Reserve Banks increased 4.8 percent in 1985, to 15.5 billion.

A major goal of Federal Reserve check operations in 1985 was to reduce the risk to depository institutions associated with return items and thereby to allow institutions to make funds available to their depositors sooner. A step toward this goal came in January, when the Board approved an amendment to Regulation J. The amendment, which became effective on October 1, requires an institution that returns a check of $2,500 or more drawn on it and collected through the Federal Reserve to notify promptly the institution at which the check was first deposited.

The System also pursued several other initiatives to speed up the return of unpaid checks. A pilot program undertaken by the Federal Reserve Bank of Dallas, in which checks are returned directly to the institution of first deposit, continued through 1985. The Federal Reserve Bank of St. Louis expanded its return item reclearing pilot in 1985, in which the Reserve Bank presents certain return items to the payor bank a second time rather than returning the items to the bank of first deposit. Another program, which began on November 1, automates the return item process by making it part of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the normal check collection stream.

A pilot project to explore check truncation, in which the necessary information on a check is converted to electronic form, was launched in 1985 in four Districts; the aim is to improve the efficiency of the forward collection process. Plans also call for Reserve Banks to participate in the National Association of Check Safeguarding program in 1986.

As a result of public comments, the Federal Reserve modified its proposed test of a two-tier fee schedule for check prices, which permits closer matching of fees and collection costs within a single check service. The pilot program, initiated in April, is a voluntary option for depositors in the two territories where the pricing concept is being tested.

In January the Board voted to discontinue as of September 1, 1986, the fractional availability option for the recovery of certain types of check float. Fractional availability, which reflects historical, rather than current, collection experience, was eliminated because of its potential for not fully recovering the costs of float.

Several amendments to Regulation J were published for comment in March 1985 including a proposal to permit Reserve Banks to collect checks drawn on payors located in foreign countries. No final action was taken on the amendments in 1985.

Automated Clearinghouse Service

The System's incentive pricing program for automated clearinghouse (ACH) services expired at the end of 1985. The 1985 fee structure was set to recover 80 percent of commercial ACH costs, including the PSAF and certain categories of float. Taking this adjustment into account, total costs for the year amounted to $22.4 million, offset by revenue of $23.1 million. The System processed 280 million commercial transactions during the year, 31.8 percent more than in 1984. In 1985, 10 Districts installed the Federal Reserve's new ACH operating system. This system enables faster, more efficient processing of ACH transactions.

In February the Reserve Banks began automating the ACH return item process by converting the paper return items to electronic form at the Federal Reserve office of first deposit. Concurrent with this change the System instituted the pricing of ACH paper return items.

The Federal Reserve made several changes to its ACH service in 1985 to accommodate increased participation by private-sector processors.

Wire Transfer of Funds and Net Settlement Service

The fund transfers volume grew 8.4 percent in 1985, for a total of 45.1 million transactions. This service and the net settlement service incurred costs of $73.0 million and earned $77.4 million, for a net surplus of $4.3 million.

A new operating system for wire transfers was installed in eight Districts during 1985, thereby improving the Fedwire's efficiency and permitting the Federal Reserve to provide more uniform service. To improve security for electronic payments and for computer-based information services, the Reserve Banks plan to encrypt the communications lines to depository institutions by the end of 1987.

In October the Federal Reserve Board authorized new operating hours for Fedwire, to begin January 1, 1986. The deadline for interdistrict, third-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

party wire transfers was extended from 4:30 p.m. to 5:00 p.m., Eastern time, to accommodate institutions in the West. In addition, to enable banks to operate more efficiently and better manage their intraday funds, the Board set a uniform opening time for the Fedwire of no later than 9:00 a.m., Eastern time.

The net settlement arrangement for the CHESS service of the Chicago Clearing House Association was modified from next-day to same-day finality under terms and conditions similar to those already in place between the Federal Reserve and other privately operated large-dollar networks. Net settlement based on same-day finality was also approved for the PRESS service of the California Bankers Clearing House Association. In addition, net settlement services based on next-day finality were approved for the California Automated Clearing House Association and for two automated teller machine networks and one point-of-sale network.

Coin and Currency Services

In 1985 the Federal Reserve sought to improve controls over its coin and currency services, increase efficiency in processing currency, and improve the quality of currency in its cash operations.

Four Reserve Banks provided transportation of cash in 1985, compared with five in 1984. In 1985, as in 1984, five Reserve Banks wrapped coins for depository institutions. Also, the System tested a prototype of second-generation equipment intended to improve the processing of currency.

The Federal Reserve continued to work with the U.S. Department of the Treasury to develop measures to deter the counterfeiting of U.S. currency.

Definitive Securities and Noncash Collection Services

The System received $25.0 million in revenue for definitive safekeeping and noncash collection in 1985; the total cost of these services, including the PSAF, was $25.3 million. The volume of definitive securities issues and deposits increased 4.7 percent in 1985 to 158.6 thousand. Noncash collection volume increased 7.8 percent to 4.6 million.

In October public comment was solicited on the general concept of consolidating priced-service activities across district lines. Comment was specifically requested on a proposal to consolidate the noncash collection services of the Ninth and Twelfth Districts because of difficulties in collecting coupons in the Twelfth District, and to maintain an appropriate level of service nationwide. No action was taken in 1985.

During 1985 deposits of immobilized securities were received from two regional depository trust companies.

Book-Entry Securities

The book-entry service incurred costs, including the PSAF, of $24.9 million and earned revenue of $28.8 million. For the year, there were 7.9 million on-line book-entry transfers.

As of October 1, book-entry services for U.S. Treasury securities became a nonpriced fiscal service, at the direction of the Department of the Treasury.

The Federal Reserve is developing a system on behalf of the U.S. Treasury that will offer limited book-entry services primarily to individual investors starting in mid-1986. This service, referred to as Treasury Direct, will re-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

place the current practice of issuing registered Treasury securities.

In 1985 the Federal Reserve added mortgage-backed securities of Federal agencies to its system of book-entry securities transfers. The book-entry system is a more secure and efficient means of maintaining securities, and it affords the secondary securities market with settlement that is simultaneous with the transfer of the securities.

Float

Federal Reserve float increased to a daily average of $440 million in 1985, up from $400 million in 1984. The costs of all Federal Reserve float are recovered each year.

In November the Board requested comment on a proposed amendment to Regulation J to reduce float caused by the closing of depository institutions on local holiday schedules. The proposal would modify procedures used by Reserve Banks to recover the value of float generated by local holidays, would reduce certain financial risks, and would establish a uniform holiday schedule to be followed by the Reserve Banks.

Examination

The Division of Federal Reserve Bank Operations examines the 12 Reserve Banks and their 25 branches each year, as required by section 21 of the Federal Reserve Act. The results of the audits are communicated to the management and directors of the respective Banks and to the Board of Governors. Also, the Division annually audits the accounts and holdings of the Federal Reserve System Open Market Account at the Federal Reserve Bank of New York and the foreign currency operations conducted by the Bank for their conformance with the policies issued by the Federal Open Market Committee. The Division furnishes copies of these reports to the Committee. The examination procedures used by the Division are reviewed each year by a private firm of certified public accountants.

Income and Expenses

The accompanying table summarizes the income, expenses, and distribution of net earnings of the Federal Reserve Banks for 1985 and 1984.

Income, Expenses, and Distribution of
Net Earnings of Federal Reserve Banks, 1985 and 1984 [1]

Thousands of dollars

Item	1985	1984
Current income	18,131,983	18,068,820
Current expenses	1,127,744	1,102,444
Operating expenses	1,022,527	983,731
Earnings credits granted	105,217	118,713
Current net income	17,004,238	16,966,376
Net addition to (deduction from) current net income	1,301,624	(412,943)
Assessments by the Board of Governors	251,116	244,722
For expenditures of Board	77,378	82,116
For cost of Federal Reserve currency	173,739	162,606
Net income before payments to U.S. Treasury	18,054,746	16,308,711
Dividends paid	103,029	92,620
Payments to U.S. Treasury (interest on Federal Reserve notes)	17,796,464	16,054,095
Transferred to surplus	155,253	161,996

1. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Income was $18,132 million in 1985, approximately the same as in 1984. Total expenses were $1,205 million ($1,023 million in operating expenses, $105 million in earnings credits granted to depository institutions, and $77 million in assessment for expenditures by the Board of Governors). The cost of Federal Reserve currency was $174 million. Income from financial services was $614 million.

The profit and loss account showed a net addition of $1,302 million, due primarily to a $1,210 million increase in the value of assets denominated in foreign currencies and revalued at market exchange rates and a net gain of $99 million on sales of U.S. government securities. Statutory dividends to member banks totaled $103 million, $10 million more than in 1984. 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 Reserve Banks.

Payments to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $17,796 million, compared with $16,054 million in 1984. This sum consists of all net income after dividends and the amount necessary to bring the surplus of the Banks to the level of their paid-in capital.

In the Statistical Tables section of this REPORT, table 7 gives a summary statement of the income and expenses of the Federal Reserve System for 1981–85; table 8 details income and expenses of each Federal Reserve Bank for 1985, and table 9 shows a condensed statement for each Bank for 1914–85. A detailed account of the assessments and expenditures of the Board of Governors appears in the next section, Financial Statements.

In its ANNUAL REPORT covering 1984, the Board included, for the first time, a chapter on the current (1985 calendar year) System budget. The chapter consolidated public information available from other sources in order to provide a single, comprehensive view of the System's budget and budgetary process. In early 1986 the Board expanded the treatment in last year's REPORT and produced a new document, *Annual Report: Budget Review*. The new publication, a companion to this REPORT, covers 1984–86

Securities and Loans of Federal Reserve Banks, 1983–85

Millions of dollars, except as noted

Item and year	Total[1]	U.S. government securities[2]	Loans
Average daily holdings[3]			
1983	152,526	151,429	1,038
1984	165,002	161,247	3,726
1985	176,688	175,359	1,329
Earnings			
1983	15,250	15,150	94
1984	17,080	16,688	389
1985	16,954	16,843	111
Average interest rate (percent)			
1983	10.00	10.00	9.05
1984	10.35	10.35	10.44
1985	9.60	9.60	8.38

1. Includes acceptances.
2. Includes federal agency obligations.
3. Based on holdings at opening of business.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in detail and trends since 1977; it gives the most detailed picture ever made of expenses incurred by the Federal Reserve.

Federal Reserve Bank Premises

During 1985 the Board of Governors authorized the construction of an addition to the Federal Reserve Bank of Chicago. Table 6, in the Statistical Tables section of this REPORT, shows the cost and book values of premises owned or occupied by the Federal Reserve Banks and Branches and of real estate acquired for future banking-house purposes.

Holdings of Securities and Loans

The accompanying table presents holdings, earnings, and average interest rates on securities and loans of the Federal Reserve Banks for the years 1983, 1984, and 1985.

Average daily holdings of securities and loans during 1985 amounted to $176,688 million, an increase of $11,686 million over 1984. Holdings of U.S. government securities increased $14,112, and loans decreased $2,397 million.

From 1984 to 1985 the average rate of interest on all types of holdings decreased: on U.S. government securities, from 10.35 to 9.60 percent, and on loans, from 10.44 to 8.38 percent.

Volume of Operations

Table 11, in the Statistical Tables section of this REPORT, shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1982–85.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Board of Governors

Financial Statements

The financial statements of the Board for the years 1985 and 1984 were examined by Price Waterhouse, independent public accountants.

Report of Independent Accountants

To the Board of Governors of the
Federal Reserve System

In our opinion, the accompanying balance sheets and the related statements of revenues and expenses, fund balance and of changes in financial position present fairly the financial position of the Board of Governors of the Federal Reserve System at December 31, 1985 and 1984, 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 after restatement for the change, with which we concur, in the method of accounting for capital assets as described in Note 2 to the financial statements. Our examinations of these statements 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.

Washington, D.C.
February 14, 1986

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

ASSETS	As of December 31	
	1985	1984
CURRENT ASSETS		
Cash	$ 8,144,767	$10,297,732
Accounts receivable	1,542,680	461,264
Stockroom and cafeteria inventories, at cost	290,475	371,434
Prepaid expenses and other assets	151,851	1,230,060
Total current assets	10,129,773	12,360,490
PROPERTY, BUILDINGS AND EQUIPMENT, at cost		
Land and improvements	1,301,314	1,301,314
Buildings	61,851,962	61,452,867
Furniture and equipment	24,799,885	20,861,213
	87,953,161	83,615,394
Less accumulated depreciation	31,777,004	26,949,388
Total property, buildings and equipment	56,176,157	56,666,006
Total assets	$66,305,930	$69,026,496
LIABILITIES AND FUND BALANCE		
LIABILITIES		
Accounts payable	$ 6,508,435	$ 6,355,224
Accrued annual leave	3,807,048	3,664,308
Accrued payroll and related taxes	2,611,001	1,912,794
Other liabilities	440,831	233,253
Total liabilities	13,367,315	12,165,579
Commitments and Contingencies (Notes 4 and 6)		
FUND BALANCE	52,938,615	56,860,917
Total liabilities and fund balance	$66,305,930	$69,026,496

The accompanying notes are an integral part of these statements.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND OF CHANGES IN FUND BALANCE

	For the years ended December 31	
	1985	1984
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$ 77,377,700	$ 82,115,700
Other revenues		
Sale of publications	1,104,154	1,131,472
Contingency Processing Center fees	981,573	-
Miscellaneous	445,954	624,264
Total other revenues	2,531,681	1,755,736
Total operating revenues	79,909,381	83,871,436
BOARD OPERATING EXPENSES		
Salaries	53,179,014	51,131,637
Retirement and insurance contributions	6,052,103	5,969,776
Depreciation	4,958,242	3,615,200
Equipment, office space, and other rentals	2,943,864	2,040,887
Contractual services	2,480,028	2,042,945
Travel	2,230,242	2,071,769
Printing and binding	2,000,230	2,309,346
Repairs and maintenance	1,928,506	1,519,417
Stationery, office and other supplies	1,776,043	1,168,282
Heat, light and power	1,504,375	1,310,682
Telephone and telegraph	1,370,313	1,496,158
Postage	1,213,322	1,077,300
Subsidies and contributions	794,611	772,167
Cafeteria operations, net	531,411	549,330
Tuition, registrations, and membership fees	495,694	450,292
Books and subscriptions	352,094	352,301
Professional fees	242,421	285,491
Other	219,070	234,421
Total operating expenses	84,271,583	78,397,401
BOARD OPERATING REVENUES (UNDER) OVER EXPENSES	(4,362,202)	5,474,035
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	173,738,745	162,606,410
Expenses for currency		
Printing, issuance, retirement and shipping costs	167,015,655	150,370,184
Advanced counterfeit deterrence research costs (Note 5)	6,283,190	12,236,226
Total currency expenses	173,298,845	162,606,410
CURRENCY ASSESSMENTS OVER EXPENSES	439,900	-
TOTAL REVENUES (UNDER) OVER EXPENSES	(3,922,302)	5,474,035
FUND BALANCE, Beginning of year	56,860,917	77,411,316
Less: Cumulative effect on prior years (to December 31, 1983) of change in accounting (Note 2)	-	26,024,434
ADJUSTED FUND BALANCE, Beginning of year	56,860,917	51,386,882
FUND BALANCE, End of year	$ 52,938,615	$ 56,860,917

The accompanying notes are an integral part of these statements.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	For the years ended December 31	
SOURCES OF CASH	1985	1984
Board operations		
Net revenues (under) over expenses	$(3,922,302)	$ 5,474,035
Add (deduct) items not requiring outlays of cash		
Depreciation	4,958,242	3,615,200
Accrued annual leave	142,740	306,286
(Gains) on disposals of equipment	(3,628)	(15,739)
(Increase) decrease in accounts receivable	(1,081,416)	662,971
Decrease (increase) in inventories	80,959	(105,006)
Decrease (increase) in prepaid expenses and other assets	1,078,209	(1,062,365)
Increase in accounts payable	153,211	3,172,398
Increase in accrued payroll and related taxes	698,207	326,358
Increase (decrease) in other liabilities	207,578	(71,558)
Funds provided by operations	2,311,800	12,302,580
Proceeds from sales of equipment	3,628	15,739
Total sources	2,315,428	12,318,319
USES OF CASH		
Capital expenditures for		
Buildings	399,094	240,783
Furniture and equipment	4,069,299	7,622,137
Total uses	4,468,393	7,862,920
(DECREASE) INCREASE IN CASH	(2,152,965)	4,455,399
CASH BALANCE, Beginning of year	10,297,732	5,842,333
CASH BALANCE, End of year	$ 8,144,767	$10,297,732

The accompanying notes are an integral part of these statements.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1985 AND 1984

(1) Significant Accounting Policies

Board Operating Revenues and Expenses—Assessments made on the Federal Reserve Banks for Board operating expenses are calculated based upon expected cash needs. These assessments, other operating revenues, and operating expenses are recorded on the accrual basis of accounting.

Issuance and Redemption of Federal Reserve Notes—The Board incurs expenses and assesses the Federal Reserve Banks for the cost of printing, issuing, shipping, and retiring Federal Reserve notes. These assessments and expenses are separately reported in the statements of revenues and expenses because they are not Board operating transactions.

Property, Buildings and Equipment—The Board's property, buildings and equipment are capitalized at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and from 10 to 50 years for building equipment and building structures.

Contingency Processing Center—The Board operates on behalf of the Federal Reserve System a contingency processing center to handle data processing requirements during emergency situations. The Board recovers from the Federal Reserve Banks a proportionate amount of the operating expenses of the center in the form of fees.

(2) Change in Accounting for Capital Assets

Beginning January 1, 1985, the Board adopted depreciation accounting for its capital assets (buildings, furniture and equipment), and concurrently changed its basis of reporting from a multi-fund approach to the commercial approach used by the Federal Reserve Banks. In prior years the Board recognized the full cost of capital asset additions as an expense at the time of acquisition and maintained the full historic cost in a separate property fund. Under the Board's new policy, furniture and equipment items having a cost of $1,000 or more are capitalized and the cost is depreciated over estimated useful lives using the straight-line method. Major additions to the buildings are capitalized and depreciated in a similar manner. This change was made to more accurately distribute capital asset expense to the periods in which use actually occurs.

The effect of this accounting change on net revenues over expenses for 1984 as previously reported is $4,247,720. The January 1, 1984, operating and property funds have been combined and adjusted for the cumulative effect of the change as though the new basis of accounting was followed in prior years.

(3) Retirement Plans

There are two major retirement plans for employees of the Board. Staff members employed by the Board prior to January 1, 1984, who did not come directly from positions in the Federal government are covered by the Board Plan. Employees who held previous positions in the Federal government prior to January 1, 1984, and immediately prior to their employment by the Board are covered by the Civil Service Plan. Employees hired subsequent to January 1, 1984, who did not hold Federal government positions prior to that date participate in the Bank Retirement Plan. Almost all employees are covered by either the Board Plan or the Civil Service Plan.

Employee contributions are the same percentage of salary under both the Board Plan and the Civil Service Plan. Benefits are similar under both plans. Under the Civil Service Plan, the Board's contributions directly match employee payroll deductions. Under the Board Plan, the Board's contributions for active employees are actuarially determined and are funded in the current period. Costs associated with annual cost-of-living adjustments (COLA) for retirees are actuarially determined. One-half of the cost of the COLA supplement is funded by a lump sum payment at the time the supplement is granted. The remaining one-half of the cost of each supplement is funded over fifteen years and is reflected in the normal contributions to the Board Plan. The lump sum payment for the 1985 supplement to retirees' benefits was $759,500. There was no COLA supplement assessed in 1984.

Board contributions to the retirement plans totaled approximately $1,960,000 in 1985 and $2,050,000 in 1984.

As of January 1, 1985 and 1984 (the dates of the most recent actuarial valuations), the accumulated plan benefits for the Federal Reserve Board Plan, including those arising from COLA supplements, were as follows:

	As of January 1	
	1985	1984
Actuarial present value of accumulated plan benefits		
Vested	$57,167,000	$56,197,000
Nonvested	3,691,000	3,552,000
	$60,858,000	$59,749,000

The assumed rate of return used in determining the present value of accumulated plan benefits was 9.5 percent in 1985 and 9.0 percent in 1984.

As of January 1, 1985 and 1984, net assets available for plan benefits exceeded the actuarial present value of accumulated plan benefits.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Under the Thrift Plan, members may contribute up to a fixed percentage of their salary. Board contributions are based upon a fixed percentage of each member's basic contribution and were $877,000 in 1985 and $864,000 in 1984.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(4) LEASED EQUIPMENT

The Board has acquired certain office automation equipment under capital lease agreements. Accordingly, the equipment and the associated liability have been recorded in the Board's financial statements. Furniture and equipment and accumulated depreciation thereon include $195,340 and $3,450, respectively, at December 31, 1985. There were no capital leases at December 31, 1984.

The following is a summary by year of future scheduled lease payments under capital leases together with the present value of lease payments which is included in other liabilities at December 31, 1985:

Year ended December 31	
1986	$ 91,200
1987	80,900
1988	60,200
Total scheduled lease payments	232,300
Less – amount representing interest	48,000
Present value of net scheduled lease payments	$184,300

In January 1986 the Board entered into a capital lease agreement for computer equipment. The commitment payable through 1989 is approximately $11,600,000.

The Board also leases office and computer equipment and office and storage space under operating leases which may be terminated within one year.

(5) ADVANCED COUNTERFEIT DETERRENCE RESEARCH

During the period 1983 through 1985, the Board sponsored programs to develop technology to deter counterfeiting of U.S. currency and to detect counterfeit currency in circulation. In connection with this program, the Board: 1) sponsored basic research into applying a deterrent device to currency; 2) sponsored the prototyping of production equipment and processes; 3) purchased certain equipment required for a contractor to make test production runs ($715,000 in 1984); 4) purchased application machines for use in the production of currency ($2,000,000 in 1985 and $1,100,000 in 1984); and 5) sponsored research into methods for detecting counterfeit currency during sorting processes by the Federal Reserve Banks.

This project was a research and development effort and, accordingly, all costs were expensed as incurred.

(6) CONTINGENCIES

The major research contract associated with the counterfeit deterrence program discussed in Note 5 expired on January 31, 1985. The contractor has submitted a contract termination claim of approximately $4 million in connection with this expiration. Board counsel believes that the contract properly expired, the claim for termination is without merit, and additional costs, if any, to the Board will not be material.

The Board has been named as a defendant in various litigation involving challenges to, or appeals from, actions or proposed actions of the Board pursuant to statutory requirement or authorization. Such lawsuits generally seek injunctive or declaratory relief against the Board rather than monetary awards. It is the opinion of Board counsel that lawsuits involving monetary awards do not represent a material liability to the Board.

(7) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the Council). During 1985 and 1984, the Board paid $131,000 and $114,000, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1985 and 1984.

The Board serves as custodian for the Council's cash account. This cash is not reflected in the accompanying financial statements. It also processes accounting transactions, including payroll for most of the Council employees, and performs other administrative services for which the Board is reimbursed by the Council.

The Board is not reimbursed for the costs of personnel who serve on the Council and on the various task forces and committees of the Council.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Statistical Tables

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1985

Thousands of dollars

Assets				
Gold certificate account				**11,089,825**
Special drawing rights certificate account				**4,718,000**
Coin				**484,793**
Loans and securities				
Loans to depository institutions			**3,059,157**	
Federal agency obligations				
Bought outright			**8,227,440**	
Held under repurchase agreement			**1,693,395**	
U.S. government securities				
Bought outright				
Bills	**85,425,185**			
Notes	**67,646,590**			
Bonds	**24,726,374**			
Total bought outright		**177,798,149**		
Held under repurchase agreement		**3,528,905**		
Total U.S. government securities			**181,327,054**	
Total loans and securities				**194,307,046**
Items in process of collection				
Transit items			9,824,724	
Other items in process of collection			1,847,025	
Total items in process of collection				**11,671,750**
Bank premises				
Land		108,732		
Buildings (including vaults)	442,816			
Building machinery and equipment	156,139			
Construction account	73,598			
Total bank premises		672,553		
Less depreciation allowance		174,000	498,552	
Bank premises, net				**607,284**
Other assets				
Furniture and equipment		455,756		
Less depreciation		205,191		
Total furniture and equipment, net			250,564	
Denominated in foreign currencies[1]			7,015,557	
Interest accrued			2,618,227	
Premium on securities			641,707	
Due from Federal Deposit Insurance Corporation			3,530,636	
Overdrafts			397,838	
Prepaid expenses			26,536	
Suspense account			105,365	
Real estate acquired for banking-house purposes			4,838	
All other			108,383	
Total other assets				**14,699,651**
Total assets				**237,578,349**

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1.—Continued

Liabilities		
Federal Reserve notes		
Outstanding (issued to Federal Reserve Banks)	208,427,078	
Less held by Federal Reserve Banks	26,978,874	
Total Federal Reserve notes, net		**181,448,204**
Deposits		
Depository institutions		**28,630,668**
U.S. Treasury, general account		**9,350,979**
Foreign, official accounts		**480,027**
Other deposits		
Officers' and certified checks	27,452	
International organizations	104,454	
All other[2]	911,245	
Total other deposits		**1,043,150**
Deferred credit items		**10,682,472**
Other liabilities		
Discount on securities	2,244,007	
Sundry items payable	40,633	
Suspense account	81,695	
All other	13,792	
Total other liabilities		**2,380,127**
Total liabilities		**234,015,627**
Capital Accounts		
Capital paid in		**1,781,361**
Surplus		**1,781,361**
Other capital accounts[3]		**0**
Total liabilities and capital accounts		**237,578,349**

1. Of this amount $2,075.8 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.

2. In closing out the other capital accounts at year-end, the Reserve Bank earnings that are payable to the Treasury are included in this account pending payment.

3. During the year, this item includes undistributed net income, which is closed out on Dec. 31; see table 8 in the Statistical Tables section of this Report.

Note. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1985 and 1984

Millions of dollars

Item	Total		Boston	
	1985	1984	1985	1984
ASSETS				
Gold certificate account	11,090	11,096	658	599
Special drawing rights certificate account	4,718	4,618	281	241
Coin	487	436	26	23
Loans				
To depository institutions	3,060	3,577	24	26
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	8,227	8,389	481	422
Held under repurchase agreements	1,694	388	0	0
U.S. government securities				
Bought outright[1]	177,798	159,223	10,386	8,013
Held under repurchase agreements	3,529	1,627	0	0
Total loans and securities	194,308	173,204	10,891	8,461
Items in process of collection	11,667	6,837	529	205
Bank premises	607	568	93	95
Other assets				
Denominated in foreign currencies[2]	7,016	3,597	196	97
All other	7,679	8,167	201	168
Interdistrict Settlement Account	0	0	+449	+1,431
Total assets	**237,572**	**208,523**	**13,324**	**11,320**
LIABILITIES				
Federal Reserve notes	181,450	168,327	11,349	9,960
Deposits				
Depository institutions	28,631	21,818	1,178	932
U.S. Treasury, general account	9,351	5,316	0	0
Foreign, official accounts	480	253	4	4
Other	1,041	865	36	25
Total deposits	39,503	28,252	1,218	961
Deferred credit items	10,679	5,992	521	177
Other liabilities and accrued dividends[3]	2,378	2,700	130	132
Total liabilities	**234,010**	**205,271**	**13,218**	**11,230**
CAPITAL ACCOUNTS				
Capital paid in	1,781	1,626	53	45
Surplus	1,781	1,626	53	45
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**237,572**	**208,523**	**13,324**	**11,320**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	208,427	193,867	13,504	11,539
LESS: Held by Bank	26,977	25,540	2,155	1,579
Federal Reserve notes, net	181,450	168,327	11,349	9,960
Collateral for Federal Reserve notes				
Gold certificate account	11,090	11,096	...	...
Special drawing rights certificate account	4,718	4,618	...	...
Other eligible assets	0	0	...	...
U.S. government and agency securities	165,642	152,613	...	...
Total collateral	**181,450**	**168,327**	...	...

For notes see end of table.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1985	1984	1985	1984	1985	1984	1985	1984
3,277	3,357	483	515	635	617	969	969
1,354	1,335	195	225	270	302	426	408
16	18	23	12	33	35	88	61
2,060	78	155	91	153	1	312	234
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2,744	2,816	288	282	481	465	726	699
1,694	388	0	0	0	0	0	0
59,305	53,453	6,226	5,349	10,394	8,816	15,682	13,270
3,529	1,627	0	0	0	0	0	0
69,332	58,362	6,669	5,722	11,028	9,282	16,720	14,203
1,338	725	533	203	432	193	682	242
31	26	48	49	28	28	101	103
1,712	878	344	176	449	248	344	183
1,521	1,112	128	111	212	174	365	280
−3,210	−2,008	−651	−218	+215	+707	−417	+1,104
75,371	**63,805**	**7,772**	**6,795**	**13,302**	**11,586**	**19,278**	**17,553**
53,848	51,096	5,870	5,687	11,341	10,125	16,656	15,428
8,153	4,392	1,136	726	1,126	883	1,584	1,413
9,351	5,316	0	0	0	0	0	0
367	140	7	7	10	10	7	8
495	480	28	15	43	24	69	63
18,366	10,328	1,171	748	1,179	917	1,660	1,484
1,486	688	485	111	434	189	584	265
793	899	80	89	134	147	196	216
74,493	**63,011**	**7,606**	**6,635**	**13,088**	**11,378**	**19,096**	**17,393**
439	397	83	80	107	104	91	80
439	397	83	80	107	104	91	80
0	0	0	0	0	0	0	0
75,371	**63,805**	**7,772**	**6,795**	**13,302**	**11,586**	**19,278**	**17,553**
57,138	55,369	7,999	8,004	12,543	11,082	18,176	17,501
3,290	4,543	2,129	2,317	1,202	957	1,520	2,073
53,848	51,096	5,870	5,687	11,341	10,125	16,656	15,428
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1985 and 1984--Continued

Millions of dollars

Item	Atlanta		Chicago	
	1985	1984	1985	1984
ASSETS				
Gold certificate account	413	360	1,451	1,510
Special drawing rights certificate account	192	161	620	646
Coin	53	50	29	26
Loans				
To depository institutions	38	38	32	2,969
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	252	199	906	1,145
Held under repurchase agreements	0	0	0	0
U.S. government securities				
Bought outright[1]	5,446	3,782	19,588	21,738
Held under repurchase agreements	0	0	0	0
Total loans and securities	5,736	4,019	20,526	25,852
Items in process of collection	909	541	958	593
Bank premises	48	39	22	21
Other assets				
Denominated in foreign currencies[2]	582	299	982	471
All other	220	138	3,659	4,375[4]
Interdistrict Settlement Account	+3,476	+2,277	−263	−5,427
Total assets	**11,629**	**7,884**	**27,984**	**28,067**
LIABILITIES				
Federal Reserve notes	7,341	5,217	23,724	23,873
Deposits				
Depository institutions	2,893	1,738	2,545	2,797
U.S. Treasury, general account	0	0	0	0
Foreign, official accounts	12	12	21	20
Other	31	6	109	113
Total deposits	2,936	1,756	2,675	2,930
Deferred credit items	914	546	849	446
Other liabilities and accrued dividends[3]	144	97	254	362
Total liabilities	**11,335**	**7,616**	**27,502**	**27,611**
CAPITAL ACCOUNTS				
Capital paid in	147	134	241	228
Surplus	147	134	241	228
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**11,629**	**7,884**	**27,984**	**28,067**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	10,558	7,897	25,553	25,469
LESS: Held by Bank	3,217	2,681	1,829	1,596
Federal Reserve notes, net	7,341	5,216	23,724	23,873

1. Includes securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes (if any) securities sold and scheduled to be bought back under matched sale-purchase transactions.
2. Assets shown in this line are valued monthly at market exchange rates.
3. Includes exchange-translation account reflecting the monthly revaluation at market exchange rates of foreign-exchange commitments.
4. Includes special investment account at the Federal Reserve Bank of Chicago in Treasury bills maturing within 90 days.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2.—Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1985	1984	1985	1984	1985	1984	1985	1984	1985	1984
357	357	156	160	617	608	713	726	1,361	1,318
157	170	63	61	263	241	307	310	590	518
26	24	22	16	48	43	39	34	84	94
15	34	3	7	207	52	19	23	42	24
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
239	241	108	113	367	400	532	531	1,103	1,076
0	0	0	0	0	0	0	0	0	0
5,162	4,568	2,343	2,144	7,930	7,588	11,492	10,086	23,844	20,416
0	0	0	0	0	0	0	0	0	0
5,416	4,843	2,454	2,264	8,504	8,040	12,043	10,640	24,989	21,516
828	688	654	421	1,840	1,520	1,358	814	1,606	692
18	17	25	25	46	36	19	19	128	110
197	97	232	126	316	166	561	266	1,101	590
114	106	92	52	156	151	540	778	471	726
+487	+357	−39	−84	−769	−228	−612	+720	+1,334	+1,369
7,600	**6,659**	**3,659**	**3,041**	**11,021**	**10,577**	**14,968**	**14,307**	**31,664**	**26,929**
5,796	5,245	2,391	2,065	7,823	7,775	11,100	10,807	24,211	21,049
896	576	471	451	1,055	1,017	2,615	2,480	4,979	4,413
0	0	0	0	0	0	0	0	0	0
4	4	5	5	7	7	12	11	24	25
21	13	13	5	37	28	51	35	108	58
921	593	489	461	1,099	1,052	2,678	2,526	5,111	4,496
709	653	630	363	1,837	1,485	751	552	1,479	517
66	76	33	44	102	117	143	164	303	357
7,492	**6,567**	**3,543**	**2,933**	**10,861**	**10,429**	**14,672**	**14,049**	**31,104**	**26,419**
54	46	58	54	80	74	148	129	280	255
54	46	58	54	80	74	148	129	280	255
0	0	0	0	0	0	0	0	0	0
7,600	**6,659**	**3,659**	**3,041**	**11,021**	**10,577**	**14,968**	**14,307**	**31,664**	**26,929**
7,091	6,475	2,999	2,585	11,100	10,806	13,043	12,640	28,723	24,230
1,295	1,230	608	520	3,277	3,030	1,943	1,833	4,512	3,181
5,796	5,245	2,391	2,065	7,823	7,776	11,100	10,807	24,211	21,049

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

3. Federal Reserve Open Market Transactions, 1985

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
U.S. GOVERNMENT SECURITIES				
Outright transactions (excluding matched transactions)				
Treasury bills				
Gross purchases	0	2,976	916	6,026
Gross sales	2,668	214	554	0
Exchange	0	0	0	0
Redemptions	1,600	400	500	0
Others within 1 year				
Gross purchases	0	0	961	245
Gross sales	0	0	0	0
Maturity shift	596	1,987	1,299	1,129
Exchange	−625	−2,739	0	−1,463
Redemptions	0	0	0	0
1 to 5 years				
Gross purchases	0	0	465	846
Gross sales	0	0	0	0
Maturity shift	−596	−1,902	−1,299	−1,114
Exchange	625	1,645	0	1,463
5 to 10 years				
Gross purchases	0	0	0	108
Gross sales	100	0	0	0
Maturity shift	0	−54	0	−16
Exchange	0	600	0	0
More than 10 years				
Gross purchases	0	0	0	96
Gross sales	0	0	0	0
Maturity shift	0	−30	0	0
Exchange	0	493	0	0
All maturities				
Gross purchases	0	2,976	2,343	7,321
Gross sales	2,768	214	554	0
Redemptions	1,600	400	500	0
Matched transactions				
Gross sales	66,668	57,076	54,718	65,845
Gross purchases	66,367	57,283	57,288	64,001
Repurchase agreements				
Gross purchases	20,225	19,584	4,922	11,540
Gross sales	21,852	17,077	7,429	4,088
Net change in U.S. government securities	−6,295	5,077	1,351	12,931
FEDERAL AGENCY OBLIGATIONS				
Outright transactions				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Redemptions	0	17	0	0
Repurchase agreements				
Gross purchases	1,463	2,428	445	983
Gross sales	1,851	2,048	825	452
Net change in federal agency obligations	−388	363	−380	531
BANKERS ACCEPTANCES				
Repurchase agreements, net	0	0	0	0
Total net change in System Open Market Account	**−6,683**	**5,440**	**971**	**13,462**

NOTE. Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

3.—Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
274	2,099	0	3,056	1,171	0	1,180	4,515	22,214
417	0	0	0	0	265	0	0	4,118
0	0	0	0	350	0	−350	0	0
800	0	200	0	0	0	0	0	3,500
0	0	0	0	0	0	0	143	1,349
0	0	0	0	0	0	0	0	0
2,443	1,312	1,238	4,895	1,028	529	2,363	943	19,763
−2,945	0	−1,778	−3,275	−1,807	−942	−615	−1,529	−17,717
0	0	0	0	0	0	0	0	0
0	0	0	6	0	0	0	868	2,185
0	0	0	0	0	0	0	0	0
−2,101	−1,312	−1,153	−3,760	−1,028	−520	−1,731	−943	−17,459
1,940	0	1,778	1,825	1,457	942	650	1,529	13,853
0	0	0	6	0	0	0	345	458
0	0	0	0	0	0	0	0	100
42	0	−85	−1,136	0	−10	−600	0	−1,857
600	0	0	800	0	0	184	0	2,184
0	0	0	0	0	0	0	197	293
0	0	0	0	0	0	0	0	0
−384	0	0	0	0	0	−32	0	−447
405	0	0	650	0	0	131	0	1,679
274	2,099	0	3,068	1,171	0	1,180	6,068	26,499
417	0	0	0	0	265	0	0	4,218
800	0	200	0	0	0	0	0	3,500
78,870	81,016	60,980	64,263	73,925	100,929	85,486	76,399	866,175
77,597	83,782	59,165	64,209	72,347	100,197	84,769	78,962	865,968
21,716	2,801	10,486	1,928	14,029	0	3,684	23,338	134,253
29,168	2,801	10,486	1,928	14,029	0	3,684	19,809	132,351
−9,668	4,865	−2,015	3,014	−408	−997	463	12,159	20,477
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
8	60	46	30	0	0	0	0	162
1,336	120	2,439	354	3,522	0	1,454	7,640	22,183
1,867	120	2,439	354	3,522	0	1,454	5,947	20,877
−540	−60	−46	−30	0	0	0	1,693	1,144
0	0	0	0	0	0	0	0	0
−10,208	**4,805**	**−2,061**	**2,984**	**−408**	**−997**	**463**	**13,853**	**21,621**

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

4. Federal Reserve Bank Holdings of U.S. Government and Federal Agency Securities, December 31, 1983–85

Millions of dollars

Description	December 31			Increase or decrease (−)	
	1985	1984	1983	1985	1984
U.S. government securities, total	**181,327**	**160,850**	**151,942**	**20,477**	**8,908**
1–15 days[1]	9,307	4,255	2,700	5,052	1,555
16–90 days	43,462	37,396	38,248	6,067	−852
91 days to 1 year	56,364	47,795	45,475	8,568	2,320
1–5 years	35,650	37,072	34,021	−1,421	3,051
5–10 years	14,785	14,100	13,485	685	615
More than 10 years	21,759	20,233	18,014	1,526	2,219
Held outright[2]					
Treasury bills	85,425	71,035	65,811	14,390	5,224
Treasury notes	67,647	65,237	63,934	2,410	1,303
Treasury bonds	24,726	22,951	20,814	1,775	2,137
Held under RPs	3,529	1,627	1,384	1,902	243
Federal agency obligations, total	**9,921**	**8,777**	**8,853**	**1,144**	**−76**
1–15 days	1,836	575	386	1,261	189
16–90 days	961	521	597	440	−76
91 days to 1 year	1,471	1,665	1,937	−193	−272
1–5 years	4,056	4,350	4,196	−294	154
5–10 years	1,187	1,267	1,333	−80	−66
More than 10 years	409	399	403	10	−4
Held outright					
Banks for Cooperatives	21	21	21	0	0
Federal Farm Credit Banks	2,477	2,363	2,420	114	−57
Federal Home Loan Banks	2,260	2,260	2,272	0	−12
Federal Home Loan Mortgage Corporation	0	0	5	0	−5
Federal Intermediate Credit Banks	50	50	50	0	0
Federal Land Banks	236	350	350	−115	0
Farmers Home Administration	101	147	147	−46	0
Federal National Mortgage Association	2,847	2,962	3,144	−115	−182
Government National Mortgage Association PCs	67	67	67	0	0
U.S. Postal Service	37	37	37	0	0
Washington Metropolitan Area Transit Authority	117	117	117	0	0
General Services Administration	14	14	14	0	0
Held under RPs	1,693	388	208	1,306	180

1. Includes securities held under repurchase agreements.

2. Excludes securities sold under matched agreements and securities held under repurchase agreements.

Note. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

6. Bank Premises of Federal Reserve Banks and Branches, December 31, 1985

Dollars

Federal Reserve Bank or Branch	Costs				Net book value	Other real estate[3]
	Land	Buildings (including vaults)[1]	Building machinery and equipment	Total[2]		
BOSTON	22,036,681	79,874,932	5,425,128	107,336,740	93,265,260	...
Annex	27,840	89,202	44,538	161,580	130,863	...
NEW YORK	3,436,277	18,432,390	21,690,030	43,558,697	26,377,899	...
Annex	477,863	1,136,219	745,855	2,359,936	825,591	...
Buffalo	887,844	2,693,268	2,257,787	5,838,900	3,342,590	...
PHILADELPHIA	1,876,601	52,997,235	5,903,704	60,777,540	48,284,412	...
CLEVELAND	1,074,281	6,707,150	4,688,060	12,469,490	6,116,205	1,224,363
Cincinnati	2,246,599	13,537,723	7,528,477	23,312,798	14,726,307	...
Pittsburgh	1,658,376	5,386,190	3,072,948	10,117,514	7,525,418	...
RICHMOND	3,912,575	56,166,758	14,314,313	74,393,645	60,812,675	...
Annex	522,733	3,725,466	3,513,044	7,761,243	3,825,158	...
Baltimore	6,472,984	26,826,903	3,842,189	37,142,076	34,773,971	...
Charlotte	347,071	1,517,751	946,943	2,811,765	1,581,212	1,675,934
ATLANTA	1,202,255	5,882,585	3,558,580	10,643,421	5,562,026	...
Birmingham	2,363,463	1,905,770	1,046,244	5,315,476	3,649,992	608,243
Jacksonville	1,066,862	15,995,449	778,381	17,840,692	15,960,089	48,365
Annex	107,925	76,236	15,843	200,003	151,252	...
Miami	3,607,531	11,975,513	2,107,796	17,690,841	15,882,505	...
Nashville	592,342	1,474,678	1,287,430	3,354,451	1,543,328	...
New Orleans	3,087,693	2,782,464	1,476,396	7,346,553	4,902,272	283,753
CHICAGO	4,511,942	17,053,899	12,195,547	33,761,388	17,621,353	...
Annex	53,066	548,119	215,796	816,981	791,912	...
Detroit	797,734	3,164,517	2,004,896	5,967,147	3,587,680	...
ST. LOUIS	700,378	8,451,682	4,599,479	13,751,539	7,408,819	...
Little Rock	1,148,492	2,082,669	1,023,475	4,254,636	2,769,487	...
Louisville	700,075	3,242,651	1,131,238	5,073,964	2,684,809	...
Memphis	1,135,623	4,216,382	2,126,755	7,478,760	5,190,642	...
MINNEAPOLIS	1,394,384	26,664,805	7,692,189	35,751,378	24,242,459	...
Helena	289,619	104,184	66,777	460,579	328,105	...
KANSAS CITY	7,736,543	25,288,256	8,028,418	41,053,217	34,948,683	517,802
Denver	2,997,746	3,667,071	2,610,017	9,274,834	6,390,671	...
Oklahoma City	646,386	2,517,100	1,672,442	4,835,928	3,249,838	...
Omaha	1,030,226	1,550,902	817,215	3,398,342	1,747,288	479,076
DALLAS	3,729,268	5,413,552	3,737,706	12,880,525	9,643,543	...
El Paso	262,477	1,348,665	393,301	2,004,443	1,763,099	...
Houston	2,049,064	2,540,968	898,037	5,488,069	4,885,317	...
San Antonio	449,813	2,269,405	574,346	3,293,564	2,776,775	...
SAN FRANCISCO	15,541,937	87,124,147	16,396,852	119,062,937	112,019,287	...
Los Angeles	5,588,659	4,339,942	2,494,074	12,422,676	8,943,488	...
Portland	207,381	1,678,512	649,432	2,535,324	1,997,940	
Salt Lake City	480,222	1,972,068	1,129,591	3,581,881	2,643,648	...
Seattle	274,772	2,236,163	1,437,648	3,948,583	2,410,199	...
Total	**108,731,601**	**516,659,539**	**156,138,917**	**781,530,056**	**607,284,066**	**4,837,534**

1. Includes expenditures for construction at some offices pending allocation to appropriate accounts.
2. Excludes charge-offs of $17,698,968 before 1952.
3. Includes acquisitions for banking-house purposes, and Bank premises formerly occupied and being held pending sale.

NOTE. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

5. Number and Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1985

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	145,600	54	3,250,100	1,286	232	32,436,474	1,573	35,832,174
New York	159,600	160	11,256,400	3,775	62	95,575,360	3,998	106,991,360
Philadelphia	126,000	49	2,902,600	1,062	77	24,537,668	1,189	27,566,268
Cleveland	130,000	56	3,169,300	1,274	53	26,971,834	1,384	30,271,134
Richmond	127,200	78	4,355,450	1,795	168	35,402,920	2,042	39,885,570
Atlanta	127,000	68	3,969,000	2,032	85	42,785,176	2,186	46,881,176
Chicago	150,600	84	4,895,100	2,694	164	62,573,446	2,943	67,619,146
St. Louis	121,000	55	3,037,396	1,177	87	24,340,218	1,320	27,498,614
Minneapolis	101,000	41	2,303,800	972	177	21,960,027	1,191	24,364,827
Kansas City	126,000	56	3,376,000	1,540	59	32,372,333	1,656	35,874,333
Dallas	123,700	57	3,394,004	1,437	55	30,872,268	1,550	34,389,972
San Francisco	160,100	88	5,291,999	2,206	82	54,552,649	2,377	60,004,748
Total	**1,597,800**	**846**	**51,201,149**	**21,250**	**1,301**	**484,380,373**	**23,409**	**537,179,322**

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

7. Income and Expenses of the Federal Reserve System, 1981–85

Millions of dollars

Item	1981	1982	1983	1984	1985
CURRENT INCOME					
Loans	196.3	174.6	132.9	569.5	427.9
Acceptances	18.7	18.3	6.0	3.2	0
U.S. government securities	14,551.1	15,492.9	15,150.2	16,687.5	16,843.1
Foreign currencies	577.4	432.5	273.8	217.1	228.7
All other	10.7	12.3	9.3	16.9	17.3
Total	**15,354.2**	**16,130.7**	**15,572.1**	**17,494.2**	**17,517.1**
CURRENT EXPENSES					
Monetary and economic policy	123.3	138.4	148.3	152.0	148.3
Supervision and regulation	118.0	140.3	155.0	163.3	175.7
Services to financial institutions and the public	614.0	648.8	678.4	704.6	746.2
Services to U.S. Treasury and government agencies	93.4	115.1	120.3	126.3	131.5
Total	948.6	1,042.6	1,102.1	1,146.1	1,201.6
LESS: Reimbursements	72.6	77.3	78.1	85.8	97.4
Priced services revenue	154.1	386.7	496.2	574.7	614.9
Net expenses	**721.9**	**578.6**	**527.7**	**485.6**	**489.4**
Federal Reserve currency costs	82.9	98.4	152.1	162.6	173.3
Net expenses including currency costs	**804.9**	**677.0**	**679.8**	**648.2**	**662.7**
Cost of earnings credits[1]	4.0	28.3	71.8	118.7	105.2
Current net income	**14,545.4**	**15,425.4**	**14,820.5**	**16,727.2**	**16,749.2**
ADDITIONS TO AND DEDUCTIONS FROM CURRENT NET INCOME					
Unrealized gains (losses) on the revaluation of foreign currency assets	(306.0)	(149.6)	(456.3)	(454.8)	1,210.0
Gains (losses) on sales of U.S. government securities	(124.0)	85.2	21.0	48.6	99.4
Other additions to or deductions from current net income	61.1	(4.5)	34.9	(6.7)	(7.9)
Total	(368.9)	(68.8)	(400.4)	(412.9)	1,301.6
Net income before distributions	**14,176.5**	**15,356.6**	**14,420.2**	**16,314.3**	**18,050.8**
DISTRIBUTIONS					
Dividends paid	74.6	79.4	85.2	92.6	103.0
Transfers to surplus	76.9	78.3	106.7	162.0	155.3
Net transfers to Board account	1.3	(5.7)	(.5)	5.5	(3.9)
Interest on Federal Reserve notes	14,023.7	15,204.6	14,228.8	16,054.1	17,796.5
Total	**14,176.5**	**15,356.6**	**14,420.2**	**16,314.3**	**18,050.8**

1. The amount of the credits granted to depository institutions on clearing balances maintained with the Reserve Banks. These earnings credits may be used to offset charges for Federal Reserve priced services. The clearing balances are invested in U.S. governmer securities, the earnings on which are reflected in th current income section of this table.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

8. Income and Expenses of Federal Reserve Banks, 1985

Item	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Loans	427,937,199	1,653,288	14,331,208	2,067,951	2,106,227
Acceptances	0	0	0	0	0
U.S. government securities	16,843,078,347	937,862,068	5,672,308,476	580,130,971	964,682,089
Foreign currencies	228,705,105	6,420,037	55,804,046	11,262,217	14,566,789
Priced services	613,829,990	37,102,796	99,676,286	25,021,005	36,425,345
All other	18,432,145	587,982	9,243,142	252,755	498,154
Total	**18,131,982,786**	**983,626,171**	**5,851,363,158**	**618,734,899**	**1,018,278,604**
CURRENT EXPENSES					
Salaries and other personnel expenses	563,144,289	37,049,000	116,059,976	29,639,535	32,437,523
Retirement and other benefits	134,266,707	8,502,750	26,001,782	7,291,701	8,553,803
Fees	14,329,746	2,134,788	1,047,236	575,672	3,696,339
Travel	20,876,804	966,260	2,575,447	833,999	1,759,190
Postage and other shipping costs	82,769,382	3,427,180	9,127,380	4,507,415	5,927,753
Communications	15,395,947	1,182,943	3,571,634	705,961	757,623
Materials and supplies	45,036,644	2,524,696	8,404,075	2,512,217	2,835,715
Building expenses					
Taxes on real estate	21,079,390	3,573,455	3,705,394	1,484,083	970,760
Property depreciation	21,088,018	2,396,542	2,175,324	1,720,426	1,200,985
Utilities	22,945,483	2,284,942	3,761,098	2,276,402	1,476,419
Rent	13,100,040	487,335	7,720,260	44,621	218,944
Other	13,818,941	774,356	3,263,534	1,114,043	465,664
Equipment					
Purchases	2,572,078	84,637	0	106,788	122,429
Rentals	46,279,650	1,644,920	8,351,104	961,947	4,359,469
Depreciation	60,308,821	3,512,313	10,598,470	3,126,515	3,128,266
Repairs and maintenance	34,261,077	2,023,059	5,741,991	1,844,293	1,150,071
Cost of earnings credits	105,217,382	6,133,438	12,446,864	8,966,615	8,534,049
All other	38,639,924	2,266,234	6,327,265	2,210,109	2,741,554
Shared costs, net [1]	0	(1,810,864)	2,562,792	2,436,204	(3,692,672)
Recoveries	(30,559,981)	(6,218,751)	(2,522,880)	(1,993,509)	(2,987,434)
Expenses capitalized [2]	(1,976,961)	(141,087)	(7,457)	(21,151)	(205,609)
Total	**1,222,593,382**	**72,798,146**	**230,911,289**	**70,343,886**	**73,450,841**
Reimbursements	94,848,892	4,259,968	22,344,412	10,621,241	5,955,043
Net expenses	1,127,744,490	68,538,178	208,566,877	59,722,645	67,495,798

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

8. —Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
22,552,116	1,900,356	318,485,481	2,816,574	2,413,372	16,672,254	38,832,490	4,105,881
0	0	0	0	0	0	0	0
1,454,471,378	477,961,822	1,986,309,592	485,322,928	222,589,785	764,335,125	1,077,764,155	2,219,339,959
11,173,962	19,015,924	32,009,495	6,397,770	7,525,813	10,286,569	18,383,040	35,859,443
50,116,744	64,856,993	81,575,186	28,017,848	34,279,665	42,813,820	44,420,512	69,523,790
756,265	1,690,626	1,599,041	438,336	298,372	260,365	1,067,391	1,739,717
1,539,070,465	**565,425,721**	**2,419,978,795**	**522,993,456**	**267,107,007**	**834,368,133**	**1,180,467,588**	**2,330,568,790**
41,684,787	48,483,889	67,621,635	28,133,297	25,621,374	36,959,981	36,182,616	63,270,676
10,329,407	11,675,035	16,005,616	7,139,410	6,015,610	9,094,835	7,782,123	15,874,635
543,146	1,973,778	1,857,710	394,111	449,920	653,653	299,296	704,097
1,818,187	1,993,065	2,838,694	989,314	1,054,530	1,642,435	1,503,150	2,902,533
6,774,101	9,031,066	8,490,569	4,691,478	5,584,910	6,265,739	5,989,674	12,952,117
1,020,115	1,652,323	1,535,986	623,430	672,176	1,158,700	955,037	1,560,019
4,143,807	4,477,114	5,113,900	2,699,443	1,865,836	3,312,113	3,058,517	4,089,211
1,758,864	1,131,414	2,499,317	422,929	2,294,395	745,987	717,718	1,775,074
3,618,464	1,121,996	1,148,291	710,618	1,040,916	1,293,444	1,051,605	3,609,407
1,971,127	1,931,580	2,496,765	1,160,585	857,354	1,224,287	1,222,198	2,282,726
442,657	144,800	2,105,921	344,768	119,459	68,703	1,039,335	363,237
1,577,317	981,247	2,283,172	667,217	572,815	528,094	528,004	1,063,478
307,391	259,608	504,150	466,516	336,111	94,620	100,799	189,029
2,195,985	6,551,898	7,867,337	1,347,458	1,761,330	1,514,938	4,548,328	5,174,936
5,993,679	4,187,252	7,836,849	2,754,188	3,264,501	3,752,881	4,230,862	7,923,045
3,454,372	2,770,306	5,851,054	1,705,126	1,578,605	2,269,093	2,162,430	3,710,677
8,117,291	11,295,260	21,098,453	4,988,184	6,176,634	5,374,044	4,375,980	7,710,572
3,466,788	3,144,894	5,155,094	1,686,730	1,858,527	1,845,582	3,166,908	4,770,239
755,018	1,297,915	(5,691,388)	1,305,087	1,638,359	877,459	(88,836)	410,927
(3,991,663)	(1,347,122)	(2,242,115)	(1,340,166)	(679,781)	(1,065,680)	(1,996,327)	(4,174,553)
(300,713)	(170,892)	243,822	(42,511)	(57,390)	(878,692)	(334,759)	(60,522)
95,680,127	**112,586,426**	**154,620,832**	**60,847,212**	**62,026,191**	**76,732,216**	**76,494,658**	**136,101,560**
6,121,099	6,196,615	10,751,371	6,067,436	2,803,977	5,073,659	4,065,245	10,588,826
89,559,028	106,389,811	143,869,461	54,779,776	59,222,214	71,658,557	72,429,413	125,512,734

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

8. Income and Expenses of Federal Reserve Banks, 1985—Continued

Dollars

Item	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	17,004,238,298	915,087,993	5,642,796,281	559,012,254	950,782,806
Additions to current net income					
Profits on sales of U.S. government securities	99,435,343	5,384,507	33,056,598	3,391,633	5,627,610
All other	1,211,263,619	33,889,682	295,272,609	59,296,990	77,448,009
Total additions	1,310,698,962	39,274,189	328,329,207	62,688,622	83,075,619
Deductions from current net income	9,074,668	560,577	1,160,787	297,516	434,823
Net additions to or deductions (−) from current net income	1,301,624,294	38,713,612	327,168,421	62,391,106	82,640,795
Assessments by Board					
Board expenditures[3]	77,377,700	2,116,000	19,025,200	3,747,700	4,902,500
Cost of Federal Reserve currency	173,738,745	10,280,468	52,739,089	5,869,244	10,450,559
Net income before payments to U.S. Treasury	18,054,746,147	941,405,138	5,898,200,412	611,786,416	1,018,070,543
Dividends paid	103,028,905	2,844,470	25,607,748	4,852,310	6,349,649
Payments to U.S. Treasury (interest on Federal Reserve notes)	17,796,464,292	930,560,317	5,829,661,765	604,330,206	1,008,680,244
Transferred to surplus	155,252,950	8,000,350	42,930,900	2,603,900	3,040,650
Surplus, January 1	1,626,108,200	44,798,550	396,509,800	79,942,000	103,959,650
Surplus, December 31	1,781,361,150	52,798,900	439,440,700	82,545,900	107,000,300

1. Includes distribution of costs for projects performed by one Bank for the benefit of one or more other Banks.
2. This item includes expenses for labor and materials temporarily capitalized and charged to activities when the products are consumed.
3. For additional details, see the last four pages of the preceding section Board of Governors, Financial Statements in this REPORT.

NOTE. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

8.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,449,511,437	459,035,910	2,276,109,333	468,213,680	207,884,793	762,709,577	1,108,038,175	2,205,056,057
8,481,391	2,697,273	12,144,614	2,851,799	1,315,504	4,552,538	6,964,270	12,967,606
59,401,124	100,942,474	169,447,271	33,886,147	39,932,238	54,489,487	96,945,102	190,312,486
67,882,515	103,639,747	181,591,886	36,737,946	41,247,742	59,042,025	103,909,371	203,280,092
571,149	547,206	736,742	584,438	246,903	852,004	1,478,353	1,604,169
67,311,366	103,092,542	180,855,144	36,153,507	41,000,839	58,190,021	102,431,018	201,675,923
3,849,200	6,373,600	10,775,500	2,188,000	2,572,100	3,499,700	6,177,900	12,150,300
15,923,504	5,384,164	24,640,150	5,414,222	2,131,426	8,025,341	11,154,896	21,725,682
1,497,050,099	550,370,688	2,421,548,827	496,764,966	244,182,106	809,374,557	1,193,136,397	2,372,855,999
5,149,817	8,445,546	14,199,298	2,935,559	3,390,797	4,657,283	8,359,610	16,236,818
1,481,448,482	529,535,842	2,393,780,879	486,053,607	236,601,859	798,313,374	1,165,861,687	2,331,636,030
10,451,800	12,389,300	13,568,650	7,775,800	4,189,450	6,403,900	18,915,100	24,983,150
80,360,450	134,156,200	227,612,600	45,947,100	54,303,950	73,731,900	129,296,150	255,489,850
90,812,250	146,545,500	241,181,250	53,722,900	58,493,400	80,135,800	148,211,250	280,473,000

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

9. Income and Expenses of Federal Reserve Banks, 1914–85

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (−)	Assessments by Board of Governors	
				Board expenditures	Federal Reserve currency costs
All Banks					
1914–15	2,173,252	2,018,282	5,875	302,304	...
1916	5,217,998	2,081,722	−193,001	192,277	...
1917	16,128,339	4,921,932	−1,386,545	237,795	...
1918	67,584,417	10,576,892	−3,908,574	382,641	...
1919	102,380,583	18,744,815	−4,673,446	594,818	...
1920	181,296,711	27,548,505	−3,743,907	709,525	...
1921	122,865,866	33,722,409	−6,314,796	741,436	...
1922	50,498,699	28,836,504	−4,441,914	722,545	...
1923	50,708,566	29,061,539	−8,233,107	702,634	...
1924	38,340,449	27,767,886	−6,191,143	663,240	...
1925	41,800,706	26,818,664	−4,823,477	709,499	...
1926	47,599,595	24,914,037	−3,637,668	721,724	1,714,421
1927	43,024,484	24,894,487	−2,457,792	779,116	1,844,840
1928	64,052,860	25,401,233	−5,026,029	697,677	805,900
1929	70,955,496	25,810,067	−4,861,642	781,644	3,099,402
1930	36,424,044	25,357,611	−93,136	809,585	2,175,530
1931	29,701,279	24,842,964	311,451	718,554	1,479,146
1932	50,018,817	24,456,755	−1,413,192	728,810	1,105,816
1933	49,487,318	25,917,847	−12,307,074	800,160	2,504,830
1934	48,902,813	26,843,653	−4,430,008	1,372,022	1,025,721
1935	42,751,959	28,694,965	−1,736,758	1,405,898	1,476,580
1936	37,900,639	26,016,338	485,817	1,679,566	2,178,119
1937	41,233,135	25,294,835	−1,631,274	1,748,380	1,757,399
1938	36,261,428	25,556,949	2,232,134	1,724,924	1,629,735
1939	38,500,665	25,668,907	2,389,555	1,621,464	1,356,484
1940	43,537,805	25,950,946	11,487,697	1,704,011	1,510,520
1941	41,380,095	28,535,547	720,636	1,839,541	2,588,062
1942	52,662,704	32,051,226	−1,568,208	1,746,326	4,826,492
1943	69,305,715	35,793,816	23,768,282	2,415,630	5,336,118
1944	104,391,829	39,659,496	3,221,880	2,296,357	7,220,068
1945	142,209,546	41,666,453	−830,007	2,340,509	4,710,309
1946	150,385,033	50,493,246	−625,991	2,259,784	4,482,077
1947	158,655,566	58,191,428	1,973,001	2,639,667	4,561,880
1948	304,160,818	64,280,271	−34,317,947	3,243,670	5,186,247
1949	316,536,930	67,930,860	−12,122,274	3,242,500	6,304,316
1950	275,838,994	69,822,227	36,294,117	3,433,700	7,315,844
1951	394,656,072	83,792,676	−2,127,889	4,095,497	7,580,913
1952	456,060,260	92,051,063	1,583,988	4,121,602	8,521,426
1953	513,037,237	98,493,153	−1,058,993	4,099,800	10,922,067
1954	438,486,040	99,068,436	−133,641	4,174,600	6,489,895
1955	412,487,931	101,158,921	−265,456	4,194,100	4,707,002
1956	595,649,092	110,239,520	−23,436	5,339,800	5,603,176
1957	763,347,530	117,931,908	−7,140,914	7,507,900	6,374,195
1958	742,068,150	125,831,215	124,175	5,917,200	5,973,240
1959	886,226,116	131,848,023	98,247,253	6,470,600	6,384,083
1960	1,103,385,257	139,893,564	13,874,702	6,533,700	7,455,011
1961	941,648,170	148,253,719	3,481,628	6,265,100	6,755,756
1962	1,048,508,335	161,451,206	−55,779	6,654,900	8,030,028
1963	1,151,120,060	169,637,656	614,835	7,572,800	10,062,901
1964	1,343,747,303	171,511,018	725,948	8,655,200	17,229,671
1965	1,559,484,027	172,110,934	1,021,614	8,576,396	23,602,856
1966	1,908,499,896	178,212,045	996,230	9,021,600	20,167,481
1967	2,190,403,752	190,561,166	2,093,876	10,769,596	18,790,084
1968	2,764,445,943	207,677,768	8,519,996	14,198,198	20,474,404
1969	3,373,360,559	237,827,579	−557,553	15,020,084	22,125,657

For notes see end of table.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

9.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
217,463	...	...	...	...	...
1,742,775	...	...	...	...	...
6,804,186	1,134,234	...	...	...	1,134,234
5,540,684	...	...	...	...	48,334,341
5,011,832	2,703,894	...	...	...	70,651,778
5,654,018	60,724,742	...	...	...	82,916,014
6,119,673	59,974,466	...	...	...	15,993,086
6,307,035	10,850,605	...	...	...	-659,904
6,552,717	3,613,056	...	...	...	2,545,513
6,682,496	113,646	...	...	...	-3,077,962
6,915,958	59,300	...	...	...	2,473,808
7,329,169	818,150	...	...	...	8,464,426
7,754,539	249,591	...	...	...	5,044,119
8,458,463	2,584,659	...	...	...	21,078,899
9,583,911	4,283,231	...	...	...	22,535,597
10,268,598	17,308	...	...	...	-2,297,724
10,029,760	...	...	...	...	-7,057,694
9,282,244	2,011,418	...	...	...	11,020,582
8,874,262	...	...	...	...	-916,855
8,781,661	...	...	...	-60,323	6,510,071
8,504,974	...	297,667	...	27,695	607,422
7,829,581	...	227,448	...	102,880	352,524
7,940,966	...	176,625	...	67,304	2,616,352
8,019,137	...	119,524	...	-419,140	1,862,433
8,110,462	...	24,579	...	-425,653	4,533,977
8,214,971	...	82,152	...	-54,456	17,617,358
8,429,936	...	141,465	...	-4,333	570,513
8,669,076	...	197,672	...	49,602	3,554,101
8,911,342	...	244,726	...	135,003	40,327,362
9,500,126	...	326,717	...	201,150	48,409,795
10,182,851	...	247,659	...	262,133	81,969,625
10,962,160	...	67,054	...	27,708	81,467,013
11,523,047	...	35,605	75,233,818	86,772	8,366,350
11,919,809	...	...	166,690,356	...	18,522,518
12,329,373	...	...	193,145,837	...	21,461,770
13,082,992	...	...	196,628,858	...	21,849,490
13,864,750	...	...	254,873,588	...	28,320,759
14,681,788	...	...	291,934,634	...	46,333,735
15,558,377	...	...	342,567,985	...	40,336,862
16,442,236	...	...	276,289,457	...	35,887,775
17,711,937	...	...	251,740,721	...	32,709,794
18,904,897	...	...	401,555,581	...	53,982,682
20,080,527	...	...	542,708,405	...	61,603,682
21,197,452	...	...	524,058,650	...	59,214,569
22,721,687	...	...	910,649,768	...	-93,600,791
23,948,225	...	...	896,816,359	...	42,613,100
25,569,541	...	...	687,393,382	...	70,892,300
27,412,241	...	...	799,365,981	...	45,538,200
28,912,019	...	...	879,685,219	...	55,864,300
30,781,548	...	...	1,582,118,614	...	-465,822,800
32,351,602	...	...	1,296,810,053	...	27,053,800
33,696,336	...	...	1,649,455,164	...	18,943,500
35,027,312	...	...	1,907,498,270	...	29,851,200
36,959,336	...	...	2,463,628,983	...	30,027,250
39,236,599	...	...	3,019,160,638	...	39,432,450

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

9. Income and Expenses of Federal Reserve Banks, 1914-85—Continued

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (−)	Assessments by Board of Governors	
				Board expenditures	Federal Reserve currency costs
1970	3,877,218,444	276,571,876	11,441,829	21,227,800	23,573,710
1971	3,723,369,921	319,608,270	94,266,075	32,634,002	24,942,528
1972	3,792,334,523	347,917,112	−49,615,790	35,234,499	31,454,740
1973	5,016,769,328	416,879,377	−80,653,488	44,411,700	33,826,299
1974	6,280,090,965	476,234,586	−78,487,237	41,116,600	30,190,288
1975	6,257,936,784	514,358,633	−202,369,615	33,577,201	37,130,081
1976	6,623,220,383	558,128,811	7,310,500	41,827,700	48,819,453
1977	6,891,317,498	568,851,419	−177,033,463	47,366,100	55,008,163
1978	8,455,390,401	592,557,841	−633,123,486	53,321,700	60,059,365
1979	10,310,148,406	625,168,261	−151,148,220	50,529,700	68,391,270
1980	12,802,319,355	718,032,836	−115,385,855	62,230,800	73,124,423
1981	15,508,349,653	814,190,392	−372,879,185	63,162,700	82,924,013
1982	16,517,385,129	926,033,957	−68,833,150	61,813,400	98,441,027
1983	16,068,362,117	1,023,678,474	−400,365,922	71,551,000	152,135,488
1984	18,068,820,742	1,102,444,454	−412,943,156	82,115,700	162,606,410
1985	18,131,982,786	1,127,744,490	1,301,624,294	77,377,700	173,738,745
Total, 1914-85	**183,886,513,300**	**14,232,097,675**	**−2,557,978,043**	**1,007,396,908**	**1,451,811,705**
Aggregate for each Bank, 1914-85					
Boston	8,803,617,629	947,943,847	−47,543,082	37,333,086	83,235,321
New York	51,829,910,006	2,925,334,810	−269,839,431	261,711,586	330,930,193
Philadelphia	8,136,548,394	752,747,865	−52,926,799	49,834,118	75,488,535
Cleveland	13,135,554,453	977,186,737	−128,864,534	82,813,890	92,087,896
Richmond	14,351,925,436	1,109,657,326	−78,391,941	52,019,976	140,751,601
Atlanta	7,468,018,891	1,181,730,325	−92,893,931	71,936,360	99,947,294
Chicago	27,968,230,990	1,876,217,691	−218,227,706	145,473,172	204,636,012
St. Louis	6,587,374,227	776,757,094	−50,960,464	31,846,172	58,931,510
Minneapolis	3,427,542,010	629,740,114	−39,241,014	29,390,115	27,095,620
Kansas City	8,126,042,728	884,742,629	−56,048,651	42,996,509	73,443,369
Dallas	10,290,905,326	779,031,666	−63,755,820	60,520,873	86,232,774
San Francisco	23,760,843,212	1,391,007,569	−157,660,377	141,521,051	179,031,580
Total	**183,886,513,300**	**14,232,097,675**	**−2,557,978,043**	**1,007,396,908**	**1,451,811,705**

1. The $1,910,033,349 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 $1,781,361,148 on Dec. 31, 1984.

NOTE. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

9.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
41,136,551	...	...	3,493,570,636	...	32,579,700
43,488,074	...	...	3,356,559,873	...	40,403,250
46,183,719	...	...	3,231,267,663	...	50,661,000
49,139,682	...	...	4,340,680,482	...	51,178,300
52,579,643	...	...	5,549,999,411	...	51,483,200
54,609,555	...	...	5,382,064,098	...	33,827,600
57,351,487	...	...	5,870,463,382	...	53,940,050
60,182,278	...	...	5,937,148,425	...	45,727,650
63,280,312	...	...	7,005,779,497	...	47,268,200
67,193,615	...	...	9,278,576,140	...	69,141,200
70,354,516	...	...	11,706,369,955	...	56,820,950
74,573,806	...	...	14,023,722,907	...	76,896,650
79,352,304	...	...	15,204,590,947	...	78,320,350
85,151,835	...	...	14,228,816,297	...	106,663,100
92,620,451	...	...	16,054,094,674	...	161,995,900
103,028,905	...	...	17,796,464,292	...	155,252,950
1,807,327,389	**149,138,300**	**2,188,893**	**162,070,168,999**	**−3,657**	**1,910,033,349** [1]
77,347,685	7,111,395	280,843	7,539,793,233	135,411	62,893,725
495,324,496	68,006,262	369,116	47,002,130,252	−433,412	476,697,271
100,394,242	5,558,901	722,406	7,001,708,746	290,661	96,876,122
155,655,819	4,842,447	82,930	11,573,796,017	−9,906	120,234,093
89,562,799	6,200,189	172,493	12,778,548,569	−71,517	96,692,058
116,220,097	8,950,561	79,264	5,744,443,527	5,491	151,812,040
252,043,469	25,313,526	151,045	24,989,646,682	11,682	265,510,004
58,401,790	2,755,629	7,464	5,548,898,095	−26,515	58,842,528
49,572,086	5,202,900	55,615	2,584,809,063	64,874	62,370,613
75,099,139	6,939,100	64,213	6,902,442,043	−8,674	84,275,750
102,393,511	560,049	102,083	9,045,764,482	55,337	152,488,728
235,312,256	7,697,341	101,421	21,358,188,291	−17,089	290,340,417
1,807,327,389	**149,138,300**	**2,188,893**	**162,070,168,999**	**−3,657**	**1,910,033,349**

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

10. Revenue and Expenses of Priced Services at Federal Reserve Banks, 1985 and 1984

Millions of dollars

Item	Total		Service			
			Commercial check collection		Wire transfer and net settlement	
	1985	1984	1985	1984	1985	1984
Revenue[1]	733.0	697.0	555.8	529.6	77.4	75.2
Expenses[1]	617.2	602.3	464.6	450.2	62.4	61.1
Net revenue	115.7	94.7	91.2	79.5	14.9	14.1
Private sector adjustment[2]	82.2	75.3	61.6	57.4	10.6	10.6
Net revenue after private sector adjustment	33.6	19.4	29.6	22.1	4.3	3.5
MEMO: Net revenue after private sector adjustment, with allowance for ACH program[3]	38.6	26.3	...	...	...	...

1. Total System revenue for 1985 and 1984 respectively comprises $613.8 million and $574.7 million of income from fees for services, and $119.1 million and $122.3 million of income related to clearing balances established by depository institutions. Total System expenses include $105.6 million and $118.7 million of earnings credits granted to depository institutions on clearing balances.

Commercial check collection, commercial ACH, book-entry securities, and definitive safekeeping and noncash collection expenses include float costs for 1985 and 1984. Wire transfer and net settlement expenses include float costs for 1985.

2. This adjustment is an imputed cost intended to reflect the taxes that would have been paid and the return on capital that would have been provided had a

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

10.—Continued

Service							
Commercial ACH [3]		Definitive safekeeping and noncash collection		Book-entry securities		Cash services	
1985	1984	1985	1984	1985	1984	1985	1984
27.5	13.8	25.0	23.0	28.8	29.2	18.5	26.2
29.1	19.7	23.0	22.7	20.1	23.2	18.0	25.4
(1.6)	(5.9)	2.0	.3	.7	6.0	.5	.7
2.5	1.2	2.3	1.8	4.8	3.9	.3	.5
(4.1)	(7.1)	(.3)	(1.5)	3.9	2.1	.2	.3
.9	(.1)	...	...	...	...	...	...

private firm furnished the services.

3. The Board established an incentive pricing program for the commercial ACH service that provides for fee structures designed to recover an increasing share of expenses over a period of several years. Revenue for the commercial ACH service was expected to represent approximately 80 percent and 60 percent of expenses plus the private sector adjustment for 1985 and 1984 respectively.

NOTE. Revenue and expenses of priced services offered by the Federal Reserve Banks are derived from the income and expense data shown in table 8. Expenses for priced services are based primarily on the Federal Reserve Planning and Control System, which provides for the allocation of expenses to the principal areas of activity of the Banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

11. Operations in Principal Departments of Federal Reserve Banks, 1982–85

Operation	1985	1984	1983	1982
Millions of pieces (except as noted)				
Loans (thousands)	24	33	22	24
Currency received and counted	14,655	13,422	11,464	10,679
Currency verified and destroyed	5,744	5,329	4,403	4,147
Coin received and counted	19,691	19,201	17,712	16,859
Checks handled				
U.S. government checks	592	598	612	655
Postal money orders	130	135	115	126
All other [1]	15,965	15,178	14,650	14,278
Issues, redemptions, and exchanges of U.S. government securities	171	168	168	156
Transfer of funds [2]	45	42	38	35
Food stamps redeemed	2,322	2,536	2,684	2,565
Millions of dollars				
Loans	307,856	852,777	214,190	184,997
Currency received and counted	182,095	183,419	141,684	128,803
Currency verified and destroyed	51,081	50,164	36,224	31,258
Coin received and counted	3,226	3,624	2,795	2,714
Checks handled				
U.S. government checks	538,261	529,895	552,493	628,639
Postal money orders	9,486	9,085	7,854	6,645
All other [1]	9,557,753	9,553,515	9,854,112	8,205,164
Issues, redemptions, and exchanges of U.S. government securities	65,866,333	50,327,014	51,352,275	26,550,780
Transfer of funds [2]	109,126,369	98,003,445	87,754,086	73,997,823
Food stamps redeemed	10,195	9,941	10,861	9,869

1. In previous *Annual Reports* data included checks handled by more than one Federal Reserve office.

2. In previous *Annual Reports* data included transfers processed by both sending and receiving Federal Reserve offices.

12. Federal Reserve Bank Interest Rates, December 31, 1985

Percent per year

Federal Reserve Bank	Loans to depository institutions			
	Short-term adjustment credit and seasonal credit[1]	Extended credit[2]		
		First 60 days of borrowing	Next 90 days of borrowing	After 150 days
Boston	7½	7½	8½	9½
New York	↑	↑	↑	↑
Philadelphia				
Cleveland				
Richmond				
Atlanta				
Chicago				
St. Louis				
Minneapolis				
Kansas City				
Dallas	↓	↓	↓	↓
San Francisco	7½	7½	8½	9½

1. Rates applied to short-term advances for the purpose of meeting temporary funding requirements and to longer-term advances made to smaller institutions for the purpose of meeting seasonally recurring needs for funds. A temporary simplified seasonal program was established on Mar. 8, 1985, and the interest rate was set at 8½ percent at that time. On May 20, this rate was lowered to 8 percent. See sections 201.3(a) and 201.3(b)(1) of Regulation A.

2. Applicable to advances when exceptional circumstances or practices involve only a particular depository institution and to advances when an institution is under sustained liquidity pressures. As an alternative, for loans outstanding for more than 150 days, a Federal Reserve Bank may charge a flexible rate that takes into account rates on market sources of funds, but in no case will the rate charged be less than the basic rate plus one percentage point. Where credit provided to a particular depository institution is anticipated to be outstanding for an unusually prolonged period and in relatively large amounts, the time period in which each rate under this structure is applied may be shortened. See section 201.3(b)(2) of Regulation A.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

13. Reserve Requirements of Depository Institutions[1]

Type of deposit, and deposit interval	Member bank requirements before implementation of the Monetary Control Act	
	Percent of deposit	Effective date
Net demand (millions of dollars) [2]		
$0–$2	7	12/30/76
$2–$10	9½	12/30/76
$10–$100	11¾	12/30/76
$100–$400	12¾	12/30/76
More than $400	16¼	12/30/76
Time and savings [2,3]		
Savings	3	3/16/67
Time [4]		
$0 million–5 million, by maturity		
30–179 days	3	3/16/84
180 days to 4 years	2½	1/8/76
4 years or more	1	10/30/75
More than $5 million, by maturity		
30–179 days	6	12/12/74
180 days to 4 years	2½	1/8/76
4 years or more	1	10/30/75

1. Reserve requirements in effect on Dec. 31, 1984. For information regarding previous reserve requirements, see earlier editions of the ANNUAL REPORT and of the *Federal Reserve Bulletin*. Under provisions of the Monetary Control Act, depository institutions include commercial banks, mutual savings banks, savings and loan associations, credit unions, agencies and branches of foreign banks, and Edge corporations.

2. Requirement schedules are graduated, and each deposit interval applies to that part of the deposits of each bank. Demand deposits subject to reserve requirements were gross demand deposits minus cash items in process of collection and demand balances due from domestic banks.

The Federal Reserve Act as amended through 1978 specified different ranges of requirements for reserve city banks and for other banks. Reserve cities were designated under a criterion adopted effective Nov. 9, 1972, by which a bank having net demand deposits of more than $400 million was considered to have the character of business of a reserve city bank. The presence of the head office of such a bank constituted designation of that place as a reserve city. Cities in which there were Federal Reserve Banks or branches were also reserve cities. Any banks having net demand deposits of $400 million or less were considered to have the character of business of banks outside of reserve cities and were permitted to maintain reserves at ratios set for banks not in reserve cities.

Effective Aug. 24, 1978, the Regulation M reserve requirements on net balances due from domestic banks to their foreign branches and on deposits that foreign branches lend to U.S. residents were reduced to zero from 4 percent and 1 percent respectively. The Regulation D reserve requirement of borrowings from unrelated banks abroad was also reduced to zero from 4 percent.

Effective with the reserve computation period beginning Nov. 16, 1978, domestic deposits of Edge corporations were subject to the same reserve requirements as deposits of member banks.

3. Negotiable order of withdrawal (NOW) accounts and time deposits such as Christmas and vacation club accounts were subject to the same requirements as savings deposits.

The average reserve requirement on savings and other time deposits before implementation of the Monetary Control Act had to be at least 3 percent, the minimum specified by law.

4. Effective Nov. 1, 1978, a supplementary reserve requirement of 2 percent was imposed on large time deposits of $100,000 or more, obligations of affiliates, and ineligible acceptances. This supplementary requirement was eliminated with the maintenance period beginning July 24, 1980.

Effective with the reserve maintenance period beginning Oct. 25, 1979, a marginal reserve requirement of 8 percent was added to managed liabilities in excess of a base amount. This marginal requirement was increased to 10 percent beginning Apr. 3, 1980, was decreased to 5 percent beginning June 12, 1980, and was eliminated beginning July 24, 1980. Managed liabilities are defined as large time deposits, Eurodollar borrowings, repurchase agreements against U.S. government and federal agency securities, federal funds borrowings from nonmember institutions, and certain other obligations. In general, the base for the marginal reserve requirement was originally the greater of (a) $100 million or (b) the average amount of the managed liabilities held by a member bank, Edge corporation, or family of U.S. branches and agencies of a foreign bank for the two reserve computation periods ending Sept. 26, 1979. For the computation period beginning Mar. 20, 1980, the base was lowered (a) 7 percent or (b) the decrease in an institution's U.S. office gross loans to foreigners and gross balances due from foreign offices of other institutions between the base period (Sept. 13–26, 1979) and the week ending Mar. 12, 1980, whichever was greater. For the computation period beginning May 29, 1980, the base was increased 7½ percent above the base used to calculate the marginal reserve in the statement week of May 14–21, 1980. In addition, beginning Mar. 19, 1980, the base was reduced to the extent that foreign loans and balances declined.

5. The Garn-St Germain Depository Institutions Act of 1982 (Public Law 97-320) provides that $2 million of reservable liabilities (transaction accounts, nonpersonal time deposits, and Eurocurrency liabilities) of each depository institution be subject to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

13. Reserve Requirements of Depository Institutions —Continued

Type of deposit, and deposit interval[5]	Depository institution requirements after implementation of the Monetary Control Act[6]	
	Percent of deposits	Effective date
Net transaction accounts[7,8]		
$0 million–$28.9 million	3	12/29/83
Over $28.9 million	12	12/29/83
Nonpersonal time deposits[9]		
By original maturity		
Less than 1½ years	0	10/6/83
1½ years or more	0	10/6/83
Eurocurrency liabilities		
All types	3	11/13/80

a zero percent reserve requirement. The Board is to adjust the amount of reservable liabilities subject to this zero percent reserve requirement each year for the next succeeding calendar year by 80 percent of the percentage increase in the total reservable liabilities of all depository institutions, measured on an annual basis as of June 30. No corresponding adjustment is to be made in the event of a decrease. Effective Dec. 9, 1982, the amount of the exemption was established at $2.1 million. Effective with the reserve maintenance period beginning Jan. 12, 1984, the amount of the exemption was increased to $2.2 million, and on Jan. 1, 1985, to $2.4 million. Effective with the reserve computation period beginning Dec. 31, 1985, the exemption was increased to $2.6 million. In determining the reserve requirements of depository institutions, the exemption shall apply in the following order: (1) nonpersonal money market deposit accounts (MMDAs) authorized under 12 CFR section 1204.122; (2) net NOW accounts (NOW accounts less allowable deductions); (3) net other transaction accounts; and (4) nonpersonal time deposits or Eurocurrency liabilities starting with those with the highest reserve ratio. With respect to NOW accounts and other transaction accounts, the exemption applies only to such accounts that would be subject to a 3 percent reserve requirement.

6. For nonmember banks and thrift institutions that were not members of the Federal Reserve System on or after July 1, 1979, a phase-in period ends Sept. 3, 1979. For banks that were members on or after July 1, 1979, but withdrew on or before Mar. 31, 1980, the phase-in period established by Public Law 97-320 ended on Oct. 24, 1985. For existing member banks the phase-in period of about three years was completed on Feb. 2, 1984. All new institutions will have a two-year phase-in beginning with the date that they open for business, except for those institutions that have total reservable liabilities of $50 million or more.

7. Transaction accounts include all deposits on which the account holder is permitted to make withdrawals by negotiable or transferable instruments, payment orders of withdrawal, and telephone and preauthorized transfers (in excess of three per month) for the purpose of making payments to third persons or others. However, MMDAs and similar accounts offered by institutions not subject to the rules of the Depository Institutions Deregulation Committee that permit no more than six preauthorized, automatic, or other transfers per month of which no more than three can be checks—are not transaction accounts (such accounts are savings deposits subject to time deposit reserve requirements).

8. The Monetary Control Act of 1980 requires that the amount of transaction accounts against which the 3 percent reserve requirement applies be modified annually by 80 percent of the percentage increase in transaction accounts held by all depository institutions determined as of June 30 each year. Effective Dec. 31, 1981, the amount was increased accordingly from $25 million to $26 million; effective Dec. 30, 1982, to $26.3 million; effective Dec. 29, 1983, to $28.9 million; effective Jan. 1, 1985, to $29.8 million; and effective Dec. 31, 1985, to $31.7 million.

9. In general, nonpersonal time deposits are time deposits, including savings deposits, that are not transaction accounts and in which a beneficial interest is held by a depositor that is not a natural person. Also included are certain transferable time deposits held by natural persons and certain obligations issued to depository institution offices located outside the United States. For details, see section 204.2 of Regulation D.

NOTE. Required reserves must be held in the form of deposits with Federal Reserve Banks or vault cash. Nonmembers may maintain reserve balances with a Federal Reserve Bank indirectly on a pass-through basis with certain approved institutions.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

14. Maximum Interest Rates Payable on Time and Savings Deposits at Federally Insured Institutions, December 31, 1985[1]

Percent per annum

Type and maturity of deposit	Commercial banks		Savings and loan associations and mutual savings banks (thrift institutions)[1]	
	Percent	Effective date	Percent	Effective date
Savings	5½	1/1/84	5½	7/1/79
Negotiable order of withdrawal accounts	5¼	12/31/80	5½	12/31/80
Negotiable order of withdrawal accounts of $1,000 or more[2]	...	1/5/83	...	1/5/83
Money market deposit account[2,3]	...	12/14/82	...	12/14/82
Time accounts				
7–31 days of less than $1,000[4]	5½	1/1/84	5½	9/1/82
7–31 days of $1,000 or more[2]	...	1/5/83	...	1/5/83
More than 31 days	...	10/1/83	...	10/1/83

1. Effective Oct. 1, 1983, restrictions on the maximum rates of interest payable by commercial banks and thrift institutions on various categories of deposits were removed. For information regarding previous interest rate ceilings on all categories of accounts, see earlier issues of the *Federal Reserve Bulletin*, the *Federal Home Loan Bank Board Journal*, and the *Annual Report of the Federal Deposit Insurance Corporation.*

2. Effective Dec. 1, 1983, IRA/Keogh (H.R. 10) Plan accounts are not subject to minimum deposit requirements. Effective Jan. 1, 1985, the minimum denomination requirement for all other NOW accounts was lowered from $2,500 to $1,000.

3. Effective Dec. 14, 1982, depository institutions are authorized to offer a new account with a required initial balance of $2,500 and an average maintenance balance of $2,500 not subject to interest rate restrictions. Effective Jan. 1, 1985, the minimum denomination and average balance maintenance requirements were lowered to $1,000. No minimum maturity period is required for this account, but depository institutions must reserve the right to require seven days' notice before withdrawals. When the average balance is less than $1,000, the account is subject to the maximum ceiling rate of interest for negotiable order of withdrawal accounts; compliance with the average balance requirement may be determined over a period of one month. Depository institutions may not guarantee a rate of interest for this account for a period longer than one month or condition the payment of a rate on a requirement that the funds remain on deposit for longer than one month.

4. Effective Jan. 1, 1985, the minimum denomination requirement was lowered from $2,500 to $1,000. Deposits of less than $1,000 issued to governmental units continue to be subject to an interest rate ceiling of 8 percent.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

15. Margin Requirements for Regulations T, U, G, and X [1]

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only [2]
1934, Oct. 1	25–45	...	...
1936, Feb. 1	25–55	...	...
Apr. 1	55	...	...
1937, Nov. 1	40	...	50
1945, Feb. 5	50	...	50
July 5	75	...	75
1946, Jan. 21	100	...	100
1947, Feb. 21	75	...	75
1949, Mar. 3	50	...	50
1951, Jan. 17	75	...	75
1953, Feb. 20	50	...	50
1955, Jan. 4	60	...	60
Apr. 23	70	...	70
1958, Jan. 16	50	...	50
Aug. 5	70	...	70
Oct. 16	90	...	90
1960, July 28	70	...	70
1962, July 10	50	...	50
1963, Nov. 6	70	...	70
1968, Mar. 11	70	50	70
June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50
1977, Jan. 1 [3]	50	50	50

1. These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry "margin securities" and "margin stock" (as defined in the regulations) when such credit is collateralized by securities. Margin requirements are the difference between the market value (100 percent) and the maximum loan value of collateral as prescribed by the Board. Regulation T was adopted effective Oct. 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective Mar. 11, 1968; and Regulation X, effective Nov. 1, 1971.

2. From Oct. 1, 1934, to Oct. 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

3. The margin required for writing options (Regulation T only) was set at 30 percent; it is expressed as a percent of the current market value of the stock underlying the option.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

16. Principal Assets and Liabilities, and Number of Insured Commercial Banks, by Class of Bank, June 30, 1985 and 1984 [1]

Asset and liability items shown in millions of dollars

Item	Insured commercial banks				Insured nonmember banks
	Total	Member banks			
		Total	National	State	
	June 30, 1985				
Loans and investments, total	1,684,424	1,224,893	980,577	244,317	459,530
Loans					
Gross	1,300,233	979,049	784,853	194,196	321,184
Net	1,283,513	967,750	776,062	191,688	315,762
Investments	384,191	245,845	195,723	50,121	138,346
U.S. government securities	251,538	157,285	127,029	30,256	94,253
Other	132,653	88,559	68,694	19,865	44,094
Cash assets, total	202,942	157,733	121,455	36,277	45,210
Deposits, total	1,648,874	1,171,900	948,920	222,980	476,974
Interbank	55,796	50,161	35,027	15,134	5,635
Other transaction	462,375	339,136	267,601	71,535	123,239
Other nontransaction	1,246,117	858,804	711,067	147,737	387,314
Total equity capital	158,769	116,331	91,187	25,144	42,438
Number of banks	14,351	5,970	4,904	1,066	8,381
	June 30, 1984				
Loans and investments, total	1,549,575	1,121,469	897,670	223,799	428,106
Loans					
Gross	1,177,609	885,002	707,863	177,140	292,607
Net	1,160,638	873,670	698,963	174,707	286,968
Investments	371,965	236,467	189,807	46,660	135,499
U.S. government securities	241,689	149,006	121,215	27,791	92,684
Other	130,276	87,461	68,593	18,868	42,815
Cash assets, total	192,962	149,751	114,234	35,518	43,210
Deposits, total	1,523,606	1,078,892	867,967	210,925	444,714
Interbank	53,307	48,787	32,210	16,577	4,520
Other demand	436,637	317,610	249,676	67,933	119,027
Other time and savings	1,033,663	712,495	586,080	126,415	321,167
Total equity capital	144,329	105,011	82,040	22,970	39,318
Number of banks	14,373	5,825	4,774	1,051	8,548

1. All insured commercial banks in the United States.

NOTE. Details may not add to totals because of rounding.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

17. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–85, and Month-End 1985

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[4]	Special drawing rights certificate account	Treasury currency outstanding[5]
	U.S. government securities			Loans	Float[1]	All other[2]	Other Federal Reserve assets[3]	Total			
	Total	Bought outright	Held under repurchase agreement								
1918	239	239	0	1,766	199	294	0	2,498	2,873	...	1,795
1919	300	300	0	2,215	201	575	0	3,292	2,707	...	1,707
1920	287	287	0	2,687	119	262	0	3,355	2,639	...	1,709
1921	234	234	0	1,144	40	146	0	1,563	3,373	...	1,842
1922	436	436	0	618	78	273	0	1,405	3,642	...	1,958
1923	134	80	54	723	27	355	0	1,238	3,957	...	2,009
1924	540	536	4	320	52	390	0	1,302	4,212	...	2,025
1925	375	367	8	643	63	378	0	1,459	4,112	...	1,977
1926	315	312	3	637	45	384	0	1,381	4,205	...	1,991
1927	617	560	57	582	63	393	0	1,655	4,092	...	2,006
1928	228	197	31	1,056	24	500	0	1,809	3,854	...	2,012
1929	511	488	23	632	34	405	0	1,583	3,997	...	2,022
1930	739	686	43	251	21	372	0	1,373	4,306	...	2,027
1931	817	775	42	638	20	378	0	1,853	4,173	...	2,035
1932	1,855	1,851	4	235	14	41	0	2,145	4,226	...	2,204
1933	2,437	2,435	2	98	15	137	0	2,688	4,036	...	2,303
1934	2,430	2,430	0	7	5	21	0	2,463	8,238	...	2,511
1935	2,431	2,430	1	5	12	38	0	2,486	10,125	...	2,476
1936	2,430	2,430	0	3	39	28	0	2,500	11,258	...	2,532
1937	2,564	2,564	0	10	19	19	0	2,612	12,760	...	2,637
1938	2,564	2,564	0	4	17	16	0	2,601	14,512	...	2,798
1939	2,484	2,484	0	7	91	11	0	2,593	17,644	...	2,963
1940	2,184	2,184	0	3	80	8	0	2,274	21,995	...	3,087
1941	2,254	2,254	0	3	94	10	0	2,361	22,737	...	3,247
1942	6,189	6,189	0	6	471	14	0	6,679	22,726	...	3,648
1943	11,543	11,543	0	5	681	10	0	12,239	21,938	...	4,094
1944	18,846	18,846	0	80	815	4	0	19,745	20,619	...	4,131
1945	24,252	24,262	0	249	578	2	0	15,091	20,065	...	4,339
1946	23,350	23,350	0	163	580	1	0	24,093	20,529	...	4,562
1947	22,559	22,559	0	85	535	1	0	23,181	22,754	...	4,562
1948	23,333	23,333	0	223	541	1	0	24,097	24,244	...	4,589
1949	18,885	18,885	0	78	534	2	0	19,499	24,427	...	4,598
1950	20,778	20,725	53	67	1,368	3	0	22,216	22,706	...	4,636
1951	23,801	23,605	196	19	1,184	5	0	25,009	22,695	...	4,709
1952	24,697	24,034	663	156	967	4	0	25,825	23,187	...	4,812
1953	25,916	25,318	598	28	935	2	0	26,880	22,030	...	4,894
1954	24,932	24,888	44	143	808	1	0	25,885	21,713	...	4,985
1955	24,785	24,391	394	108	1,585	29	0	26,507	21,690	...	5,008
1956	24,915	24,610	305	50	1,665	70	0	26,699	21,949	...	5,066
1957	24,238	23,719	519	55	1,424	66	0	25,784	22,781	...	5,146
1958	26,347	26,252	95	64	1,296	49	0	27,755	20,534	...	5,234
1959	26,648	26,607	41	458	1,590	75	0	28,771	19,456	...	5,311
1960	27,384	26,984	400	33	1,847	74	0	29,338	17,767	...	5,398
1961	28,881	30,478	159	130	2,300	51	0	31,362	16,889	...	5,585
1962	30,820	28,722	342	38	2,903	110	0	33,871	15,978	...	5,567
1963	33,593	33,582	11	63	2,600	162	0	36,418	15,513	...	5,578
1964	37,044	36,506	538	186	2,606	94	0	39,930	15,388	...	5,405

For notes see last two pages of table.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

17.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings[6]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[3]	Required clearing balances	Other Federal Reserve liabilities and capital[3]	Member bank reserves[7]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[8]	Required[9]	Excess[9]
4,951	288	51	96	25	118	0	0	1,636	0	1,585	51
5,091	385	31	73	28	208	0	0	1,890	0	1,822	68
5,325	218	57	5	18	298	0	0	1,781	0	0	0
4,403	214	96	12	15	285	0	0	1,753	0	1,654	99
4,530	225	11	3	26	276	0	0	1,934	0	0	0
4,757	213	38	4	19	275	0	0	1,898	0	1,884	14
4,760	211	51	19	20	258	0	0	2,220	0	2,161	59
4,817	203	16	8	21	272	0	0	2,212	0	2,256	−44
4,808	201	17	46	19	293	0	0	2,194	0	2,250	−56
4,716	208	18	5	21	301	0	0	2,487	0	2,424	63
4,686	202	23	6	21	348	0	0	2,389	0	2,430	−41
4,578	216	29	6	24	393	0	0	2,355	0	2,428	−73
4,603	211	19	6	22	375	0	0	2,471	0	2,375	96
5,360	222	54	79	31	354	0	0	1,961	0	1,994	−33
5,388	272	8	19	24	355	0	0	2,509	0	1,933	576
5,519	284	3	4	128	360	0	0	2,729	0	1,870	859
5,536	3,029	121	20	169	241	0	0	4,096	0	2,282	1,814
5,882	2,566	544	29	226	253	0	0	5,587	0	2,743	2,844
6,543	2,376	244	99	160	261	0	0	6,606	0	4,622	1,984
6,550	3,619	142	172	235	263	0	0	7,027	0	5,815	1,212
6,856	2,706	923	199	242	260	0	0	8,724	0	5,519	3,205
7,598	2,409	634	397	256	251	0	0	11,653	0	6,444	5,209
8,732	2,213	368	1,133	599	284	0	0	4,026	0	7,411	6,615
11,160	2,215	867	774	586	291	0	0	12,450	0	9,365	3,085
15,410	2,193	799	793	485	256	0	0	13,117	0	11,129	1,988
20,499	2,303	579	1,360	356	339	0	0	12,886	0	11,650	1,236
25,307	2,375	440	1,204	394	402	0	0	14,373	0	12,748	1,625
28,515	2,287	977	862	446	495	0	0	15,915	0	14,457	1,458
28,952	2,272	393	508	314	607	0	0	16,139	0	15,577	562
28,868	1,336	870	392	569	563	0	0	17,899	0	16,400	1,499
28,224	1,325	1,123	642	547	590	0	0	20,479	0	19,277	1,202
27,600	1,312	821	767	750	106	0	0	16,568	0	15,550	1,018
27,741	1,293	668	895	565	714	0	0	17,681	0	16,509	1,172
29,206	1,270	247	526	363	746	0	0	20,056	0	19,667	389
30,433	1,270	389	550	455	777	0	0	19,950	0	20,520	−570
30,781	761	346	423	493	839	0	0	20,160	0	19,397	763
30,509	796	563	490	441	907	0	0	18,876	0	18,618	258
31,158	767	394	402	554	925	0	0	19,005	0	18,903	102
31,790	775	441	322	426	901	0	0	19,059	0	19,089	−30
31,834	761	481	356	246	998	0	0	19,034	0	19,091	−57
32,193	683	358	272	391	1,122	0	0	18,504	0	18,574	−70
32,591	391	504	345	694	841	0	0	18,174	310	18,619	−135
32,869	377	485	217	533	941	0	0	17,081	2,544	18,988	637
33,918	422	465	279	320	1,044	0	0	17,387	2,544	18,988	96
35,338	380	597	247	393	1,007	0	0	17,454	3,262	20,071	645
37,692	361	880	171	291	1,065	0	0	17,049	4,099	20,677	471
39,619	612	820	229	321	1,036	0	0	18,086	4,151	21,663	574

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

17. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–85, and Month-End 1985—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[4]	Special drawing rights certificate account	Treasury currency outstanding[5]
	U.S. government securities[10]			Loans	Float[1]	All other[2]	Other Federal Reserve assets[3]	Total			
	Total	Bought outright[11]	Held under repurchase agreement								
1965	40,768	40,478	290	137	2,248	187	0	43,340	13,733	...	5,575
1966	44,316	43,655	661	173	2,495	193	0	47,177	13,159	...	6,317
1967	49,150	48,980	170	141	2,576	164	0	52,031	11,982	...	6,784
1968	52,937	52,937	0	186	3,443	58	0	56,624	10,367	...	6,795
1969	57,154	57,154[2]	0	183	3,440	64	2,743	64,584	10,367	...	6,852
1970	62,142	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971	70,804	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972	71,230	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973	80,495	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974	85,714	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975	94,124	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976	104,093	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977	111,274	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978	118,591	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979	126,167	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	13,083
1980	130,592	128,038	2,554	1,809	4,467	776	8,739	146,383	11,160	2,518	13,427
1981	140,348	136,863	3,485	1,601	1,762	195	9,230	153,136	11,151	3,318	13,687
1982	148,837	144,544	4,293	717	2,735	1,480	9,890	63,659	11,148	4,618	13,786
1983	160,795	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732
1984	169,627	167,612	2,015	3,577	833	0	12,347	186,384	11,096	4,618	16,418
1985	191,248	186,025	5,223	3,060	988	0	15,302	210,598	11,090	4,718	17,075
1985											
Jan.	162,944	162,944	0	2,139	502	0	12,305	177,890	11,095	4,618	16,476
Feb.	165,384	165,496	2,888	2,329	−56	0	11,129	181,786	11,093	4,618	16,531
Mar.	169,355	169,355	0	2,582	298	0	12,476	184,711	11,093	4,618	16,601
Apr.	182,816	174,832	7,984	1,525	254	0	13,057	197,652	11,091	4,618	16,673
May	172,608	172,608	0	1,765	−816	0	11,705	185,262	11,091	4,618	16,726
June	177,413	177,413	0	1,338	262	0	12,429	191,442	11,090	4,618	16,770
July	175,352	175,352	0	1,567	−571	0	14,575	190,923	11,090	4,618	16,817
Aug.	178,336	178,336	0	2,068	−152	0	12,441	192,693	11,090	4,618	16,868
Sept.	177,929	177,929	0	2,520	69	0	13,630	194,148	11,090	4,618	16,971
Oct.	176,932	176,932	0	886	335	0	14,731	192,884	11,090	4,718	16,971
Nov.	177,395	177,395	0	1,602	909	0	14,823	194,729	11,090	4,718	17,019
Dec.	191,248	186,025	5,223	3,060	988	0	15,302	210,598	11,090	4,718	17,075

1. Beginning with 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.
2. Data consist principally of acceptances and, until Aug. 21, 1959, industrial loans, authority for which expired on that date.
3. For the period before Apr. 16, 1969, this category includes the total of Federal Reserve capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets, and was reported as "Other Federal Reserve accounts"; thereafter, "Other Federal Reserve assets" and "Other Federal Reserve liabilities and capital" are shown separately.
4. For the period before Jan. 30, 1934, data include gold held in Federal Reserve Banks and in circulation.
5. These figures include currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details see the regular table, "Currency and Coin in Circulation," in the *Treasury Bulletin*.
6. This category consists of the coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.
7. Beginning in November 1979, includes reserves of member banks, Edge corporations, and U.S. agencies and branches of foreign banks. Beginning on Nov. 13, 1980, includes reserves of all depository institutions.
8. Between Dec. 1, 1959, and Nov. 23, 1960, part of the amount was allowed as reserves; thereafter all was allowed.
9. These figures are estimated through 1958. Before 1929, they were available only on call dates (in 1920 and 1922 the call dates were Dec. 29). Beginning on Sept. 12, 1968, the amount is based on close-of-business figures for the reserve period two weeks before the report date.
10. Beginning on Dec. 1, 1966, these securities include federal agency obligations held under repur-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

17.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings[6]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[3]	Required clearing balances	Other Federal Reserve liabilities and capital[3]	Member bank reserves[7]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[8]	Required[9]	Excess[9,12]
42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	−238
44,663	1,176	416	174	588	−147	0	0	19,779	4,310	24,321	−232
47,226	1,344	1,123	135	563	−773	0	0	21,092	4,631	25,905	−182
50,961	695	703	216	747	−1,353	0	0	21,818	4,921	27,439	−700
53,950	596	1,312	134	807	0	0	0	22,085	5,187	28,173	−901
57,903	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	−460
61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98[12]
72,497	317	2,542	251	1,419[13]	0	0	2,669	27,060	6,781	35,268	−1,360
79,743	185	2,113	418	1,275[13]	0	0	2,935	25,843	7,370	37,011	−3,798
86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	−1,103[14]
93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	−1,535
103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	−1,265
114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	−893
125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	−2,835
136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	−1,442
154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
171,935	479	3,661	191	851	0	1,013	5,392	20,413	17,821	39,179	−945
183,796	513	5,316	253	867	0	1,126	5,952	20,693	n.a.	n.a.	n.a.
197,488	550	9,351	480	1,041	0	1,490	5,940	27,141	n.a.	n.a.	n.a.
177,569	535	5,349	244	560	0	1,164	5,964	18,694	n.a.	n.a.	n.a.
178,416	557	3,308	332	461	0	1,226	5,863	23,866	n.a.	n.a.	n.a.
179,210	554	3,063	253	347	0	1,359	6,600	25,638	n.a.	n.a.	n.a.
180,858	586	19,305	348	324	0	1,302	6,652	20,660	n.a.	n.a.	n.a.
184,691	602	1,933	205	557	0	1,337	6,242	22,131	n.a.	n.a.	n.a.
185,886	588	3,288	310	321	0	1,348	6,291	25,888	n.a.	n.a.	n.a.
187,040	577	2,656	274	323	0	1,395	6,325	24,858	n.a.	n.a.	n.a.
188,548	548	3,656	223	389	0	1,435	6,240	24,230	n.a.	n.a.	n.a.
187,325	546	4,174	535	497	0	1,444	6,530	25,718	n.a.	n.a.	n.a.
189,490	547	1,528	268	372	0	1,469	6,339	25,650	n.a.	n.a.	n.a.
193,463	556	2,294	340	598	0	1,483	6,475	22,347	n.a.	n.a.	n.a.
197,488	550	9,351	480	1,041	0	1,490	5,940	27,141	n.a.	n.a.	n.a.

chase agreements and beginning on Sept. 29, 1971, federal agency issues bought outright.

11. Includes, beginning in 1969, securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes (if any) securities sold and scheduled to be bought back under matched sale-purchase transactions.

12. Beginning with the week ending Nov. 15, 1972, figures include $450 million of reserve deficiencies on which Federal Reserve Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective Nov. 9, 1972. Allowable deficiencies are as follows (beginning with first statement week of quarter, in millions): 1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; and 1974—Q1, $67, and Q2, $58. The transition period ended after the second quarter of 1974.

13. For the period before 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 Federal Reserve 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 Federal Reserve Banks that are associated with marginal reserves are no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States and (2) Eurodollar liabilities.

14. Beginning with the week ending Nov. 19, 1975, figures are adjusted to include waivers of penalties for reserve deficiencies, in accordance with the change in Board policy that became effective Nov. 19, 1975.

NOTE. For a description of figures and discussion of their significance, see *Banking and Monetary Statistics, 1941-1970* (Board of Governors of the Federal Reserve System, 1976), pp. 507-23.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

18. Changes in Number of Banking Offices in the United States, 1985p

Type of office and change	All banks	Commercial banks (including stock savings banks and nondeposit trust companies)						Mutual savings banks	
		Total	Member			Nonmember			
			Total	National	State	Insured	Noninsured	Insured	Noninsured
Banks, Dec. 31, 1984	**15,489**	**15,126**	**5,982**	**4,910**	**1,072**	**8,530**	**614**[1]	**267**	**96**
Changes during 1985									
New banks	347	345	226	178	48	92	27	2	0
Ceased banking operation	−31	−31	−16	−12	−4	−10	−5	0	0
Banks converted into branches	−318	−313	−142	−111	−31	−167	−4	−5	0
Other[2]	−45	−59	0	2	−2	−53	−6	94	−80
Net change	**−47**	**−58**	**68**	**57**	**11**	**−138**	**12**	**91**	**−80**
Dec. 31, 1985	**15,442**	**15,068**	**6,050**	**4,967**	**1,083**	**8,392**	**626**	**358**	**16**
Branches and additional offices, Dec. 31, 1984[3]	**43,128**	**40,808**	**26,038**	**21,222**	**4,816**	**14,666**	**104**	**2,088**	**232**
Changes during 1985									
De novo	1,321	1,249	650	493	157	587	12	65	7
Banks converted	318	313	142	111	31	167	4	5	0
Discontinued	−553	−533	−380	−315	−65	−153	0	−20	0
Sale of branch		−1	−29	−32	3	28	0	1	0
Other[2]	1,138	1,256	1,174	1,182	−8	114	−32	80	−198
Net change	**2,224**	**2,284**	**1,557**	**1,439**	**118**	**743**	**−16**	**131**	**−191**
Dec. 31, 1985[3]	**45,352**	**43,092**	**27,595**	**22,661**	**4,934**	**15,409**	**88**	**2,219**	**41**

1. As of Dec. 31, 1985, includes 14 noninsured state member banks and 2 noninsured national trust companies.
2. Includes interclass changes.
3. Excludes banking facilities.
p Preliminary. Final data will be available in the *Annual Statistical Digest, 1985*, forthcoming.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1985

Bank of Virginia, Richmond, Virginia, *to merge with* **Citizens Trust Bank, Portsmouth, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/30/84)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (1/22/85)

Bank of Virginia (Applicant), with assets of $2.8 billion, proposes to merge with Citizens Trust Bank (Bank), with assets of $124 million.

Applicant is a subsidiary of the Bank of Virginia Company (BVA), which controls 7.5 percent of deposits in the Norfolk-Portsmouth banking market. If the proposed merger were consummated, BVA would control 11.7 percent of commercial bank deposits in that market. The proposal would have no significantly adverse effect on competition.

The proposed merger would not alter the satisfactory financial condition of Applicant and BVA. Considerations relating to the convenience and needs of the community are consistent with approval.

Bank of New York, New York, New York, *to acquire the assets and assume the deposit liabilities of the* **Great Neck Branch of Hamburg Savings Bank, Brooklyn, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12/21/84)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (2/1/85)

Bank of New York (Applicant), with assets of $13.2 billion, proposes to acquire the Great Neck Branch of Hamburg Savings Bank (Branch), with deposits of $29 million.

Applicant is a subsidiary of the Bank of New York Company (BONY), which currently controls 2.2 percent of commercial bank deposits in the New York banking market. If the proposed merger were consummated, BONY would continue to control 2.2 percent of the market deposits. The proposal would have no significantly adverse effect on competition.

The proposed merger would not alter the satisfactory financial condition of Applicant and BONY. The considerations relating to the convenience and needs of the community are consistent with approval.

Chemical Bank, Cass City, Michigan, *to acquire the assets and assume the deposit liabilities of the* **Marlette Branch of Peoples State Bank of Caro, Marlette, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/8/85)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (2/26/85)

Chemical Bank (Applicant), with assets of $25 million, proposes to acquire the Marlette Branch (Branch) of Peoples State Bank of Caro. Deposits at Branch amount to $2 million.

The relevant market in the proposal is the Sanilac market, in which Branch is located. Applicant is not presently represented there. The acquisition would have no significant effect on competition because Applicant would have a small share of area deposits.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Merchants & Farmers Bank, Columbus, Mississippi, *to merge with* **Tombigbee Bank & Trust Company, Fulton, Mississippi**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/15/85)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (3/3/85)

Merchants & Farmers Bank (Applicant), with assets of $68 million, proposes to merge with Tombigbee Bank & Trust Company (Bank), with assets of $24 million.

Applicant does not currently operate offices in the Itawamba County and Tupelo markets, where Bank's offices are situated, and there would be no significant effect on competition.

Applicant plans to offer a higher lending limit at the offices now operated by Bank. The considerations relating to the convenience and needs of the community therefore lend weight to approval. Financial factors are consistent with approval.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1985—Continued

Central Bank of the South, Birmingham, Alabama, *to acquire certain assets and assume certain deposits and other liabilities of* **branches of First National Bank of Mobile, and AmSouth Bank, Mobile, Alabama**

Summary Report by the Attorney General (3/8/85)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve Bank (3/22/85)

Central Bank of the South (Applicant), with assets of $3 billion, proposes to acquire certain assets and assume certain deposits and other liabilities of certain branches (Branches) of First National Bank of Mobile and AmSouth Bank, N.A. total deposits of branches to be acquired are $113 million. Branches are situated in the Mobile banking market, and Applicant, which now ranks fifth of nine organizations in that market, with 7.4 percent of market deposits, would rank fourth, with 13.7 percent of market deposits. The proposal would have no significantly adverse effect on competition.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Farmers & Merchants Bank of Central California, Ledi, California, *to acquire certain assets and assume substantially all of the liabilities of* **Golden Valley Bank, Turlock, California**

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 Reserve Bank to act immediately to safeguard depositors of Golden Valley Bank.

Basis for Approval by the Federal Reserve Bank (3/22/85)

Farmers & Merchants Bank of Central California (Applicant), with assets of $301 million, proposes to acquire Golden Valley Bank (Bank), with assets of $73 million.

In view of the financial condition of Bank, the California superintendent of banks has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Farmers & Merchants Bank of Long Beach, Long Beach, California, *to acquire certain assets and assume substantially all of the liabilities of* **Capistrano National Bank, San Juan Capistrano, California**

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 Reserve Bank to act immediately to safeguard depositors of Capistrano National Bank.

Basis for Approval by the Federal Reserve Bank (4/8/85)

Farmers and Merchants Bank of Long Beach (Applicant), with assets of $691 million, proposes to acquire Capistrano National Bank (Bank), with assets of $49 million.

In view of the financial condition of Bank, the Comptroller of the Currency has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Central Fidelity Bank, Richmond, Virginia, *to merge with* **First National Bank of Poquoson, Poquoson, Virginia**

Summary Report by the Attorney General (3/29/85)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve Bank (4/10/85)

Central Fidelity Bank (Applicant), with assets of $2.9 billion, proposes to merge with First National Bank of Poquoson (Bank), with assets of $30 million. Applicant is the sole banking subsidiary of Central Fidelity Banks, Inc. (Corporation).

The relevant market in this proposal is the Newport News–Hampton market, in which Corporation controls 8.1 percent of deposits. If the proposed merger took place, Corporation would control 10.3 percent of market deposits. Ten thrift institutions operate offices in this market. Overall, the proposal would have no significant competitive effects.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19.—Continued

Blue Ridge Bank, Floyd, Virginia, *to acquire certain assets and assume certain deposit liabilities of the* **Christiansburg Branch of Jefferson National Bank, Winchester, Virginia**

Summary Report by the Attorney General (4/26/85)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve Bank (4/16/85)
Blue Ridge Bank (Applicant), with assets of $12 million, proposes to acquire a branch (Branch) of Jefferson National Bank. Deposits at Branch amount to $3 million.

The relevant market in the proposal is approximated by the counties of Montgomery and Pulaski plus the independent city of Radford, where Branch holds the smallest share of deposits held by 11 commercial banking organizations. Because Applicant is not now represented in this market, the proposal would have no significant effect on competition.

The considerations relating to the convenience and needs of the community furnish some support for approval because after the acquisition Applicant will provide new or enhanced banking services at Branch. Financial factors are consistent with approval.

Johnstown Bank and Trust Company, Johnstown, Pennsylvania, *to acquire the assets and assume the deposit liabilities of* **two branches of Equibank, Pittsburgh, Pennsylvania**

Summary Report by the Attorney General (5/24/85)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve Bank (6/10/85)
Johnstown Bank and Trust Company (Applicant), with assets of $370 million, proposes to acquire two branches (Branches) of Equibank. Branches have deposits of $24 million.

Branches are in the Greensburg/Latrobe banking market, where they hold 2.2 percent of market deposits. Applicant controls 0.5 percent of market deposits held by 14 banking organizations in this market. Because Applicant would control less than 3 percent of market deposits following the acquisition, the proposal would have no significant effect on competition.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Peoples Bank and Trust Company, Cedar Rapids, Iowa, *to acquire certain assets and assume substantially all the liabilities of* **Urbanna Savings Bank, Urbanna, Iowa**

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 Reserve Bank to act immediately to safeguard depositors of Urbanna Savings Bank.

Basis for Approval by the Federal Reserve Bank (6/21/85)
Peoples Bank and Trust Company (Applicant), with assets of $211 million, proposes to acquire Urbanna Savings Bank (Bank), with assets of $7 million.

In view of the financial condition of Bank, the Iowa Department of Banking recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Pacific Inland Bank, Anaheim, California, *to acquire the assets and assume the liabilities of* **Town and Country Bank, Seal Beach, California**

Summary Report by the Attorney General (3/29/85)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve Bank (6/28/85)
Pacific Inland Bank (Applicant), with assets of $29 million, proposes to acquire Town and Country Bank (Bank), with assets of $35 million.

The relevant market in the proposal is the Metropolitan Los Angeles area, in which Applicant and Bank are located. Because Applicant would hold less than 1 percent of deposits in the market following the acquisition, the proposal would have no significant effect on competition.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1985—Continued

Glenwood State Bank, Glenwood, Iowa, *to acquire certain assets and assume certain liabilities of* **Mineola State Bank, Mineola, Iowa**

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 Reserve Bank to act immediately to safeguard depositors of Mineola State Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (8/6/85)
Glenwood State Bank (Applicant), with assets of $48 million, proposes to acquire certain assets and assume certain liabilities of Mineola State Bank (Bank), which has assets of $5.1 million. In view of the financial condition of Bank, the Iowa superintendent of banks recommended immediate action by the Federal Reserve System to prevent probable failure of Bank.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Buffalo Bank, Eleanor, West Virginia, *to merge with* **First Community Bank-Winfield, Winfield, West Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/2/85)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (8/12/85)
The Buffalo Bank (Applicant), with assets of $28 million, proposes to merge with First Community Bank-Winfield (Bank), with assets of $6 million.

The relevant market in this proposal is approximated by Kanawha and Putnam counties, in which the bank resulting from the merger would rank 11th among 19 banking organizations. The proposal would have no significant effect on competition.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

United Counties Trust Company, Elizabeth, New Jersey, *to acquire certain assets and assume certain liabilities of the* **Keensburg branch of United Jersey Bank/Mid State, Hazlet, New Jersey**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/22/85)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE SECRETARY OF THE BOARD (9/23/85)
United Counties Trust Company (Applicant), with assets of $910 million, proposes to acquire certain assets and assume certain liabilities of the Keensburg Branch (Branch) of United Jersey Bank/Mid State. Branch has deposits of $6 million.

The relevant market in the proposal is the Asbury Park market, where Applicant ranks fourth among 14 banking organizations, with 8.9 percent of market deposits. Because Branch holds less than 1 percent of market deposits, the acquisition would have no significant effect on competition.

The banking factors and the considerations relating to the convenience and needs of the community are consistent with approval.

Bayshore Bank of Florida, Miami, Florida, *to acquire certain assets and assume substantially all of the liabilities of* **Tower Bank, N.A., Hialeah Gardens, Florida**

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 Reserve Bank to act immediately to safeguard depositors of Tower Bank, N.A.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (10/3/85)
Bayshore Bank of Florida (Applicant), with assets of $35 million, proposes to acquire Tower Bank, N.A. (Bank), with assets of $16 million.

In view of the financial condition of Bank, the Comptroller of the Currency has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Farmers and Merchants Bank of Long Beach, Long Beach, California, *to merge with* **Town and Country Bank, Seal Beach, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/18/85)
The proposed transaction would not be significantly adverse to competition.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19.—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (10/25/85)
Farmers and Merchants Bank of Long Beach (Applicant), with assets of $764 million, proposes to merge with Town and Country Bank (Bank), with assets of $33 million.

In view of the financial condition of Bank, the California superintendent of banks has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Banco de Ponce, Hato Rey, Puerto Rico, *to acquire certain assets and assume certain liabilities of the* **Pitkin Avenue Branch of East New York Savings Bank, New York, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/20/85)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (11/1/85)
Banco de Ponce (Applicant), with assets of $2 billion, proposes to acquire a branch (Branch) of East New York Savings Bank. Deposits at Branch amount to $26 million. The relevant market in the proposal is the Metropolitan New York area, in which Branch is located and in which Applicant is represented. The acquisition would not have a significant effect on competition because Applicant would have a small share of area deposits.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Georgia Bank, Atlanta, Georgia, *to merge with* **Gwinnett Bank & Trust Company, Norcross, Georgia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/1/85)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (11/27/85)
First Georgia Bank (Applicant), with assets of $649 million, proposes to merge with Gwinnett Bank & Trust Company (Bank), which has assets of $123 million.

Applicant is a subsidiary of First Railroad & Banking Company of Georgia, Augusta, Georgia (Company). Company is the 6th largest of 26 banking organizations in the Atlanta banking market, and controls 3.5 percent of market deposits. Bank ranks 10th, with 0.7 percent of market deposits. In view of the relatively small size of Bank in the market, there would be no significant competitive effects.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Central Trust Company, Rochester, New York, *to acquire the assets and assume the liabilities of the* **Hilton, New York, Branch of Chemical Bank, New York, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/8/85)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (12/31/85)
Central Trust Company (Applicant), with assets of $658 million, proposes to acquire the assets and assume the deposit liabilities of the Hilton, New York branch (Branch) of Chemical Bank, with deposits of $17 million.

Applicant is a subsidiary of Irving Bank Corporation, New York, New York (Company). Company is the fifth largest of 13 banking organizations in the Rochester banking market and as a result of the acquisition would increase its market share from 6.0 percent to 6.4 percent. The proposal would have no significant competitive effects.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank of New York, New York, New York *to acquire the assets and assume the liabilities of* **Fidata Trust Company, New York, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12/13/85)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE BANK (12/31/85)
Bank of New York (Applicant), with assets of $15 billion, proposes to acquire the assets and liabilities of Fidata Trust Company (Bank), with assets of $592 million. Applicant is a subsidiary of the Bank of New York Company, and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1985—Continued

in view of the size and number of banking alternatives in the Metropolitan New York market, competitive considerations with respect to this application are consistent with approval.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Mergers Approved Involving Wholly Owned Subsidiaries of the Same Bank Holding Company

The following transactions involve banks that are subsidiaries of the same bank holding company. In each case the summary report by the attorney general indicates that the transaction would not have a significantly adverse effect on competition because the proposed merger is essentially a corporate reorganization. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board of Governors, whichever approved the application, determined that the competitive effects of the proposed transaction, the financial and managerial resources and the prospects of the banks concerned, and the convenience and needs of the community to be served were consistent with approval.

Name of bank, type of transaction, and other banks involved [1]	Assets (millions of dollars)	Date of approval
Norstar Bank of Upstate New York, Albany, New York	1,488	2/25/85
Merger		
Oneida National Bank, Utica, New York	939	
Ohio Citizens Bank, Toledo, Ohio	744	2/28/85
Merger		
Two branches of BancOhio National Bank, Columbus, Ohio	43	
Gravois Bank, St. Louis County, Missouri	245	3/21/85
Merger		
Gravois Bank at Mehlville, St. Louis County, Missouri	14	
Valley Bank and Trust Company, Salt Lake City, Utah	636	3/25/85
Merger		
Bountiful Valley Bank, Bountiful, Utah	16	
Weber Valley Bank, Ogden, Utah	24	
Colonial Bank, Montgomery, Alabama	75	4/19/85
Merger		
Colonial Bank of Opp, N.A., Opp, Alabama	18	
First Virginia Bank of Tidewater, Norfolk, Virginia	249	6/4/85
Merger		
First Virginia Bank-Eastern Shore, Onancock, Virginia	60	
First Georgia Bank, Atlanta, Georgia	448	6/11/85
Merger		
First Georgia Bank, Cobb County, Marietta, Georgia	125	
Commercial & Exchange Bank, Bremen, Georgia	25	
Peoples Bank of Leslie, Leslie, Michigan	34	6/20/85
Merger		
Independent Bank–South Michigan, Olivet, Michigan	10	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19.—Continued

Name of bank, type of transaction, and other banks involved [1]	Assets (millions of dollars)	Date of approval
Wheeling Dollar Savings and Trust Company, Wheeling, West Virginia	209	6/21/85
Merger		
Wheeling Dollar Bank, Wheeling, West Virginia	21	
M&I Marshall & Ilsley Bank, Milwaukee, Wisconsin	1,896	8/7/85
Merger		
Heritage Bank, Wauwatosa, Wisconsin	464	
First Interstate Bank of California, Los Angeles, California	17,481	8/28/85
Merger		
Warner Center Branch of First Interstate Bank, Ltd., Los Angeles, California	3	
Fifth Third Bank, Cincinnati, Ohio	1,875	9/18/85
Merger		
Fifth Bank of Miami Valley, Kettering, Ohio	49	
Toledo Trust Company, Toledo, Ohio	1,863	9/26/85
Merger		
Society National Bank of Northwest Ohio, Fostoria, Ohio	277	
Trustcorp Company, Columbus, Ohio	48	9/26/85
Merger		
Society National Bank of Mid-Ohio, Bucyrus, Ohio	69	
1st Source Bank, South Bend, Indiana	809	10/4/85
Merger		
1st Source Bank of Marshall County, Plymouth, Indiana	153	
Fifth Third Bank of Columbus, Columbus, Ohio	20	10/22/85
Merger		
Fayette County Bank, Jeffersonville, Ohio	34	
Princeton Bank, Princeton, New Jersey	421	10/22/85
Merger		
Bank of New Jersey, N.A., Moorestown, New Jersey	615	
Manufacturers Hanover Trust Company, New York, New York	61,000	10/30/85
Merger		
Manufacturers Hanover, N.A., Rochester, New York	595	
Citizens State Bank, Silverton, Ohio	39	11/22/85
Merger		
C.S. Bank, Silverton, Silverton, Ohio	([2])	
Georgia Railroad Bank & Trust Company, Augusta, Georgia	607	11/27/85
Merger		
Georgia State Bank, Martinez, Georgia	57	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1985—Continued

Name of bank, type of transaction, and other banks involved[1]	Assets (millions of dollars)	Date of approval
Georgia Railroad Bank & Trust Company, Augusta, Georgia ...	607	11/27/85
Merger		
Washington Loan & Banking Company, Washington, Georgia...	48	
Comerica Bank, Detroit, Michigan..........................	7,115	11/27/85
Merger		
Comerica Bank, N.A., Grosse Pointe, Michigan	46	
Continental Bank and Trust Company, Salt Lake City, Utah	281	11/27/85
Merger		
Moore Financial of Utah, Salt Lake City, Utah...............	(2)	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

2. A newly organized bank, not in operation.

Mergers Approved Involving a Nonoperating Institution with an Existing Bank

The following transactions have no significant effect on competition: they merely facilitate the acquisition of the voting shares of a bank or banks by a holding company. In such cases the summary report by the attorney general indicates that the transaction will merely combine an existing bank with a nonoperating institution; in consequence, and without regard to the acquisition of the surviving bank by the holding company, the merger would have no effect on competition. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board of Governors, whichever approved the application, determined that the proposal would, in itself, have no adverse competitive effects and that the financial factors and considerations relating to the convenience and needs of the community were consistent with approval.

Name of bank, type of transaction, and other banks involved[1]	Assets (millions of dollars)	Date of approval
Cortland Interim Bank, Cortland, Ohio	(2)	2/28/85
Merger		
Cortland Savings & Banking Company, Cortland, Ohio........	162	
Wheeling Interim Bank	(2)	4/1/85
Merger		
Half Dollar Trust and Savings Bank, Wheeling, West Virginia ..	67	
New Bank of Hartsville, Hartsville, South Carolina...........	(2)	4/12/85
Merger		
Bank of Hartsville, Hartsville, South Carolina	56	
Metamora Interim Bank, Metamora, Ohio....................	(2)	4/16/85
Merger		
Metamora State Bank, Metamora, Ohio......................	13	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19.—Continued

Name of bank, type of transaction, and other banks involved[1]	Assets (millions of dollars)	Date of approval
New Belknap Bank, Belmont, New Hampshire	([2])	4/26/85
Merger		
Belknap Bank & Trust Company, Belmont, New Hampshire	42	
Ponce Interim Bank, Ponce, Puerto Rico	([2])	5/6/85
Merger		
Banco de Ponce, Ponce, Puerto Rico	1,952	
Farmers Interim Bank, Pomeroy, Ohio	([2])	5/14/85
Merger		
Farmers Bank and Savings, Pomeroy, Ohio	44	
First Virginia Bank-South Hill, South Hill, Virginia	([2])	5/15/85
Merger		
Citizens Bank, Inc., South Hill, Virginia	146	
First Interim Bank, Arlington, Virginia	([2])	5/28/85[3]
Merger		
First Commercial Bank, Arlington, Virginia	46	
First Virginia Bank-Hanover, Ashland, Virginia	([2])	6/4/85
Merger		
First Virginia Bank-Colonial, Richmond, Virginia	148	
George Mason Interim Bank, Fairfax, Virginia	([2])	6/17/85
Merger		
George Mason Bank, Fairfax, Virginia	86	
Mobile County Bank, Grand Bay, Alabama	([2])	7/25/85
Merger		
First National Bank of Mobile, Grand Bay, Alabama	168	
ATS State Bank, Dubuque, Iowa	([2])	8/9/85
Merger		
American Trust and Savings Bank, Dubuque, Iowa	203	
Shawsville Interim Bank, Inc., Shawsville, Virginia	([2])	8/12/85
Merger		
Bank of Shawsville, Shawsville, Virginia	28	
LSB Bank, Linden, Indiana	([2])	8/20/85
Merger		
Linden State Bank, Linden, Indiana	20	
Fidelity Bank Northeast, Minneapolis, Minnesota	([2])	8/29/85
Merger		
Fidelity Bank and Trust Company, Minneapolis, Minnesota	159	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1985—Continued

Name of bank, type of transaction, and other banks involved [1]	Assets (millions of dollars)	Date of approval
Society Bank of Northwest Ohio, Port Clinton, Ohio	([2])	9/26/85
Merger		
Three branches of Society National Bank of Northwest Ohio, Fosteria, Ohio	55	
CBT Interim Bank, Fruit Heights, Ohio	([2])	9/27/85
Merger		
Continental Bank and Trust Company, Salt Lake City, Utah	2,722	
Apple Country Bank, Charlottesville, Virginia	([2])	10/2/85
Merger		
Albemarle Bank and Trust Company, Charlottesville, Virginia	17	
Bibb Interim Bank, West Blocton, Alabama	([2])	10/4/85
Merger		
First State Bank of Bibb County, West Blocton, Alabama	11	
New Independence Bank, Plano, Texas	([2])	10/21/85
Merger		
Independence Bank, Plano, Texas	42	
Green Valley Bank, Inc., Bluefield, West Virginia	([2])	10/25/85
Merger		
Valley Bank and Trust Company, Bluefield, West Virginia	13	
M.B. Bank, Minerva, Ohio	([2])	10/25/85
Merger		
Minerva Banking Company, Minerva, Ohio	35	
First Virginia Bank-Southside, Farmville, Virginia	([2])	10/30/85
Merger		
First National Bank of Farmville, Farmville, Virginia	96	
First Virginia Bank-Middle Peninsula, Urbanna, Virginia	([2])	10/30/85
Merger		
Bank of Middlesex, Urbanna, Virginia	68	
Citizens Interim Bank, Ocala, Florida	([2])	11/13/85
Merger		
Citizens First Bank of Ocala, Ocala, Florida	51	
ONB Merger Bank, Greencastle, Indiana	([2])	11/29/85
Merger		
First Citizens Bank and Trust Company, Greencastle, Indiana	78	
Peoples Interim Bank, Van Wert, Ohio	([2])	12/10/85
Merger		
Peoples Bank and Trust Company, Van Wert, Ohio	56	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

19.—Continued

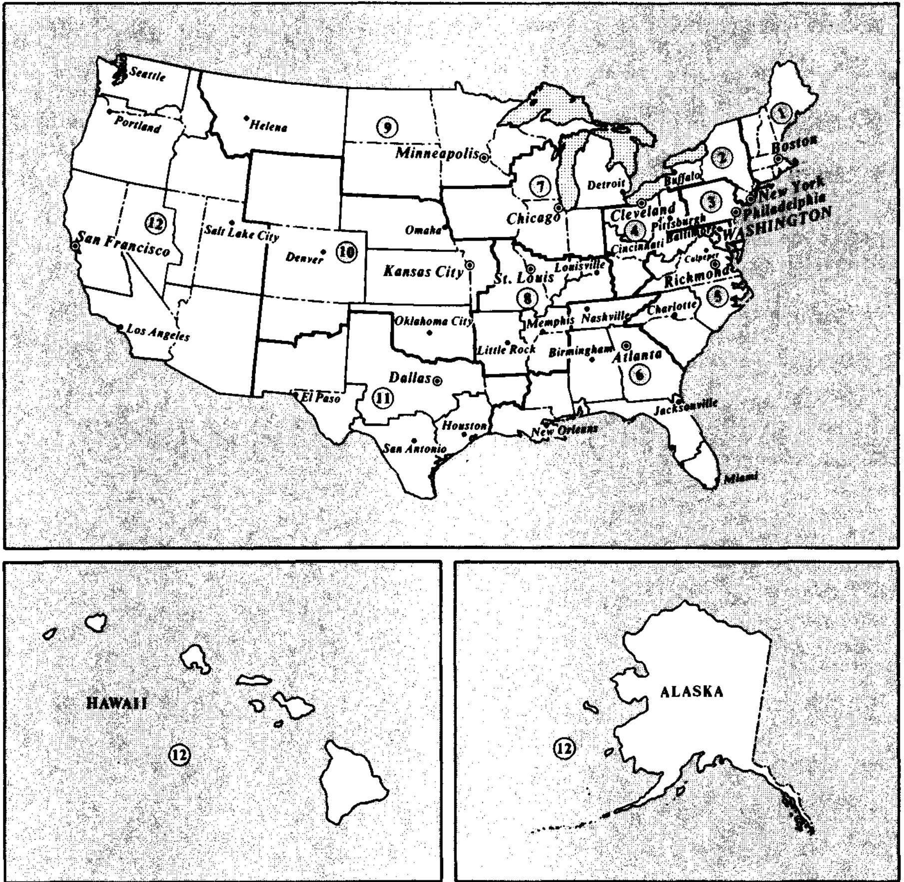
Name of bank, type of transaction, and other banks involved [1]	Assets (millions of dollars)	Date of approval
Monroe County Bank, Monroeville, Alabama	43	12/12/85
Merger		
First National Bank of Monroeville, Monroeville, Alabama	19	
Gassaway Interim Bank, Inc., Gassaway, West Virginia	([2])	12/12/85
Merger		
Bank of Gassaway, Gassaway, West Virginia	47	
Boca Interim Bank, Boca Raton, Florida	([2])	12/16/85
Merger		
Boca Bank, Boca Raton, Florida	38	
Beaver Trust Company Interim Bank, Beaver, Pennsylvania	([2])	12/18/85
Merger		
Beaver Trust Company, Beaver, Pennsylvania	152	
Sun Bank/Suncoast, N.A., St. Petersburg, Florida	541	12/19/85
Merger		
Sun Bank of Tampa Bay, Florida	506	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.
2. A newly organized bank, not in operation.
3. Application denied by the Board.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

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

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Reserve Directories and Meetings

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Board of Governors of the Federal Reserve System

December 31, 1985

	Term expires
PAUL A. VOLCKER of New Jersey, *Chairman*[1]	January 31, 1992
PRESTON MARTIN of California, *Vice Chairman*[1]	January 31, 1996
HENRY C. WALLICH of Connecticut	January 31, 1988
J. CHARLES PARTEE of Virginia	January 31, 1986
EMMETT J. RICE of New York	January 31, 1990
MARTHA R. SEGER of Michigan	January 31, 1998
Vacant	January 31, 1994

OFFICE OF BOARD MEMBERS

JOSEPH R. COYNE, *Assistant to the Board*
DONALD J. WINN, *Assistant to the Board*
STEVEN M. ROBERTS, *Assistant to the Chairman*
ANTHONY F. COLE, *Special Assistant to the Board*
BOB S. MOORE, *Special Assistant to the Board*
NAOMI P. SALUS, *Special Assistant to the Board*

OFFICE OF STAFF DIRECTOR FOR MONETARY AND FINANCIAL POLICY

STEPHEN H. AXILROD, *Staff Director*
DONALD L. KOHN, *Deputy Staff Director*
STANLEY J. SIGEL, *Assistant to the Board*
NORMAND R.V. BERNARD, *Special Assistant to the Board*

OFFICE OF STAFF DIRECTOR FOR MANAGEMENT

S. DAVID FROST, *Staff Director*
EDWARD T. MULRENIN, *Assistant Staff Director*
CHARLES L. HAMPTON, *Senior Technical Adviser*
PORTIA W. THOMPSON, *Equal Employment Opportunity Programs Officer*

OFFICE OF STAFF DIRECTOR FOR FEDERAL RESERVE BANK ACTIVITIES

THEODORE E. ALLISON, *Staff Director*
JOSEPH W. DANIELS, SR., *Adviser, Federal Reserve System Equal Employment Opportunity Program*

OFFICE OF COMPUTING AND INFORMATION SERVICES

ALLEN E. BEUTEL, *Executive Director*

OFFICE OF THE SECRETARY

WILLIAM W. WILES, *Secretary*
BARBARA R. LOWREY, *Associate Secretary*
JAMES MCAFEE, *Associate Secretary*

LEGAL DIVISION

MICHAEL BRADFIELD, *General Counsel*
J. VIRGIL MATTINGLY, JR., *Deputy General Counsel*
RICHARD M. ASHTON, *Associate General Counsel*
OLIVER IRELAND, *Associate General Counsel*
RICKI R. TIGERT, *Assistant General Counsel*
MARYELLEN A. BROWN, *Assistant to the General Counsel*

DIVISION OF RESEARCH AND STATISTICS

JAMES L. KICHLINE, *Director*
EDWARD C. ETTIN, *Deputy Director*
MICHAEL J. PRELL, *Deputy Director*
JOSEPH S. ZEISEL, *Deputy Director*
JARED J. ENZLER, *Associate Director*
DAVID E. LINDSEY, *Associate Director*
ELEANOR J. STOCKWELL, *Associate Director*
THOMAS D. SIMPSON, *Deputy Associate Director*
LAWRENCE SLIFMAN, *Deputy Associate Director*
HELMUT F. WENDEL, *Deputy Associate Director*

1. The designations as Chairman and Vice Chairman expire on August 6, 1987, and March 31, 1986, respectively, unless the services of these members of the Board shall have terminated sooner.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

DIVISION OF RESEARCH AND STATISTICS—Continued
MARTHA BETHEA, *Assistant Director*
ROBERT M. FISHER, *Assistant Director*
DAVID B. HUMPHREY, *Assistant Director*
SUSAN J. LEPPER, *Assistant Director*
RICHARD D. PORTER, *Assistant Director*
PETER A. TINSLEY, *Assistant Director*
LEVON H. GARABEDIAN, *Assistant Director* (Administration)

DIVISION OF INTERNATIONAL FINANCE
EDWIN M. TRUMAN, *Director*
ROBERT F. GEMMILL, *Staff Adviser*
LARRY J. PROMISEL, *Senior Associate Director*
CHARLES J. SIEGMAN, *Senior Associate Director*
DAVID H. HOWARD, *Deputy Associate Director*
PETER HOOPER III, *Assistant Director*
KAREN H. JOHNSON, *Assistant Director*
RALPH W. SMITH, JR., *Assistant Director*

DIVISION OF FEDERAL RESERVE BANK OPERATIONS
CLYDE H. FARNSWORTH, JR., *Director*
ELLIOTT C. MCENTEE, *Associate Director*
DAVID L. ROBINSON, *Associate Director*
C. WILLIAM SCHLEICHER, JR., *Associate Director*
WALTER ALTHAUSEN, *Assistant Director*
CHARLES W. BENNETT, *Assistant Director*
ANNE M. DEBEER, *Assistant Director*
JACK DENNIS, JR., *Assistant Director*
EARL G. HAMILTON, *Assistant Director*
JOHN H. PARRISH, *Assistant Director*
FLORENCE M. YOUNG, *Adviser*

DIVISION OF BANKING SUPERVISION AND REGULATION
WILLIAM TAYLOR, *Director*
THOMAS E. CIMENO, JR., *Deputy Director* [2]
FREDERICK R. DAHL, *Associate Director*
DON E. KLINE, *Associate Director*
FREDERICK M. STRUBLE, *Associate Director*
STEPHEN C. SCHEMERING, *Deputy Associate Director*
RICHARD SPILLENKOTHEN, *Deputy Associate Director*

DIVISION OF BANKING SUPERVISION AND REGULATION—Continued
HERBERT A. BIERN, *Assistant Director*
ANTHONY CORNYN, *Assistant Director*
JAMES I. GARNER, *Assistant Director*
JAMES D. GOETZINGER, *Assistant Director*
ROBERT S. PLOTKIN, *Assistant Director*
SIDNEY M. SUSSAN, *Assistant Director*
LAURA M. HOMER, *Securities Credit Officer*

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS
GRIFFITH L. GARWOOD, *Director*
JERAULD C. KLUCKMAN, *Associate Director*
GLENN E. LONEY, *Assistant Director*
DOLORES S. SMITH, *Assistant Director*

DIVISION OF PERSONNEL
DAVID L. SHANNON, *Director*
JOHN R. WEIS, *Assistant Director*
CHARLES W. WOOD, *Assistant Director*

DIVISION OF SUPPORT SERVICES
ROBERT E. FRAZIER, *Director*
WALTER W. KREIMANN, *Associate Director*
GEORGE M. LOPEZ, *Assistant Director*

OFFICE OF THE CONTROLLER
GEORGE E. LIVINGSTON, *Controller*
BRENT L. BOWEN, *Assistant Controller*

DIVISION OF COMPUTING SERVICES
BRUCE M. BEARDSLEY, *Director*
ELIZABETH B. RIGGS, *Assistant Director*
ROBERT J. ZEMEL, *Assistant Director*
THOMAS C. JUDD, *Assistant Director* (Contingency Processing Center)

DIVISION OF INFORMATION SERVICES
WILLIAM R. JONES, *Director*
STEPHEN R. MALPHRUS, *Assistant Director*
WILLIAM C. SCHNEIDER, JR., *Assistant Director*
RICHARD C. STEVENS, *Assistant Director*

2. On loan from the Federal Reserve Bank of Boston.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Open Market Committee

December 31, 1985

Members

PAUL A. VOLCKER, *Chairman,* Board of Governors

E. GERALD CORRIGAN, *Vice Chairman,* elected by Federal Reserve Bank of New York

JOHN J. BALLES, elected by Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco

ROBERT P. BLACK, elected by Federal Reserve Banks of Boston, Philadelphia, and Richmond

ROBERT P. FORRESTAL, elected by Federal Reserve Banks of Atlanta, St. Louis, and Dallas

SILAS KEEHN, elected by Federal Reserve Banks of Cleveland and Chicago

PRESTON MARTIN, Board of Governors

J. CHARLES PARTEE, Board of Governors

EMMETT J. RICE, Board of Governors

MARTHA R. SEGER, Board of Governors

HENRY C. WALLICH, Board of Governors

Officers

STEPHEN H. AXILROD,
Staff Director and Secretary

NORMAND R.V. BERNARD,
Assistant Secretary

NANCY M. STEELE,
Deputy Assistant Secretary

MICHAEL BRADFIELD,
General Counsel

JAMES H. OLTMAN,
Deputy General Counsel

JAMES L. KICHLINE,
Economist

EDWIN M. TRUMAN,
Economist (International)

J. ALFRED BROADDUS,
Associate Economist

RICHARD G. DAVIS,
Associate Economist

DONALD L. KOHN,
Associate Economist

DAVID E. LINDSEY,
Associate Economist

MICHAEL J. PRELL,
Associate Economist

KARL A. SCHELD,
Associate Economist

CHARLES J. SIEGMAN,
Associate Economist

SHEILA L. TSCHINKEL,
Associate Economist

PETER D. STERNLIGHT, *Manager for Domestic Operations, System Open Market Account*

SAM Y. CROSS, *Manager for Foreign Operations, System Open Market Account*

During 1985, the Federal Open Market Committee held eight regularly scheduled meetings (See Record of Policy Actions of the Federal Open Market Committee in this REPORT.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Advisory Council

December 31, 1985

Members

District 1—ROBERT L. NEWELL, *Chairman and Chief Executive Officer,* Connecticut National Bank, Hartford, Connecticut

District 2—LEWIS T. PRESTON, *Chairman of the Board and Chief Executive Officer,* Morgan Guaranty Trust Company of New York, New York, New York

District 3—GEORGE A. BUTLER, *Chairman,* First Pennsylvania Bank, N.A., Philadelphia, Pennsylvania

District 4—JULIEN L. MCCALL, *Chairman and Chief Executive Officer,* National City Corporation, Cleveland, Ohio

District 5—JOHN G. MEDLIN, JR., *Chairman of the Board and Chief Executive Officer,* Wachovia Bank and Trust Company, N.A., *President and Chief Executive Officer,* The First Wachovia Corporation, Winston-Salem, North Carolina

District 6—PHILIP F. SEARLE, *Chairman of the Board,* Sun Banks, Inc., Orlando, Florida

District 7—HAL C. KUEHL, *Chairman of the Board and Chief Executive Officer,* First Wisconsin National Bank of Milwaukee, Milwaukee, Wisconsin

District 8—WILLIAM H. BOWEN, *Chairman of the Board and Chief Executive Officer,* First Commercial Bank, N.A., Little Rock, Arkansas

District 9—LLOYD P. JOHNSON, *Chairman, President, and Chief Executive Officer,* Norwest Corporation, Minneapolis, Minnesota

District 10—N. BERNE HART, *Chairman of the Board, President, and Chief Executive Officer,* United Banks of Colorado, Inc., Denver, Colorado

District 11—NAT S. ROGERS, *Consultant and Director,* First City Bancorporation of Texas, Inc., Houston, Texas

District 12—G. ROBERT TRUEX, JR., *Chairman,* Rainier Bancorporation and Rainier National Bank, Seattle, Washington

Officers

LEWIS T. PRESTON, *President*

PHILIP F. SEARLE, *Vice President*

HERBERT V. PROCHNOW, *Secretary*

WILLIAM J. KORSVIK, *Associate Secretary*

Directors

WILLIAM H. BOWEN

N. BERNE HART

Meetings of the Federal Advisory Council were held on February 7-8, May 2-3, September 5-6, and October 31-November 1, 1985. The Board of Governors met with the council on February 8, May 3, September 6, and November 1, 1985. 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 a 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.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Consumer Advisory Council

December 31, 1985

Members

RACHEL G. BRATT, *Assistant Professor,* Department of Urban and Environmental Policy, Tufts University, Medford, Massachusetts

JONATHAN BROWN, *Director,* BankWatch, Washington, D.C.

THOMAS L. CLARK, JR., *Deputy Superintendent of Banks,* New York State Banking Department, New York, New York

JEAN A. CROCKETT, *Professor of Finance,* Wharton Graduate School, University of Pennsylvania, Philadelphia, Pennsylvania

THERESA FAITH CUMMINGS, *Executive Director,* Springfield/Sangamon County Action, Inc., Springfield, Illinois

STEVEN M. GEARY, *Associate General Counsel,* Missouri Division of Finance, Jefferson City, Missouri

RICHARD F. HALLIBURTON, *Deputy Director,* Legal Aid of Western Missouri, Kansas City, Missouri

CHARLES C. HOLT, *Professor of Management,* University of Texas at Austin, Austin, Texas

EDWARD N. LANGE, *Partner,* Davis, Wright, Todd, Riese & Jones, Seattle, Washington

KENNETH V. LARKIN, *Director of Development,* Earl Warren Legal Institute, Boalt School of Law, University of California at Berkeley, Berkeley, California

TIMOTHY D. MARRINAN, *Senior Corporate Counsel,* First Bank System, Inc., Minneapolis, Minnesota

FRED S. MCCHESNEY, *Assistant Professor of Law,* Emory University, Atlanta, Georgia

FRED H. MILLER, *Professor of Law,* University of Oklahoma, Norman, Oklahoma

MARGARET M. MURPHY, *Associate Professor and Director,* Columbia Center, Johns Hopkins University, Columbia, Maryland

ROBERT F. MURPHY, *President,* General Motors Acceptance Corporation, Detroit, Michigan

HELEN E. NELSON, *President,* Consumer Research Foundation, Mill Valley, California

LAWRENCE S. OKINAGA, *Partner,* Carlsmith, Carlsmith, Wichman & Case, Honolulu, Hawaii

JOSEPH L. PERKOWSKI, *Chief Executive Officer,* Minneapolis Federal Employees Credit Union, Minneapolis, Minnesota

ELVA QUIJANO, *Vice President and Executive Professional Officer,* Republic Bank of San Antonio, San Antonio, Texas

BRENDA L. SCHNEIDER, *Director of Community Relations,* Manufacturers National Bank, Detroit, Michigan

PAULA A. SLIMAK, *Director of Consumer Affairs,* City of Cleveland, Cleveland, Ohio

GLENDA G. SLOANE, *Director,* Housing and Community Development, Center for National Policy Review, Catholic University School of Law, Washington, D.C.

HENRY J. SOMMER, *Supervising Attorney,* Community Legal Services, Inc., Philadelphia, Pennsylvania

TED L. SPURLOCK, *Vice President and Director of Credit and Consumer Banking Services,* J.C. Penney Company, Inc., New York, New York

MEL STILLER, *Executive Director,* Consumer Credit Counseling Service of Eastern Massachusetts, Boston, Massachusetts

CHRISTOPHER J. SUMNER, *President and Chief Executive Officer,* Western Savings & Loan Company, Salt Lake City, Utah

WINNIE F. TAYLOR, *Professor of Law,* Holland Law Center, University of Florida, Gainesville, Florida

MICHAEL M. VAN BUSKIRK, *Assistant Vice President, Corporate Affairs,* Banc One Corporation, Columbus, Ohio

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MERVIN WINSTON, *Vice President,* First Bank System, Inc., Minneapolis, Minnesota

MICHAEL ZOROYA, *Senior Vice President of Credit,* The May Department Stores, St. Louis, Missouri

Officers

TIMOTHY D. MARRINAN, *Chairman*

THOMAS L. CLARK, JR., *Vice Chairman*

Meetings of the Consumer Advisory Council with members of the Board of Governors were held on March 13–14, June 20–21, and October 24–25, 1985. The council is composed of representatives of the financial industry, and of consumer and community interests, as well as academics. It was established pursuant to the 1976 amendments to the Equal Credit Opportunity Act to advise the Board on matters related to consumer financial services.

Thrift Institutions Advisory Council

December 31, 1985

Members

THOMAS R. BOMAR, *President,* AmeriFirst Federal Savings and Loan Association, Miami, Florida

ELLIOTT G. CARR, *President and Chief Executive Officer,* The Cape Cod Five Cents Savings Bank, Harwich Port, Massachusetts

M. TODD COOKE, *Chairman and Chief Executive Officer,* PSFS, Philadelphia, Pennsylvania

J. MICHAEL CORNWALL, *Chairman and Chief Executive Officer,* First Texas Savings Association, Dallas, Texas

RICHARD H. DEIHL, *Chairman of the Board and Chief Executive Officer,* Home Savings of America, Los Angeles, California

HAROLD W. GREENWOOD, JR., *Chairman, President, and Chief Executive Officer,* Midwest Federal Savings & Loan Association, Minneapolis, Minnesota

JOHN A. HARDIN, *Chairman and President,* First Federal Savings Bank, Rock Hill, South Carolina

FRANCES LESNIESKI, *President,* Michigan State University Federal Credit Union, East Lansing, Michigan

JOHN T. MORGAN, *Chairman and Chief Executive Officer,* American Savings Bank of New York, New York, New York

SARAH R. WALLACE, *President,* First Federal Savings and Loan Association of Newark, Newark, Ohio

MICHAEL R. WISE, *Chairman and Chief Executive Officer,* Silverado Banking, Denver, Colorado

Officers

THOMAS R. BOMAR, *President*

RICHARD H. DEIHL, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on February 28, June 18, September 19, and November 21, 1985. The council, which is composed of representatives from credit unions, savings and loan associations, and savings banks, consults with and advises the Board on issues pertaining to the thrift industry and on various other matters within the Board's jurisdiction.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Officers of Federal Reserve Banks, Branches, and Offices

December 31, 1985[1]

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON[3]	Joseph A. Baute Thomas I. Atkins	Frank E. Morris Robert W. Eisenmenger	
NEW YORK[3]	John Brademas Clifton R. Wharton, Jr.	E. Gerald Corrigan Thomas M. Timlen	
Buffalo	M. Jane Dickman		John T. Keane
PHILADELPHIA	Robert M. Landis Nevius M. Curtis	Edward G. Boehne Richard L. Smoot	
CLEVELAND[3]	William H. Knoell E. Mandell de Windt	Karen N. Horn William H. Hendricks	
Cincinnati	Robert E. Boni		Charles A. Cerino[4]
Pittsburgh	Robert S. Kaplan		Harold J. Swart[4]
RICHMOND[3]	Leroy T. Canoles, Jr. Robert A. Georgine	Robert P. Black Jimmie R. Monhollon	
Baltimore	Robert L. Tate		Robert D. McTeer, Jr.[4]
Charlotte	Wallace J. Jorgenson		Albert D. Tinkelenberg[4]
Culpeper			John G. Stoides[4]
ATLANTA	John H. Weitnauer, Jr. Bradley Currey, Jr.	Robert P. Forrestal Jack Guynn	Delmar Harrison
Birmingham	Martha A. McInnis		Fred R. Herr
Jacksonville	E. William Nash, Jr.		James D. Hawkins
Miami	Eugene E. Cohen		Patrick K. Barron
Nashville	Condon S. Bush		Jeffrey J. Wells
New Orleans	Leslie B. Lampton		Henry H. Bourgaux Jr.
CHICAGO[3]	Stanton R. Cook Robert J. Day	Silas Keehn Daniel M. Doyle	
Detroit	Russell G. Mawby		Roby L. Sloan[4]
ST. LOUIS	W.L. Hadley Griffin Mary P. Holt	Thomas C. Melzer Joseph P. Garbarini	
Little Rock	Sheffield Nelson		John F. Breen
Louisville	Henry F. Frigon		James E. Conrad
Memphis	Donald B. Weis		Paul I. Black, Jr.
MINNEAPOLIS	John B. Davis, Jr. Michael W. Wright	Gary H. Stern Thomas E. Gainor	
Helena	Gene J. Etchart		Robert F. McNellis
KANSAS CITY	Irvine O. Hockaday, Jr. Robert G. Lueder	Roger Guffey Henry R. Czerwinski	
Denver	James E. Nielson		Wayne W. Martin[4]
Oklahoma City	Patience S. Latting		William G. Evans
Omaha	Kenneth L. Morrison		Robert D. Hamilton

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
DALLAS	Robert D. Rogers Bobby R. Inman	Robert H. Boykin William H. Wallace	
El Paso	John Sibley		Joel L. Koonce, Jr.
Houston	Robert T. Sakowitz		J.Z. Rowe[4]
San Antonio	Robert F. McDermott		Thomas H. Robertson
SAN FRANCISCO	Alan C. Furth Fred W. Andrew	John J. Balles Richard T. Griffith	
Los Angeles	Richard C. Seaver		Robert M. McGill[4]
Portland	Paul E. Bragdon		Angelo S. Carella[4]
Salt Lake City	Don M. Wheeler		E. Ronald Liggett
Seattle	John W. Ellis		Gerald R. Kelly[4]

1. A current list of these officers appears each month in the *Federal Reserve Bulletin.*
2. The Chairman of a Federal Reserve Bank, by statute, serves as Federal Reserve Agent.
3. Additional offices of these Banks are located at Lewistown, Maine; Windsor Locks, Connecticut; Cranford, New Jersey; Jericho, New York; Utica at Oriskany, New York; Columbus, Ohio; Columbia, South Carolina; Charleston, West Virginia; Des Moines, Iowa; Indianapolis, Indiana; and Milwaukee, Wisconsin.
4. Senior Vice President.

Conference of Chairmen

The chairmen of the Federal Reserve Banks are organized into the Conference of Chairmen that meets to consider matters of common interest and to consult with and advise the Board of Governors. Such meetings, attended also by the deputy chairmen, were held in Washington on June 6–7 and December 4–5, 1985.

The Executive Committee of the Conference of Chairmen during 1985 comprised William H. Knoell, Chairman, Robert D. Rogers, Vice Chairman, and Alan C. Furth, member.

On December 5, 1985, Robert D. Rogers was elected Chairman of the conference and of its Executive Committee to serve for the succeeding year; John H. Weitnauer, Jr. was elected Vice Chairman of the conference and a member of the Executive Committee; and Joseph A. Baute was elected as the other member of the Executive Committee.

Conference of Presidents

The presidents of the Federal Reserve Banks are organized into the Conference of Presidents, which meets periodically to consider matters of common interest and to consult with and advise the Board of Governors. On October 29, 1984, Robert H. Boykin, President of the Federal Reserve Bank of Dallas, was elected Chairman, and Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, was elected Vice Chairman of the conference for 1985. Lyne H. Carter of the Federal Reserve Bank of Dallas was appointed Secretary, and Joanna H. Frodin of the Federal Reserve Bank of Philadelphia was appointed Assistant Secretary.

Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Baks was organized in 1969 to meet periodically for the consideration of operational and other matters. On November 23, 1984, William H. Wallace, First Vice President of the Federal Reserve Bank of Dallas, was elected Chairman, and Richard L. Smoot, Fist Vice President of the Federal Reserve Bank of Philadelphia, was elected Vice Chairman of the conference for 1985. Lyne H. Carter of the Federal Reserve Bank of Dallas was appointed Secretary, and Joanna H. Frodin of the Federal Reserve Bank of Philadelphia was appointed Assistant Secretary.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Directors

The following list of directors of Federal Reserve Banks and Branches shows the class of directorship, the principal business affiliation, and the date the term expires for each director. Each Federal Reserve Bank has nine members on its board of directors: three Class A and three Class B directors, who are elected by the stockholding member banks, and three Class C directors, who are appointed by the Board of Governors of the Federal Reserve System. Directors are chosen without discrimination as to race, creed, color, sex, or national origin.

Class A directors represent the stockholding member banks in each Federal Reserve District. Class B and Class C directors represent the public and are chosen with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers; they may not be officers, directors, or employees of any bank. In addition, Class C directors may not be stockholders of any bank.

For the election of Class A and Class B directors, the Board of Governors classifies the member banks of each Federal Reserve District into three groups; each group comprises banks with similar capitalization. Each group then elects one Class A and one Class B director. The Board of Governors designates one Class C director as chairman of the board of directors and Federal Reserve Agent of each District Bank and appoints an other as deputy chairman.

Federal Reserve Branches have either five or seven directors, a majority of whom are appointed by the parent Federal Reserve Bank; the others are appointed by the Board of Governors. One of the directors appointed by the Board is designated annually as chairman of the board of that Branch in a manner prescribed by the parent Federal Reserve Bank.

See the preceding table, "Officers of Federal Reserve Banks, Branches, and Offices" for the name of the chairman and deputy chairman of the board of directors of each Reserve Bank and of the chairman of each Branch.

A list of the current directors of the Federal Reserve Banks and Branches appears each spring in the *Federal Reserve Bulletin.*

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

District 1—BOSTON

		Term expires Dec. 31
Class A		
William W. Treat	President, Bank Meridian, N.A., Hampton, New Hampshire	1985
William S. Edgerly	Chairman and President, State Street Bank and Trust Company, Boston, Massachusetts	1986
Homer B. Ellis, Jr.	President, Factory Point National Bank, Manchester Center, Vermont	1987
Class B		
Matina S. Horner	President, Radcliffe College, Cambridge, Massachusetts	1985
Richard M. Oster	President and Chief Executive Officer, Cookson America, Inc., Providence, Rhode Island	1986
George N. Hatsopoulos	Chairman of the Board and President, Thermo Electron Corporation, Waltham, Massachusetts	1987
Class C		
Thomas I. Atkins	Attorney, Brooklyn, New York	1985
Michael J. Harrington	Harrington Company, Peabody, Massachusetts	1986
Joseph A. Baute	Chairman and Chief Executive Officer, Markem Corporation, Keene, New Hampshire	1987

District 2—NEW YORK

Class A		
Alfred Brittain III	Chairman of the Board, Bankers Trust Company, New York, New York	1985
T. Joseph Semrod	Chairman of the Board, United Jersey Bank, Hackensack, New Jersey	1986
Robert W. Moyer	President and Chief Executive Officer, Wilber National Bank, Oneonta, New York	1987
Class B		
William S. Cook	President and Chief Executive Officer, Union Pacific Corporation, New York, New York	1985
John R. Opel	Chairman of the Board, International Business Machines Corporation, Armonk, New York	1986
John F. Welch, Jr.	Chairman of the Board, General Electric Company, Fairfield, Connecticut	1987
Class C		
John Brademas	President, New York University, New York, New York	1985
Clifton R. Wharton, Jr.	Chancellor, State University of New York System, Albany, New York	1986
Virginia A. Dwyer	Senior Vice President—Finance, American Telephone and Telegraph Company, New York, New York	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BUFFALO BRANCH		Term expires Dec. 31
Appointed by Federal Reserve Bank		
William Balderston III	President and Chief Executive Officer, Chase Lincoln First Bank, N.A., Rochester, New York	1985
Donald I. Wickham	President, Tri-Way Farms, Inc., Stanley, New York	1985
Herbert Fort	President, The Bath National Bank, Bath, New York	1986
Ross B. Kenzie	Chairman of the Board, Goldome FSB, Buffalo, New York	1987
Appointed by the Board of Governors		
M. Jane Dickman	Partner, Touche Ross & Co., Buffalo, New York	1985
Matthew Augustine	President and Chief Executive Officer, Eltrex Industries, Inc., Rochester, New York	1986
Joseph Yantomasi	Consultant, United Auto Workers, Buffalo, New York	1987

District 3—PHILADELPHIA

Class A		
JoAnne Brinzey	Chief Executive Officer and Cashier, The First National Bank at Gallitzin, Gallitzin, Pennsylvania	1985
John H. Walther	Chairman of the Board, New Jersey National Bank, Pennington, New Jersey	1986
Ronald H. Smith	President and Chief Executive Officer, CCNB Bank, N.A., New Cumberland, Pennsylvania	1987
Class B		
Eberhard Faber IV	Chairman of the Board and Chief Executive Officer, Eberhard Faber, Inc., Wilkes-Barre, Pennsylvania	1985
Carl E. Singley	Dean and Professor of Law, Temple University Law School, Philadelphia, Pennsylvania	1986
Charles F. Seymour	Chairman and Chief Executive Officer, Jackson-Cross Company, Philadelphia, Pennsylvania	1987
Class C		
Nevius M. Curtis	Chairman and Chief Executive Officer, Delmarva Power & Light Company, Wilmington, Delaware	1985
Robert M. Landis	Partner, Dechert, Price and Rhoads, Philadelphia, Pennsylvania	1986
George E. Bartol III	Chairman of the Board, Hunt Manufacturing Company, Philadelphia, Pennsylvania	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

District 4—CLEVELAND

		Term expires Dec. 31
Class A		
William A. Stroud	President, First-Knox National Bank, Mount Vernon, Ohio	1985
J. David Barnes	Chairman and Chief Executive Officer, Mellon Bank, Pittsburgh, Pennsylvania	1986
Raymond D. Campbell	Chairman, President, and Chief Executive Officer, Independent State Bank of Ohio, Columbus, Ohio	1987
Class B		
John W. Kessler	President, John W. Kessler Company, Columbus, Ohio	1985
John R. Hall	Chairman of the Board and Chief Executive Officer, Ashland Oil, Inc., Ashland, Kentucky	1986
Richard D. Hannan	Chairman of the Board and President, Mercury Instruments, Inc., Cincinnati, Ohio	1987
Class C		
Lewis R. Smoot, Sr.	President and Chief Executive Officer, The Sherman R. Smoot Company, Columbus, Ohio	1985
W.H. Knoell	President and Chief Executive Officer, Cyclops Corporation, Pittsburgh, Pennsylvania	1986
E. Mandell de Windt	Chairman of the Board, Eaton Corporation, Cleveland, Ohio	1987

CINCINNATI BRANCH

Appointed by Federal Reserve Bank		
Clement L. Buenger	President and Chief Executive Officer, The Fifth Third Bank, Cincinnati, Ohio	1985
Vernon J. Cole	Executive Vice President and Chief Executive Officer, Harlan National Bank, Harlan, Kentucky	1986
Sherrill Cleland	President, Marietta College, Marietta, Ohio	1987
Jerry L. Kirby	Chairman of the Board, President, and Chief Executive Officer, Citizens Federal Savings and Loan Association, Dayton, Ohio	1987
Appointed by the Board of Governors		
Vacancy		1985
Robert E. Boni	President and Chief Executive Officer, Armco Inc., Middletown, Ohio	1986
Don Ross	Owner, Dunreath Farm, Lexington, Kentucky	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

PITTSBURGH BRANCH

Name	Position	Term expires Dec. 31
Appointed by Federal Reserve Bank		
A. Dean Heasley	President and Chief Executive Officer, Century National Bank and Trust Company, Rochester, Pennsylvania	1985
G.R. Rendle	President and Chief Executive Officer, Gallatin National Bank, Uniontown, Pennsylvania	1986
Charles L. Fuellgraf, Jr.	Chief Executive Officer, Fuellgraf Electric Company, Butler, Pennsylvania	1987
James S. Pasman, Jr.	Vice Chairman, Aluminum Company of America, Pittsburgh, Pennsylvania	1987
Appointed by the Board of Governors		
Robert S. Kaplan	Professor of Industrial Administration, Graduate School of Industrial Administration, Carnegie-Mellon University, Pittsburgh, Pennsylvania	1985
Vacancy		1986
Milton A. Washington	President and Chief Executive Officer, Allegheny Housing Rehabilitation Corporation, Pittsburgh, Pennsylvania	1987

District 5—RICHMOND

Name	Position	Term expires Dec. 31
Class A		
Willard H. Derrick	President and Chief Executive Officer, Sandy Spring National Bank and Savings Institution, Sandy Spring, Maryland	1985
Robert S. Chiles, Sr.	President and Chief Executive Officer, Greensboro National Bank, Greensboro, North Carolina	1986
Robert F. Baronner	Chairman of the Board and Chief Executive Officer, One Valley Bancorp of West Virginia, Inc. and Kanawha Valley Bank, N.A., Charleston, West Virginia	1987
Class B		
George Dean Johnson, Jr.	Partner, Johnson, Smith, Hibbard, Cleveland, Wildman, and Dennis, Spartanburg, South Carolina	1985
Thomas B. Cookerly	President, Broadcast Division, Allbritton Communications, Washington, D.C.	1986
Floyd D. Gottwald, Jr.	Chairman of the Board and Chief Executive Officer, Ethyl Corporation, Richmond, Virginia	1987
Class C		
Robert A. Georgine	President, Building & Construction Trades Department, AFL–CIO, Washington, D.C.	1985
Leroy T. Canoles, Jr.	President, Kaufman & Canoles, Norfolk, Virginia	1986
Hanne Merriman	President, Garfinckel's, Washington, D.C.	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BALTIMORE BRANCH

		Term expires Dec. 31
Appointed by Federal Reserve Bank		
Howard I. Scaggs	Chairman of the Board, American National Building and Loan Association, Baltimore, Maryland	1985
Hugh D. Shires	Senior Vice President (retired), The First National Bank of Maryland, Baltimore, Maryland	1985
Charles W. Hoff III	President and Chief Executive Officer, Farmers and Mechanics National Bank, Frederick, Maryland	1986
Raymond V. Haysbert, Sr.	President and Chief Executive Officer, Parks Sausage Company, Baltimore, Maryland	1987
Appointed by the Board of Governors		
Edward H. Covell	President, The Covell Company, Easton, Maryland	1985
Robert L. Tate	Chairman, Tate Industries, Baltimore, Maryland	1986
Gloria L. Johnson	President, Hutzler Brothers Company, Baltimore, Maryland	1987

CHARLOTTE BRANCH

Appointed by Federal Reserve Bank		
J. Donald Collier	President and Chief Executive Officer, First National Bank, Orangeburg, South Carolina	1985
James G. Lindley	President and Chief Executive Officer, South Carolina National Corporation, and Chairman and Chief Executive Officer, The South Carolina National Bank, Columbia, South Carolina	1985
John A. Hardin	Chairman of the Board and President, First Federal Savings Bank, Rock Hill, South Carolina	1986
James M. Culberson, Jr.	Chairman and President, The First National Bank of Randolph County, Asheboro, North Carolina	1987
Appointed by the Board of Governors		
G. Alex Bernhardt	President, Bernhardt Industries, Inc., Lenoir, North Carolina	1985
Wallace J. Jorgenson	President, Jefferson-Pilot Communications Co., Charlotte, North Carolina	1986
James E. Bostic, Jr.	General Manager, Convenience Products Division, Georgia-Pacific Corporation, Aiken, South Carolina	1987

District 6—ATLANTA

Class A		
Dan B. Andrews	President, First National Bank, Dickson, Tennessee	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Mary W. Walker	President, The National Bank of Walton County, Monroe, Georgia	1986
E.B. Robinson, Jr.	Chairman and Chief Executive Officer, Deposit Guaranty National Bank, Jackson, Mississippi	1987

Class B

Bernard F. Sliger	President, Florida State University, Tallahassee, Florida	1985
Harold B. Blach, Jr.	President, Blach's Inc., Birmingham, Alabama	1986
Horatio C. Thompson	President, Horatio Thompson Investment, Inc., Baton Rouge, Louisiana	1987

Class C

John H. Weitnauer, Jr.	Chairman and Chief Executive Officer, Richway, Atlanta, Georgia	1985
Bradley Currey, Jr.	President, Rock-Tenn Company, Norcross, Georgia	1986
Jane C. Cousins	President and Chief Executive Officer, Merrill Lynch Realty/Cousins, Miami, Florida	1987

BIRMINGHAM BRANCH

Appointed by Federal Reserve Bank

G. Mack Dove	President, AAA Cooper Transportation Company, Dothan, Alabama	1985
Grady Gillam	Chairman, AmSouth Bank, N.A., Gadsden, Alabama	1985
Charles L. Peery	Chairman, The First National Bank of Florence, Florence, Alabama	1986
Willard L. Hurley	Chairman and Chief Executive Officer, First Alabama Bancshares, Inc., Birmingham, Alabama	1987

Appointed by the Board of Governors

Martha A. McInnis	President, EnviroSouth, Inc., Montgomery, Alabama	1985
Margaret E.M. Tolbert	Director, Carver Research Foundation, Tuskegee Institute, Tuskegee, Alabama	1986
A.G. Trammell	President, Alabama Labor Council, AFL–CIO, Birmingham, Alabama	1987

JACKSONVILLE BRANCH

Appointed by Federal Reserve Bank

George C. Boone, Jr.	President and Chief Executive Officer, Security First Federal Savings and Loan Association, Daytona Beach, Florida	1985
E.F. Keen, Jr.	Vice Chairman, NCNB Bancorporation, Inc., Bradenton, Florida	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
John D. Uible	Chairman and Chief Executive Officer, Florida National Banks of Florida, Inc., Jacksonville, Florida	1986
Buell G. Duncan, Jr.	Chairman and Chief Executive Officer, Sun Bank, N.A., Orlando, Florida	1987

Appointed by the Board of Governors

E. William Nash, Jr.	President, South-Central Operations, The Prudential Insurance Company of America, Jacksonville, Florida	1985
JoAnn Doke Smith	Co-owner, Smith Brothers, Micanopy, Florida	1986
Andrew A. Robinson	Dean, College of Education and Human Services, University of North Florida, Jacksonville, Florida	1987

MIAMI BRANCH

Appointed by Federal Reserve Bank

D.S. Hudson, Jr.	Chairman, First National Bank and Trust Company of Stuart, Stuart, Florida	1985
Robert L. Kester	Vice Chairman, Barnett Bank of South Florida, N.A., Pompano Beach, Florida	1986
Robert D. Rapaport	Chairman, Royal Palm Savings Association, Palm Beach, Florida	1987
Robert M. Taylor	Chairman and Chief Executive Officer, The Mariner Group, Inc., Fort Myers, Florida	1987

Appointed by the Board of Governors

Sue McCourt Cobb	Attorney, Greenberg, Traurig, Askew, Hoffman, Lipoff, Rosen, and Quentel, P.A., Miami, Florida	1985
Eugene E. Cohen	Chief Financial Officer and Treasurer, Howard Hughes Medical Institute, Coconut Grove, Florida	1986
Robert D. Apelgren	President, Apelgren Corporation, Pahokee, Florida	1987

NASHVILLE BRANCH

Appointed by Federal Reserve Bank

Samuel H. Howard	Senior Vice President of Public Affairs, Hospital Corporation of America, Nashville, Tennessee	1985
Owen G. Shell, Jr.	President and Chief Executive Officer, First American National Bank of Nashville, Nashville, Tennessee	1985
Robert W. Jones	Chairman and President, First National Bank, McMinnville, Tennessee	1986
Will A. Hildreth	President and Chief Executive Officer, First National Bank of Loudon County, Lenoir City, Tennessee	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Appointed by the Board of Governors		
Condon S. Bush	President, Bush Brothers & Company, Dandridge, Tennessee	1985
Patsy R. Williams	Partner, Rhyne Lumber Company, Newport, Tennessee	1986
C. Warren Neel	Dean, College of Business Administration, The University of Tennessee, Knoxville, Tennessee	1987

NEW ORLEANS BRANCH

Appointed by Federal Reserve Bank		
Philip K. Livingston	Vice Chairman, President, and Chief Executive Officer, Citizens National Bank, Hammond, Louisiana	1985
Tom Burkett Scott, Jr.	President and Chief Executive Officer, Unifirst Bank for Savings, F.A., Jackson, Mississippi	1985
Carl E. Jones, Jr.	Chairman, President, and Chief Executive Officer, Merchants National Bank of Mobile, Mobile, Alabama	1986
James G. Boyer	Chairman, President, and Chief Executive Officer, Gulf National Bank at Lake Charles, Lake Charles, Louisiana	1987
Appointed by the Board of Governors		
Sharon A. Perlis	President, Sharon A. Perlis, Law Corporation, Metairie, Louisiana	1985
Leslie B. Lampton	President, Ergon, Inc., Jackson, Mississippi	1986
Roosevelt Steptoe	Professor of Economics, Southern University, Baton Rouge Campus, Baton Rouge, Louisiana	1987

District 7—CHICAGO

Class A		
Patrick E. McNarny	President, First National Bank of Logansport, Logansport, Indiana	1985
Ollie Jay Tomson	President, The Citizens National Bank of Charles City, Charles City, Iowa	1986
Barry F. Sullivan	Chairman of the Board, First National Bank of Chicago, Chicago, Illinois	1987
Class B		
Mary Garst	Manager, Cattle Division, Garst Company, Coon Rapids, Iowa	1985
Leon T. Kendall	Chairman and Chief Executive Officer, Mortgage Guaranty Insurance Corporation, Milwaukee, Wisconsin	1986
Edward D. Powers	President and Chief Executive Officer, Mueller Company, Decatur, Illinois	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Class C		
Stanton R. Cook	President, Tribune Company, Chicago, Illinois	1985
Robert J. Day	Chairman and Chief Executive Officer, USG Corporation, Chicago, Illinois	1986
Marcus Alexis	Dean, College of Business Administration, University of Illinois at Chicago, Chicago, Illinois	1987

DETROIT BRANCH

Appointed by Federal Reserve Bank		
Charles T. Fisher III	Chairman and President, National Bank of Detroit, Detroit, Michigan	1985
Ronald D. Story	President, The Ionia County National Bank of Ionia, Ionia, Michigan	1986
Richard M. Gillett	Chairman of the Board, Old Kent Financial Corporation, Grand Rapids, Michigan	1987
Thomas R. Ricketts	Chairman of the Board and President, Standard Federal Bank, Troy, Michigan	1987
Appointed by the Board of Governors		
Russell G. Mawby	Chairman of the Board and Chief Executive Officer, W.K. Kellogg Foundation, Battle Creek, Michigan	1985
Karl D. Gregory	Professor of Economics and Management, School of Economics and Management, Oakland University, Rochester, Michigan	1986
Robert E. Brewer	Senior Vice President—Finance and Director, K Mart Corporation, Troy, Michigan	1987

District 8—ST. LOUIS

Class A		
Donald L. Hunt	President, First National Bank of Marissa, Marissa, Illinois	1985
Clarence C. Barksdale	Chairman of the Board, Centerre Bank, N.A., St. Louis, Missouri	1986
H.L. Hembree III	Chairman of the Board and Chief Executive Officer, Arkansas Best Corporation, Fort Smith, Arkansas	1987
Class B		
Robert J. Sweeney	President and Chief Executive Officer, Murphy Oil Corporation, El Dorado, Arkansas	1985
Frank A. Jones, Jr.	President, Dietz Forge Company, Memphis, Tennessee	1986
Jesse M. Shaver, Jr.	President, JMS Corporation, Louisville, Kentucky	1987
Class C		
Robert L. Virgil, Jr.	Dean, School of Business, Washington University, St. Louis, Missouri	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Mary P. Holt	President, Clothes Horse, Little Rock, Arkansas	1986
W.L. Hadley Griffin	Chairman of the Executive Committee, Brown Group, Inc., St. Louis, Missouri	1987

LITTLE ROCK BRANCH

Appointed by Federal Reserve Bank

D. Eugene Fortson	President, The Southwestern Company, Little Rock, Arkansas	1985
William H. Kennedy, Jr.	Chairman of the Board, Worthen Banking Corporation, Pine Bluff, Arkansas	1986
Wilbur P. Gulley, Jr.	Chairman of the Board and Chief Executive Officer, Savers Federal Savings and Loan Association, Little Rock, Arkansas	1987
W. Wayne Hartsfield	President and Chief Executive Officer, First National Bank, Searcy, Arkansas	1987

Appointed by the Board of Governors

Shirley J. Pine	Professor, Department of Communicative Disorders, University of Arkansas at Little Rock, Little Rock, Arkansas	1985
Richard V. Warner	Group Vice President, Wood Products Group, Potlatch Corporation, Warren, Arkansas	1986
Sheffield Nelson	Partner, House, Wallace, Nelson, and Jewell, P.A., Little Rock, Arkansas	1987

LOUISVILLE BRANCH

Appointed by Federal Reserve Bank

Allan S. Hanks	President, The Anderson National Bank of Lawrenceburg, Lawrenceburg, Kentucky	1985
Frank B. Hower, Jr.	Chairman and Chief Executive Officer, Liberty National Bank and Trust Company of Louisville, Louisville, Kentucky	1986
John E. Darnell, Jr.	Chairman of the Board, The Owensboro National Bank, Owensboro, Kentucky	1987
R.I. Kerr, Jr.	Chairman of the Board, President, and Chief Executive Officer, Great Financial Federal, Louisville, Kentucky	1987

Appointed by the Board of Governors

Henry F. Frigon	President and Chief Executive Officer, BATUS, Inc., Louisville, Kentucky	1985
William C. Ballard, Jr.	Executive Vice President, Finance and Administration, Humana, Inc., Louisville, Kentucky	1986
Raymond M. Burse	President, Kentucky State University, Frankfort, Kentucky	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MEMPHIS BRANCH		*Term expires Dec. 31*
Appointed by Federal Reserve Bank		
William H. Brandon, Jr.	President, First National Bank of Phillips County, Helena, Arkansas	1985
Wayne W. Pyeatt	President, Memphis Fire Insurance Company, Memphis, Tennessee	1986
Edgar H. Bailey	Chairman and Chief Executive Officer, Leader Federal Savings and Loan Association, Memphis, Tennessee	1987
John P. Dulin	President, First Tennessee Bank, N.A., Memphis, Tennessee	1987
Appointed by the Board of Governors		
Vacancy		1985
Donald B. Weis	President, Tamak Transportation Corporation, West Memphis, Arkansas	1986
G. Rives Neblett	Neblett, Fortier, and Havens, Attorneys at Law, Shelby, Mississippi	1987

District 9—MINNEAPOLIS

Class A		
Curtis W. Kuehn	President, The First National Bank in Sioux Falls, Sioux Falls, South Dakota	1985
Burton P. Allen, Jr.	President, First National Bank, Milaca, Minnesota	1986
Thomas M. Strong	President and Chief Executive Officer, Citizens State Bank, Ontonagon, Michigan	1987
Class B		
Richard L. Falconer	District Staff Manager, Northwestern Bell, St. Paul, Minnesota	1985
Harold F. Zigmund	Chairman (retired), Blandin Paper Company, Duluth, Minnesota	1986
William L. Mathers	President, Mathers Land Company, Inc., Miles City, Montana	1987
Class C		
Sister Generose Gervais	Consultant, Saint Mary's Hospital, Rochester, Minnesota	1985
John B. Davis, Jr.	Executive Director, Children's Theatre Company and School, Minneapolis, Minnesota	1986
Michael W. Wright	Chairman, President, and Chief Executive Officer, Super Valu Stores, Inc., Minneapolis, Minnesota	1987

HELENA BRANCH

Appointed by Federal Reserve Bank		
Roger H. Ulrich	President, First State Bank, Malta, Montana	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Name	Position	Term expires Dec. 31
Dale W. Anderson	President and Chief Executive Officer, Norwest Bank Great Falls, N.A., Great Falls, Montana	1986
Seabrook Pates	President and General Manager, Midland Implement Company, Inc., Billings, Montana	1987

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Gene J. Etchart	Past President, Hinsdale Livestock Company, Glasgow, Montana	1985
Marcia S. Anderson	President, Bridger Canyon Stallion Station, Inc., Bozeman, Montana	1986

District 10—KANSAS CITY

Class A

Name	Position	Term expires Dec. 31
Howard K. Loomis	President, The Peoples Bank, Pratt, Kansas	1985
Wayne D. Angell	Chairman of the Board, The First State Bank of Pleasanton, Pleasanton, Kansas	1986
Donald D. Hoffman	Chairman of the Board, Central Bank of Denver, Denver, Colorado	1987

Class B

Name	Position	Term expires Dec. 31
Vacancy		1985
Richard D. Harrison	Chairman and Chief Executive Officer, Fleming Companies, Inc., Oklahoma City, Oklahoma	1986
Duane C. Acker	President, Kansas State University, Manhattan, Kansas	1987

Class C

Name	Position	Term expires Dec. 31
Irvine O. Hockaday, Jr.	Executive Vice President and Member of the Office of the Chairman, Hallmark Cards, Inc., Kansas City, Missouri	1985
Frederick W. Lyons, Jr.	President and Chief Executive Officer, Marion Laboratories, Inc., Kansas City, Missouri	1986
Robert G. Lueder	Chairman of the Board, Lueder Construction Company, Omaha, Nebraska	1987

DENVER BRANCH

Appointed by Federal Reserve Bank

Name	Position	Term expires Dec. 31
George S. Jenks	President and Chief Executive Officer, Sunwest Financial Services, Inc., Albuquerque, New Mexico	1985
Kenneth C. Naramore	Chairman of the Board and Chief Executive Officer, Stockmen's Bank and Trust Company, Gillette, Wyoming	1985
Roger L. Reisher	Co-Chairman, FirstBank Holding Company of Colorado, Lakewood, Colorado	1986

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Junius F. Baxter	Chairman of the Board and Chief Executive Officer, Bank Western Federal Savings Bank, Denver, Colorado	1987

Appointed by the Board of Governors

Anthony W. Williams	President, Williams, Turner, & Holmes, P.C., Grand Junction, Colorado	1985
James C. Wilson	President and Chief Executive Officer, Rocky Mountain Energy, Broomfield, Colorado	1986
James E. Nielson	President and Chief Executive Officer, JN Incorporated, Cody, Wyoming	1987

OKLAHOMA CITY BRANCH

Appointed by Federal Reserve Bank

William H. Crawford	Chairman and Chief Executive Officer, First National Bank and Trust Company, Frederick, Oklahoma	1985
William O. Alexander	President and Chief Executive Officer, Continental Federal Savings & Loan Association, Oklahoma City, Oklahoma	1986
Marcus R. Tower	Tulsa, Oklahoma	1986

Appointed by the Board of Governors

Patience S. Latting	Oklahoma City, Oklahoma	1985
John F. Snodgrass	President and Trustee, Samuel Roberts Noble Foundation, Inc., Ardmore, Oklahoma	1986

OMAHA BRANCH

Appointed by Federal Reserve Bank

William W. Cook, Jr.	President, The Beatrice National Bank and Trust Company, Beatrice, Nebraska	1985
Charles H. Thorne	Chairman of the Board and Chief Executive Officer, First Federal Savings and Loan Association of Lincoln, Lincoln, Nebraska	1985
Donald J. Murphy	Father Flanagan's Boys' Home, Boys Town, Nebraska	1986

Appointed by the Board of Governors

Kenneth L. Morrison	President, Morrison-Quirk Grain Corporation, Hastings, Nebraska	1985
Janice D. Stoney	Executive Vice President and Chief Operating Officer, Northwestern Bell Telephone Company, Omaha, Nebraska	1986

District 11—DALLAS

Class A

John P. Gilliam	Chairman of the Board and Chief Executive Officer, First National Bank in Valley Mills, Valley Mills, Texas	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Miles D. Wilson	Chairman of the Board and Chief Executive Officer, The First National Bank of Bellville, Bellville, Texas	1986
Gene Edwards	Chairman of the Board, First Amarillo Bancorporation, Inc., Amarillo, Texas	1987
Class B		
Robert Ted Enloe III	President, Lomas & Nettleton Financial Corporation, Dallas, Texas	1985
Kent Gilbreath	Associate Dean, Hankamer School of Business, Baylor University, Waco, Texas	1986
Robert L. Pfluger	Rancher, San Angelo, Texas	1987
Class C		
Robert D. Rogers	President and Chief Executive Officer, Texas Industries, Inc., Dallas, Texas	1985
Hugh G. Robinson	President, Cityplace Development Corporation, Dallas, Texas	1986
Bobby R. Inman	Chairman of the Board, President, and Chief Executive Officer, Microelectronics and Computer Technology Corporation, Austin, Texas	1987

EL PASO BRANCH

Appointed by Federal Reserve Bank		
Hector Holguin	Founder and Chairman, Holguin Corporation, El Paso, Texas	1985
David L. Stone	President, The Portales National Bank, Portales, New Mexico	1986
Tony A. Martin	Chairman of the Board, First City National Bank of Midland, Midland, Texas	1987
Gerald W. Thomas	President Emeritus and Professor of Animal Range Science, Center for International Programs, New Mexico State University, Las Cruces, New Mexico	1987
Appointed by the Board of Governors		
Peyton Yates	President, Yates Drilling Company, Artesia, New Mexico	1985
John Sibley	President, Delaware Mountain Enterprises, Carlsbad, New Mexico	1986
Mary Carmen Saucedo	Associate Superintendent, Central Area Office, El Paso Independent School District, El Paso, Texas	1987

HOUSTON BRANCH

Appointed by Federal Reserve Bank		
Will E. Wilson	Chairman of the Executive Committee, First City National Bank of Beaumont, Beaumont, Texas	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Marcella D. Perry	Consultant, Heights Savings Association, Houston, Texas	1986
Thomas B. McDade	Vice Chairman, Texas Commerce Bancshares, Inc., Houston, Texas	1987
David E. Sheffield	President and Chief Executive Officer, First Victoria National Bank, Victoria, Texas	1987

Appointed by the Board of Governors

Robert T. Sakowitz	Chairman of the Board and President, Sakowitz, Inc., Houston, Texas	1985
Walter M. Mischer, Jr.	President, The Mischer Corporation, Houston, Texas	1986
Andrew L. Jefferson, Jr.	Attorney, Jefferson, Mims, and Plummer, Houston, Texas	1987

SAN ANTONIO BRANCH

Appointed by Federal Reserve Bank

George Brannies	Chairman of the Board and President, The Mason National Bank, Mason, Texas	1985
C. Ivan Wilson	Chairman of the Board and Chief Executive Officer, First City Bank of Corpus Christi, Corpus Christi, Texas	1986
Joe D. Barbee	President and Chief Executive Officer, Barbee-Neuhaus Implement Company, Weslaco, Texas	1987
Robert T. Rork	Chairman of the Board and Chief Executive Officer, RepublicBank San Antonio, N.A., San Antonio, Texas	1987

Appointed by the Board of Governors

Robert F. McDermott	Chairman of the Board and President, United Services Automobile Association, San Antonio, Texas	1985
Lawrence L. Crum	Professor of Banking and Finance, The University of Texas at Austin, Austin, Texas	1986
Ruben M. Garcia	President, Modern Machine Shop, Inc., Laredo, Texas	1987

District 12—SAN FRANCISCO

Class A

Spencer F. Eccles	Chairman, President, and Chief Executive Officer, First Security Corporation, Salt Lake City, Utah	1985
Rayburn S. Dezember	Chairman, Central Pacific Corporation, Bakersfield, California	1986
Donald J. Gehb	President and Chief Executive Officer, Alameda Bancorporation and Alameda First National Bank, Alameda, California	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Class B		
Togo W. Tanaka	Chairman, Gramercy Enterprises, Inc., Los Angeles, California	1985
John C. Hampton	Chairman and President, Willamina Lumber Company, Portland, Oregon	1986
George H. Weyerhaeuser	President and Chief Executive Officer, Weyerhaeuser Company, Tacoma, Washington	1987
Class C		
Carolyn S. Chambers	President, Chambers Cable Co., Inc., Eugene, Oregon	1985
Fred W. Andrew	Chairman, President, and Chief Executive Officer, Superior Farming Company, Bakersfield, California	1986
Alan C. Furth	Vice Chairman, Santa Fe Southern Pacific Corporation and President, Southern Pacific Company, San Francisco, California	1987

LOS ANGELES BRANCH

Appointed by Federal Reserve Bank		
Bram Goldsmith	Chairman and Chief Executive Officer, City National Bank, Beverly Hills, California	1985
William L. Tooley	Chairman, Tooley and Company, Investment Builders, Los Angeles, California	1985
Harvey J. Mitchell	President and Chief Executive Officer, Escondido National Bank, Escondido, California	1986
Robert R. Dockson	Chairman and Chief Executive Officer, CalFed, Inc., Los Angeles, California	1987
Appointed by the Board of Governors		
Thomas R. Brown, Jr.	Chairman of the Board, Burr-Brown Corporation, Tucson, Arizona	1985
Lola M. McAlpin-Grant	Attorney, Inglewood, California	1986
Richard C. Seaver	President, Hydril Company, Los Angeles, California	1987

PORTLAND BRANCH

Appointed by Federal Reserve Bank		
Herman C. Bradley, Jr.	President and Chief Executive Officer, Tri-County Banking Company, Junction City, Oregon	1985
William S. Naito	Vice President, Norcrest China Company, Portland, Oregon	1986
John A. Elorriaga	Chairman of the Board and Chief Executive Officer, United States National Bank of Oregon, Portland, Oregon	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
G. Dale Weight	Chairman of the Board and Chief Executive Officer, Benjamin Franklin Federal Savings and Loan Association, Portland, Oregon	1987

Appointed by the Board of Governors

G. Johnny Parks	Former Northwest Regional Director, International Longshoremen's & Warehousemen's Union, Portland, Oregon	1985
Paul E. Bragdon	President, Reed College, Portland, Oregon	1986
Sandra A. Suran	Partner-in-Charge, Peat Marwick Mitchell & Co., Beaverton, Oregon	1987

SALT LAKE CITY BRANCH

Appointed by Federal Reserve Bank

John A. Dahlstrom	Chairman of the Board, Tracy-Collins Bank and Trust Company, Salt Lake City, Utah	1985
Fred C. Humphreys	Chairman, President, and Chief Executive Officer, The Idaho First National Bank and Moore Financial Group, Boise, Idaho	1985
Albert C. Gianoli	Chairman of the Board and President, First National Bank of Ely, Ely, Nevada	1986
Lela M. Ence	Executive Director, University of Utah Alumni Association, Salt Lake City, Utah	1987

Appointed by the Board of Governors

D.N. Rose	President and Chief Executive Officer, Mountain Fuel Supply Company, Salt Lake City, Utah	1985
Robert N. Pratt	President, Moriah Enterprises, Inc., Bountiful, Utah	1986
Don M. Wheeler	President, Wheeler Machinery Company, Salt Lake City, Utah	1987

SEATTLE BRANCH

Appointed by Federal Reserve Bank

William W. Philip	Chairman of the Board and President, Puget Sound National Bank, Tacoma, Washington	1985
H.H. Larison	President, Columbia Paint Company, Spokane, Washington	1986
John N. Nordstrom	Co-Chairman of the Board, Nordstrom, Inc., Seattle, Washington	1987
William S. Randall	President and Chief Executive Officer, First Interstate Bank of Washington, N.A., Seattle, Washington	1987

Appointed by the Board of Governors

Byron I. Mallott	President and Chief Executive Officer, Sealaska Corporation, Juneau, Alaska	1985

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

		Term expires Dec. 31
Carol A. Birkholz	Managing Partner, Laventhol & Horwath, Seattle, Washington	1986
John W. Ellis	President and Chief Executive Officer, Puget Sound Power & Light Company, Bellevue, Washington	1987

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Index

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Index

Acceptances, bankers (*See* Bankers acceptances)
Adjustable-rate mortgages, 147, 151, 156
Advertising of interest on deposits, proposed revisions to Regulation Q, 148, 187
Agriculture
  Seasonal credit program, modification, 70
Assets and liabilities
  Banks, by class, 229
  Board of Governors, 196
  Federal Reserve Banks, 202–07
Audits (*See* Examinations, inspections, regulation, and audits)
Automated clearinghouse service, 153, 189, 190
Automated teller machines, 153
Automobile credit, 146, 151

Balance of payments (*See* International developments, review of 1985)
Bank, new definitions, legislative recommendation, 158
Bank Export Services Act, 180
Bank holding companies
  Activities approved, pending, and denied, 181–82
  Applications by, processing and notice of Board decisions, 180–82
  Capital-adequacy guidelines, 68–69, 174–75, 185
  Community Reinvestment Act relative to, 149
  Control of, change, 178
  Dividends paid by, Board policy statement, 69
  Examination, inspection, and regulation, 168, 170–78
  Financial statements, revisions and additions, 173
  International activities, 169, 178
  Investments, 179–80
  Legislative recommendations, 158–60
  Litigation, 162–67
Bank holding companies—Continued
  Number and assets, 169
  Stock repurchases by, 185
  Surveillance and monitoring program, 171
Bank Holding Company Act
  Legislative recommendations and litigation, 158–61, 162–67
  Provisions, 169, 177, 180–81
Bank Merger, Act, 178
Bank mergers and consolidations, 161, 178, 180–82
Bankers acceptances
  Authority to purchase and to enter into repurchase agreements, 74–76
  Federal Reserve Banks
    Holdings, 194, 202, 204, 206
    Income, 193, 214–17
  Open market transactions, 208
Repurchase agreements, 74–76, 202, 204, 206, 208
Banking offices, changes in number, 234
Banking supervision and regulation by Federal Reserve System, 69, 168–85
Board of Governors (*See also* Federal Reserve System)
  Cash, sources, uses, and balance at end of 1985, 198
  Consumer Advisory Council (*See* Consumer Advisory Council)
  Delegated authority, 178, 180, 185
  Financial statements, 195–200
  Interpretations (*See* Interpretations)
  Legislative recommendations, 156, 158–61
  Litigation, 162–67
  Members and officers, 248
  Policy actions (*See* Policy actions)
  Pricing of Federal Reserve services and in the payment mechanism (*See* Fees)
  Publications (*See* Publications)
  Regulations (*See* Regulations)
  Regulatory simplification, 186–88
  Salaries, 197

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Board of Governors—Continued
Training (*See* Training)
Branch banks
Federal Reserve
Bank premises, 159, 193, 212
Directors, 256-74
Vice presidents in charge, 254-55
Foreign, of U.S. banking organizations, 64, 170, 178
Foreign banks, 64, 170
Budget review, Federal Reserve System, 193
Business credit transactions, educational pamphlet planned, 148

Call reports (*See* Condition statements)
Capital accounts
Banks, by class, 229
Federal Reserve Banks, 203, 204, 206
Capital-adequacy guidelines, 67-68, 174-75, 185
Change in Bank Control Act of 1978, 178
Check clearing and collection
Availability of funds, speedup, 157, 189
Fees for Federal Reserve services, 189
Float (*See* Float)
Nonpayment of certain checks, improved procedures for notification, 65, 147, 159, 187-88
Volume of operations, 224
Coin and currency services, 191
Community affairs officers, 149-50
Commercial banks (*See also* Insured commercial banks)
Banking offices, changes in number, 234
Supervision and regulation by Federal Reserve System, 69, 168-85
Transfers of funds (*See* Transfers of funds)
Community Reinvestment Act
Annual report to Congress, 145
Examination under, 149, 155
Issue considered by Consumer Advisory Council related to, and usefulness of data from, 156-57
Promotion of goals, 149
Publication regarding, 150
Comptroller of the Currency
Conformity with, 67-68
Jurisdiction, 170, 172, 178
Reports, orders, and legislative recommendations by, 150-51, 157
Condition statements of Federal Reserve Banks, 202-07
Consumer Advisory Council, 156, 252
Consumer and community affairs, 145-57
Consumer Credit Protection Act, 148
Credit (*See also* Loans)
Automobile, 146, 151
Equal Credit Opportunity (*See* Equal Credit Opportunity Act and Regulation B)
Real estate (*See* Mortgage loans)
Seasonal credit program, modification, 76
Securities, 64-65, 182-84, 188
Truth in Lending (*See* Truth in Lending Act)
Credit cards, 157, 181
Credit Practices Rule, adoption of similar rule, and staff guidelines for, 67, 146
Currency and coin services, 191

Depository institutions
Checks (*See* Check clearing and collection)
Interest on deposits (*See* Interest on deposits)
Repurchase agreement transactions by, joint policy statement, 68, 175
Reserve requirements (*See* Reserve requirements of depository institutions)
Reserves and related items, 230-33
Services to (*See* Fees)
Depository Institutions Deregulation Committee, 187
Deposits
Banks, by class, 229
Checks (*See* Check clearing and collection)
Federal Reserve Banks, 203, 204, 206, 231, 235
Interest rates (*See* Interest on deposits)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Deposits—Continued
Reserve requirements (*See* Reserve requirements of depository institutions)
Directors, Federal Reserve Banks and Branches
Legislative recommendation, 159
List, 256–74
Discount rates at Federal Reserve Banks (*See* Interest rates)
Dividends
Federal Reserve Banks, 192–93, 216, 219, 221
Federal Reserve System, 1981–85, 213
Payment of, Board policy statement, 67

Earnings of Federal Reserve Banks (*See* Income of Federal Reserve Banks)
Economy in 1985, 5–11
Edge and agreement corporations, 169–70
Educational activities (*See* Training)
Electronic data processing activities, examination, 170
Electronic Fund Transfer Act
Annual report to Congress, 145
Compliance with, 150–52
Economic impact, 152–53
Legislative recommendation, 157
Electronic fund transfers (*See* Transfers of funds and Regulation E)
Electronic fund transfer systems, policy of reducing risks on large-dollar transfers, 176
Equal Credit Opportunity Act
Annual report to Congress, 145
Compliance with, 148, 150–51
Regulation B (*See* Regulations)
Usefulness of data from, 156
Examinations, inspections, regulation, and audits
Bank holding companies, 159, 169, 171–78
Federal Reserve Banks, 192
International activities, 170
Large-dollar electronic fund transfers, 176
Examinations, inspections, regulation, and audits—Continued
Program to strengthen, 172–77
Specialized, 170
State member banks, 155–56, 168–69, 171–77
Surveillance and monitoring program, relation to, 171
System Open Market Account, 192
Expenses
Board of Governors, 195–200
Federal Reserve Banks, 192, 218–21
Federal Reserve System, 1981–85, 213
Export trading companies, 179–80

Fair Credit Billing Act, 151
Fair Housing Act, usefulness of data from, 156
Farm Credit Act, 166
Farm Credit Administration, 151–52, 183
Farmers Home Administration, 68
Federal Advisory Council, 251
Federal agency securities
Authority to purchase and to enter into repurchase agreements, 74–76, 89, 96, 135
Federal Reserve Bank holdings and earnings, 194, 202, 204, 206, 210, 232
Federal Reserve open market transactions, 1985, 208
Repurchase agreements, 67, 74–76, 202, 204, 206, 208, 210
Authorization for, 74–76
Board policy statement, 67
Tables, 202, 204, 206, 208, 210
Transfer, by Reserve Banks, 191
Federal Bureau of Investigation, training by, 172
Federal Deposit Insurance Corporation, 67–68, 150–51, 158, 160, 170, 172, 178
Guidelines and reports, 67, 150–51
Provisions involving, and jurisdiction, 158, 160, 170, 178
Federal Financial Institutions Examination Council, 68, 172, 175
Federal Financing Bank, 75

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Home Loan Bank Board
Actions taken, 146, 150-51, 172, 183
Publication, 147
Federal Open Market Committee
Audit of System Open Market Account, 192
Continuing authorizations, review, 96
Litigation, 166
Meetings, 74
Members and officers, 250
Policy actions, 74-143
Federal Reserve Act
Legislative recommendations and litigation, 159, 166
Provisions, 169, 179, 184, 192
Federal Reserve Agents, 255
Federal Reserve Banks
Assessments for expenses of Board of Governors, 197, 216, 218, 220
Bank premises, 159, 193, 202, 204, 206, 212
Branches (*See* Branch banks)
Capital accounts, 203-04, 206
Chairmen and deputy chairmen, 254-55
Coin and currency services, 191
Condition statement, 202-07
Dallas Bank, pilot program, 189
Delegated authority, 178, 180, 185
Deposits, 203-04, 206, 231, 233
Directors, 159, 256-74
Dividends paid, 193, 216, 219, 221
Examination or audit, 192
Income and expenses, 192, 214-21
Interest rates, 69-73, 224
Loans and securities, 193, 202, 204, 206, 210, 212, 230, 232
New York Bank, 69, 74, 128, 175, 192
Officers and employees, number and salaries, 211
Operations, volume, 224
Presidents and first vice presidents, 211, 254-55
Pricing of services and in the payment mechanism, 189-94, 214, 222
Profit and loss, 216
St. Louis Bank, pilot program, 189
Seasonal credit program, loans under, 76
Training, 149, 171
Federal Reserve Board (*See* Board of Governors)
Federal Reserve Bulletin, 182
Federal Reserve notes
Condition statement data, 202-07
Cost of issuance and redemption, 193, 197
Interest paid to U.S. Treasury on, 193, 213
Litigation, 166-67
Federal Reserve Reserve Reform Act of 1977, 159
Federal Reserve System (*See also* Board of Governors)
Banking supervision and regulation by, 69, 168-85
Budget review, 193
Consumer affairs (*See* Consumer and community affairs)
Costs of certain services, 191
Foreign currency operations (*See* Foreign currencies)
Income and expenses, 1981-85, 213
Map of Federal Reserve Districts, 246
Membership, 185
Pricing of services and in the payment mechanism, 189-94, 214, 222
Training (*See* Training)
Federal Savings and Loan Insurance Corporation, 160
Federal Trade Commission, 67, 146, 151-52
Federal Trade Commission Improvement Act
Annual report to Congress, 145
Responsibilities under, 146
Fedwire, 176, 190-91
Fees
Federal Reserve services to depository institutions
Automated clearinghouse service, 189-90
Check clearing and collection, 189
Pricing of, and in the payment mechanism, 189-94, 214, 222
Securities and noncash collection services, 191
U.S. Treasury securities, 191
Financial Institutions Supervisory Act of 1966, 165, 169

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Financial markets and monetary policy, 12–19
Foreign banking and financing (*See* Regulations: K)
Float (*See also* Check clearing and collection), 189–90, 192
Foreign banks, 64, 170, 179
Foreign branches of U.S. banking organizations (*See* Branches)
Foreign currencies
  Authorization and directive for operations in, and review of documents, 74, 77–79, 96, 128
  Federal Reserve income on, 214
  Warehousing, agreement with U.S. Treasury, 96
Freedom of Information Act, 165
Full Employment and Balanced Growth Act of 1978, 3, 27

Garn–St Germain Depository Institutions Act of 1982, 64, 160–61
Glass–Steagall Act, 165
Gold certificate accounts of Reserve Banks and gold stock, 202, 204, 206, 230, 232

Home Mortgage Disclosure Act of 1975, 156

Income
  Federal Reserve Banks, 192, 214–21
  Federal Reserve System, 1981–85, 213
Insured commercial banks (*See also* Commercial banks)
  Acquisition authority in emergency, legislative recommendation, 161
  Assets and liabilities, 229
  Banking offices, changes in number, 234
  Number, by class of bank, 229
Interest on deposits (*See also* Interest rates)
  Advertising, proposed revisions to Regulation Q, 148, 187
  Maximum rates payable on time and savings deposits, 227
Interest on deposits—Continued
  Payment on demand deposits, prohibition, 187
  Regulation Q (*See* Regulations)
Interest rates (*See also* Interest on deposits)
  Credit cards, 156
  Federal Reserve Banks
    Changes, 69-73
    Table, 224
  Mortgage loans, 147
International Banking Act of 1978, 66, 179
International banking activities, 169, 178
International banking facilities, 179
International banking operations (*See* Regulations: K)
International developments, review of 1985, 20–26
Interpretations
  Regulations B, E, and Z, 148
  Margin regulations (G, T, U, and X), 182–84
  Regulation Q, 187
Interstate banking, 156, 160–61, 181
Interstate Commerce Commission, 152
Investment Company Act of 1940, 183
Investments
  Bank holding companies, 179, 180
  Banks, by class, 229
  Federal Reserve Banks, 202, 204, 206
  Foreign, by U.S. banking organizations, 180
  State member banks, 184, 229

Labor market developments, 10
Leasing, consumer, 148
Legislative recommendations
  Board of Governors, 156, 158–61
  Other agencies with enforcement responsibilities, 156–57
Litigation
  Bank holding companies, 162–67
  Board procedures and regulations, challenges, 165–67
Loans (*See also* Credit)
  Agricultural (*See* Agriculture)
  Banks, by class, 229

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Loans—Continued
Executive officers of state member banks, 184
Federal Reserve Banks
Holdings and income, 194, 202, 204, 206, 210, 214, 216, 230, 232
Interest rates, 69–73, 224
To depository institutions, 202, 204, 206, 214, 230, 232
Guaranteed by U.S. government, revisions to Board policy, 68
Real estate (*See* Mortgage loans)
Volume of operations, 224

Margin credit regulations (*See* Regulations: G, T, U, and X)
Margin requirements
Option contracts, Board policy actions, 65, 181, 183, 188
Table, 228
Member banks (*See also* Depository institutions and National banks)
Assets, liabilities, and capital accounts, 229
Banking offices, changes in number, 234
Borrowings and loans (*See* Loans)
Branches, 178–79
Capital-adequacy guidelines (*See* Capital-adequacy guidelines)
Control of, changes, 178
Dividends paid by, Board policy, 69
Investments, 179, 180
Membership in Federal Reserve System, 185
Number, 229
Reserve requirements, 225
Reserves and related items, 230–33
State member banks (*See* State member banks)
Surveillance and monitoring program, 171
Transfers of funds (*See* Transfers of funds)
Mergers and consolidations, 161, 177–78, 180–82, 235–45
Monetary Control Act of 1980, 64, 159, 187, 189
Monetary policy
Financial markets relative to, 12–19
Reports to Congress, 27–59
Review of 1985, 3–11
Money market deposit accounts, proposed amendment of Regulation D, 187
Mortgage loans, 64, 147, 151, 156, 186
Mutual savings banks, 234

National Association of Securities Dealers, 183
National banks (*See also* Member banks)
Assets, liabilities, and capital accounts, 229
Banking offices, changes in number, 234
Capital-adequacy guidelines (*See* Capital-adequacy guidelines)
Foreign branches, 179
Number, 229
National Credit Union Administration, 150, 172, 183
Nonbank banks, 158, 181
Nonmember depository institutions
Assets and liabilities, 229
Banking offices, changes in number, 234
Number, 229

Option contracts, Board policy actions, 65, 181, 183, 188
Over-the-counter marginable stocks, 183

Payment mechanism (*See* Fees)
Policy actions
Board of Governors
Discount rates at Federal Reserve Banks, 69–73
Regulations, 63–67
Statements and other actions, 67–68
Federal Open Market Committee
Authority to effect transactions in System Open Market Account
Continuing authorizations and directives, review, 96

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Policy actions—Continued
FOMC—Continued
Authority—Continued
Domestic operations, 74-77, 89-90, 96-97, 104, 115, 122, 135
Foreign currency operations, 74, 77-79, 128-29, 136
Presidents and vice presidents of Federal Reserve Banks
Conferences, 255
List, 254-55
Salaries of presidents, 210
Prices, 5
Pricing of Federal Reserve services and in the payment mechanism, 189-94, 214, 222
Private sector adjustment factor, 189-91
Profit and loss, Federal Reserve Banks, 216
Publications
Annual Report: Budget Review, 193
Business credit transactions, educational pamphlet planned, 64, 148
"Community Development Corporations and the Federal Reserve," 150
"Consumer Handbook to Adjustable Rate Mortgages," by Federal Reserve Board and Federal Home Loan Bank Board, 147
Federal Reserve Bulletin, 182
Federal Reserve Regulatory Service, 184
Federal Trade Commission, 151
Marginable over-the-counter stocks, list, 183
Regulations B, E, and Z, official staff commentaries, 148

Real estate loans (*See* Mortgage loans)
Regulation of banking organizations (*See* Banking supervision and regulation by Federal Reserve System)
Regulations (*See also* Regulatory Improvement Project)
AA, Unfair or Deceptive Acts or Practices, 67, 146

Regulations—Continued
B, Equal Credit Opportunity, 63, 147-48, 151, 156, 186
D, Reserve Requirements of Depository Institutions, 64, 179, 187
E, Electronic Fund Transfers, 67, 148, 152-53
F, Securities of State Member Banks, 184
G, Securities Credit by Persons Other than Banks, Brokers, or Dealers, 64-65, 182-83, 188
J, Collection of Checks and Other Items and Wire Transfers of Funds, 65, 147, 160, 187, 190, 192
K, International Banking Operations, 66, 179, 186
Q, Interest on Deposits, 148, 156, 179, 187
T, Credit by Brokers and Dealers, 64-65, 182-83
U, Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks, 64, 182-83, 188
X, Borrowers of Securities Credit, 182
Z, Truth in Lending, 147-50, 156
Regulatory Improvement Project, 63, 186
Regulatory simplification, 186-88
Repurchase agreements
Authority to purchase and to enter into, 74-76
Bankers acceptances (*See* Bankers acceptances)
Federal agency securities (*See* Federal agency securities)
Transactions, joint policy statement, 67, 175
U.S. government securities (*See* U.S. government securities)
Reserve requirements of depository institutions
Changes, 64
Regulation D (*See* Regulations)
Money market deposit accounts, proposed amendment of Regulation D, 187
Table, 225
Reserves and related items, 230-33

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Salaries
Board of Governors, 197
Federal Reserve Banks, 211
Savings and loan associations, 65, 183, 188
Schools (*See* Training)
Securities (*See also specific types)*
Credit, 64-65, 182-84, 188
Lending, Board policy, 175
Municipal securities dealers, clearing agents, and transfer agents, 171-72
Over-the-counter, 183
Regulation, 182-84
Repurchase agreement transactions, joint policy statement, 65, 175
Services by Federal Reserve, 191
Securities Acts Amendments of 1975, 171
Securities and Exchange Commission, 65, 152, 182-84, 188
Securities Exchange Act of 1934, 182-84
Small Business Administration, 68, 152
Special drawing rights, 202, 204, 206, 230, 232
State member banks (*See also* Member banks)
Advertising interest on deposits, proposed revisions to Regulation Q, 148, 187
Applications by, 184
Assets and liabilities, 168, 229
Banking offices, changes in number, 234
Basic banking services, recommendations concerning, 156
Capital-adequacy guidelines, 67, 174-75, 185
Consumer complaints against, 153-55
Control of, change, 178
Examinations and inspections, 155, 168-69, 170-77, 183
Fees (*See* Fees)
Financial disclosures, 184
Foreign branches, 179
Interest on deposits (*See* Interest on deposits)
Loans to executive officers, 184
Membership in Federal Reserve System, 185
State member banks—Continued
Mergers and consolidations (*See* Bank mergers and consolidations)
Number, 168, 229
Reserve requirements (*See* Reserve requirements of depository institutions)
Stock market credit (*See* Securities credit)
Stock repurchases by bank holding companies, 185
Supervision of banking organizations (*See* Banking supervision and regulation by Federal Reserve System)
System Open Market Account
Audit, 192
Authority to effect transactions in
Continuing authorizations, review, 96
Domestic operations, 80, 90, 97, 104, 115, 122, 129, 136
Authorization for, 74-77, 89, 96, 135
Domestic Policy Directive, 76, 80, 90, 97, 104, 115, 122, 129, 136
Foreign currency operations, 74, 77-79, 128

Thrift institutions, legislative recommendations and approval of acquisitions, 158-60, 181
Thrift Institutions Advisory Council, 253
Training, 149, 156, 172
Transfer agents, 171
Transfers of funds (*See also* Fees)
Check clearing and collection (*See* Check clearing and collection)
Federal Reserve operations, volume, 224
Large-dollar transfers, policy on reducing risks, 176
Pricing of Federal Reserve services and in the payment mechanism, 189-94, 214, 222
Trust activities, examination, 170-71
Truth in Lending Act
Annual report to Congress, 145
Compliance with, 150-51

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Truth in Lending Act—Continued
Preemption, 149
Regulation Z (*See* Regulations)

United States Department of Agriculture, 151-52
U.S. Department of Justice, 152, 162
U.S. Department of Transportation, 151-152
U.S. Department of the Treasury, 191-93
U.S. government securities
Authority to buy, to enter into repurchase agreements, and to lend, 74-76, 89, 96, 135
U.S. government securities—Continued
Bank holdings, by class of bank, 229
Federal Reserve Banks
Holdings, 194, 202, 204, 206, 210, 230, 232
Income, 193, 214-17
Transfers by, 191
Open market transactions, 208
Repurchase agreements
Authorization for, 74-76
Board policy statement, 67
Tables, 202, 204, 206, 208, 210, 230, 232
U.S. Supreme Court, 181

FRB 1—10,000—0686 C

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis