74th Annual Report 1987

Board of Governors of the Federal Reserve System

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Letter of Transmittal

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., June 28, 1988

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-Fourth Annual Report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 1987.

Sincerely,

Alan Greenspan, *Chairman*

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Part 1

Monetary Policy and the U.S. Economy in 1987

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Introduction

The national economy scored major gains in 1987. Growth of real gross national product outstripped most expectations, and the unemployment rate dropped below 6 percent for the first time in the 1980s. With such sectors as agriculture, mining, and manufacturing benefiting considerably from an improved competitive position internationally, the expansion of the economy was better balanced than in 1985–86. Wage increases remained moderate and contributed to favorable cost trends in many sectors; however, a rebound in oil prices, coupled with the effects of the dollar's decline on the prices of imported goods generally, pushed the rate of price inflation back up to the 4 percent range by most measures.

The year was marked also by the sharpest-ever decline in the stock market—a 508-point drop in the most widely watched index—and continued concern about the twin deficits in the federal budget and the trade accounts. Some progress was made in reducing the budget deficit during 1987, and the trade account showed some improvement toward the end of the year, but both deficits remained large.

At times last year, soaring commodity prices and sharp declines in the dollar and bond prices signaled the possibility of greater inflationary dangers. With the economy moving toward higher levels of resource utilization, the Federal Reserve had to be especially alert to these and other indications of pressures that might have led to a significant departure from the longer-run trend toward price stability. In these circumstances, monetary policy was characterized by a tendency toward greater restraint through last October; this tendency was reflected in a moderate rise in money market interest rates, which in turn damped growth of the monetary aggregates. While M3 grew at a pace equal to the lower bound of the range set for 1987 by the Federal Open Market Committee, M2 fell short of its range. After the plunge in the stock market in October, the System focused its efforts primarily on ensuring adequate liquidity in the economy, and interest rates subsequently reversed a good part of the rise that had occurred earlier in the year.

By early 1988, however, conditions in financial markets had not yet returned fully to "normal," and the edginess of participants continued to be reflected in volatility and fairly sizable risk premiums. Moreover, the economy had shown some signs of weakness. In particular, the fourth quarter of 1987 was marked by a sharp rise in inventories in a few sectors, and indications of a slackening in labor demand appeared early in 1988. Against this backdrop, the System eased a bit further the pressures on reserve positions of depository institutions.

While the Federal Reserve has had to be responsive to the near-term risks of an economic downturn, it has not lost sight of the potential influence of policy actions on longer-term trends in the economy. The United States is in the process of an important readjustment in the balance of economic activity, after a

NOTE. This discussion of economic and financial developments in 1987 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 1988).

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period of several years in which growth of domestic spending outstripped the pace of domestic production. Over that span, the trade balance moved into deep deficit, and the nation began to amass a huge net external debt. It is important to allow room for a significant improvement in our trade balance, especially given that the low rates of unemployment and the high rates of capacity utilization evident in many segments of industry suggest the need for added care in maintaining progress toward price stability.

These considerations underlay the decisions of the Federal Open Market Committee when it met in February 1988 to chart its monetary policy strategy for the year. They also must be kept in the forefront as decisionmakers elsewhere in the government set policy. In particular, continuing fiscal restraint is crucial if we are to free resources to finance productivity-enhancing private investment while bringing about an improved pattern of international transactions. Moreover, additional efforts at bringing greater coherence to policies domestically and internationally will promote greater stability in financial markets and greater internal and external balance to the economy.

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The Economy in 1987

The economy completed a fifth consecutive year of expansion in 1987, with real gross national product increasing almost 4 percent over the four quarters of the year.[1] The overall growth in output not only was greater than in 1986 but also was better balanced across industries and regions of the country. In addition, the rise in activity supported a net gain of more than 3 million jobs last year, and the civilian unemployment rate stood at 5.8 percent in December, nearly a percentage point below its year-earlier level.

Virtually all broad measures of inflation, after dropping sharply in 1986, rebounded in 1987 to about the pace seen in 1984 and 1985. In large part, the pattern of price movements over the past two years reflected developments in oil markets, where prices rebounded last year after a marked decline in 1986. However, prices of some imported consumer goods and of a number of industrial commodities at the producer level also rose sharply. In contrast, wage trends remained restrained last year, although tightening labor markets and the faster pace of inflation stemmed the pattern of wage deceleration evident in previous years.

As suggested above, a number of sectors that had been depressed in recent years began to show signs of improvement in 1987. The turnaround was most pronounced in manufacturing, where production and employment, especially in capital goods and industrial materials industries, picked up sharply in response both to stronger orders from abroad and to higher capital spending by domestic producers. Improvement also was apparent in the domestic energy sector, where, in response to the partial recovery in oil prices, oil drilling retraced a small part of its earlier precipitous decline, and in agriculture, where higher exports and continued federal support boosted farm income and helped bring about some firming in land prices.

In addition, the composition of activity moved toward a better balance between domestic spending and domestic production. Weak consumer spending reduced the growth of domestic demand in 1987. At the same time, domestic production was supported by the increase in the international competitiveness of U.S. industry: the continued improvement in productivity in manufacturing and the moderate pace of increase in labor compensation permitted U.S. firms to lower the foreign currency prices of their goods while expanding profits. Indeed, much of the improvement in economic conditions last year could be traced to the effects of this increase in competitiveness on the volume of imports and exports. Nevertheless, the combination of a substantial increase in the value of oil imports and rising prices of non-oil imports more than offset an improvement in real net exports, and the nominal trade deficit widened to almost $160 billion in 1987. In addition, a further erosion of net income on investments and other service transactions pushed the current account deficit above $160 billion.

Although economic activity rose at a brisk pace for 1987 as a whole, the October stock market crash added substan-

1. Except where noted, all percent changes are from the fourth quarter of the previous year to the fourth quarter of the year indicated.

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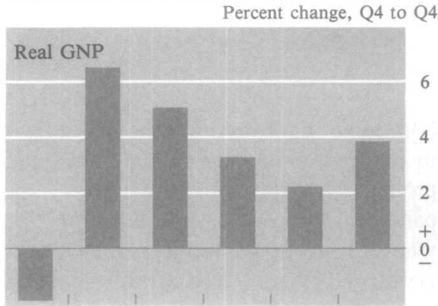
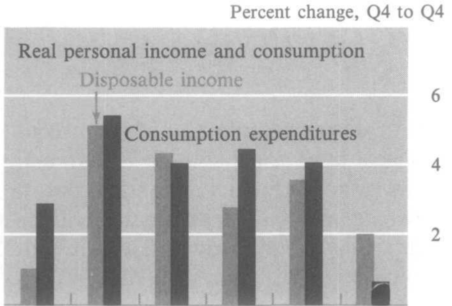
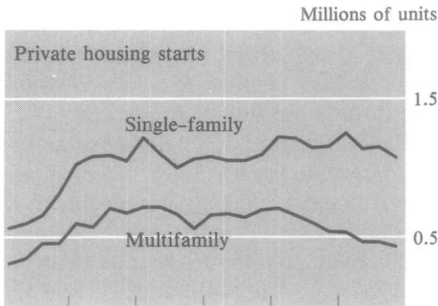
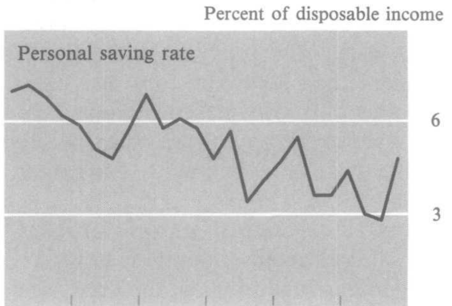
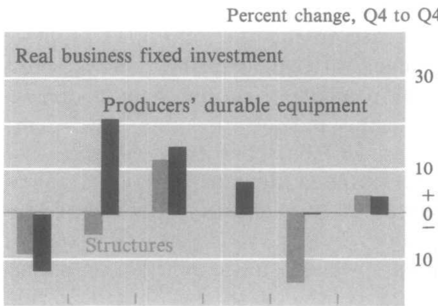
Indicators of Economic Performance

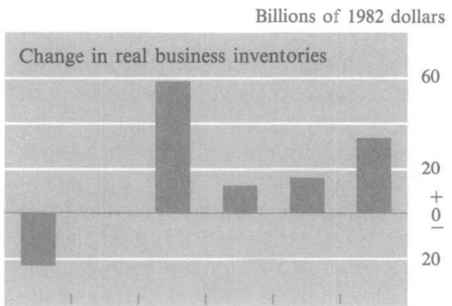


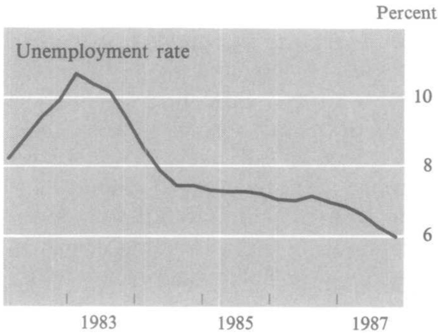


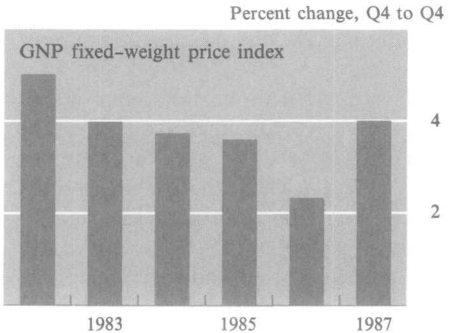












All data are seasonally adjusted. The unemployment data are from the Department of Labor; the other data are from the Department of Commerce.

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tial uncertainty to the prospects for continued economic growth. The sharp drop in stock prices reduced household wealth considerably and raised the possibility of a further slowing in consumer spending, domestic business investment, and housing construction. At year-end, it was still too early to assess the ultimate economic effect of the stock market decline, but that effect seemed likely to be offset, at least partly, by the decline in interest rates after the crash.

Household Sector

Spending by households, which had been a major contributor to growth in earlier years, slowed considerably in 1987. Real consumer spending rose less than 1 percent, after a 4 percent gain in 1986. In large part, the cutback in spending reflected smaller increases in real disposable income. Substantial growth in employment and in farm and interest income fueled continued gains in nominal incomes; but a pickup in consumer price inflation eroded much of that rise and reduced the growth in real income to about 2 percent last year, compared with 3½ percent in 1986. Moreover, although the rise in stock prices added further to household wealth through August and supported consumption, the subsequent stock market decline returned equity wealth to 1986 levels.

In general, consumers cut back their expenditures for both durable and nondurable goods, while spending on services continued to increase at about the pace of recent years. Within the durable goods category, sales of new cars fell from 11½ million units in 1986 to about 10¼ million units last year. Some of that dropoff can be traced to an especially slow pace of sales in early 1987, as consumers shifted automobile purchases into 1986 to take advantage first of major sales incentives and then of the sales tax deduction available only under the old tax law. Nevertheless, domestic auto sales were relatively sluggish throughout 1987, despite the availability of special incentive programs on a wide range of models during much of the year.

Housing activity in 1987 was damped by the upward movement in mortgage rates, continued high vacancy rates for multifamily units, and changes in the tax law. Total housing starts were 1.62 million for the year as a whole, about 10 percent below the 1986 total and the lowest in five years. Single-family homebuilding began the year at a brisk pace but weakened considerably as conventional mortgage interest rates began to rise in April, reaching about 11½ percent for fixed-rate loans by mid-October. Although interest rates on mortgages dropped substantially thereafter, the stimulative effect of that change on housing demand may have been offset by stock market losses and reduced consumer confidence. In the multifamily market, activity also weakened over the year; near record-high vacancy rates on rental units and tax-law changes that reduced the profitability of rental housing continued to deter building.

Business Sector

Business spending on plant and equipment rose about 4½ percent in real terms in 1987. In large part, investment spending was associated with the overall pickup in economic activity. However, financial conditions also were conducive to spending, with cash flows strong and the costs of external capital fairly attractive through much of the year.

Outlays for equipment began the year on the weak side, with spending down sharply in the first quarter after firms shifted expenditures into late 1986 to

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take advantage of the favorable treatment of investment under the depreciation provisions of the old tax law. However, investment in equipment rebounded sharply in the second and third quarters, especially investment in computers and other office equipment, which had shown essentially no growth in 1986. In contrast, spending on industrial equipment was not especially brisk despite the strong gains in manufacturing production.

Outlays for nonresidential structures also turned up last year after a sharp drop in 1986. Much of the turnaround reflected an improvement in the energy sector in response to higher oil prices. In particular, drilling of oil and gas wells was up more than 20 percent over the year after having dropped 40 percent in 1986. Outside of the energy area, spending on structures was about unchanged, after falling nearly 9 percent in 1986. Producers were somewhat less reluctant to expand industrial facilities because of the substantial rise in production, while office construction, although down a bit last year, held up surprisingly well in view of the high vacancy rates still prevailing in many locales.

Business inventory investment generally moved in line with sales over most of 1987, but a sharp accumulation of stocks in the fourth quarter suggested the possibility of excess inventory levels at some retailers. In manufacturing, inventories changed little on balance over the first half of the year but rose considerably in the second half as activity picked up. Stockbuilding was most evident in capital goods industries; orders and shipments strengthened substantially as producers added supplies in anticipation of higher production levels. In the retail trade sector, inventories of goods other than automobiles also rose over the year, pushing the inventory–sales ratio to a relatively high level by December. The accumulation was most pronounced for home goods such as furniture and appliances and for apparel. At auto dealers, stocks generally rose in 1987, and at year-end, supplies appeared to be well above desired levels despite the prevalence of special incentive programs and production cutbacks late in the year.

Before-tax profits of nonfinancial corporations increased substantially in 1987. Profits were especially strong in manufacturing, where a pickup in shipments, firming prices, and good control of costs contributed to improved margins. In other industries, before-tax profits were little changed from 1986 levels. However, after-tax profits for the sector as a whole fell a bit on an annual average basis, as increases in corporate tax liabilities associated with the new tax laws more than offset the overall rise in profits.

Government Sector

Significant progress was made last year toward reducing federal budget deficits. The deficit for fiscal year 1987, at $150 billion, was about one-third smaller than the record level of the previous year, and the administration and the Congress reached agreement on a broad plan for deficit-reduction actions totaling more than $30 billion in fiscal 1988 and about $46 billion in fiscal 1989.

However, a number of factors that raised receipts and lowered outlays in fiscal 1987 are not likely to be repeated, and without further legislative action, deficits could expand again unless economic circumstances remain favorable. About half the deficit reduction in fiscal 1987 could be traced to these one-time factors, as tax-reform effects boosted revenues, and asset sales and changes in the timing of certain payments reduced outlays. The remainder of the reduction in the deficit reflected strong growth in

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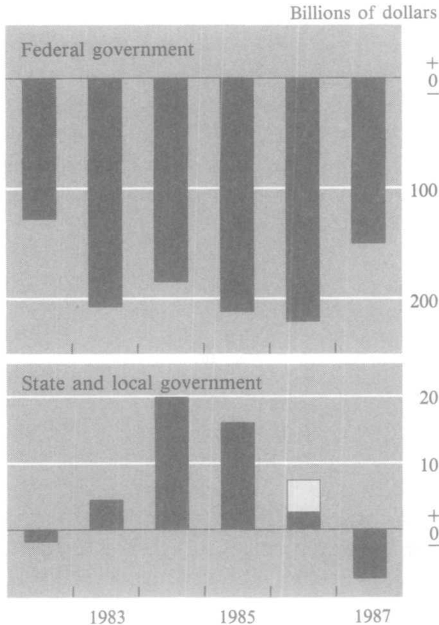
Government Surpluses and Deficits



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

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

The total 1986 surplus of $7.4 billion for state and local governments contained about $4.7 billion of nonrecurring inflows from settlements involving oil company overcharges, Outer Continental Shelf rents, and stripper-well charges, as well as shifting of some revenue-sharing payments to fiscal 1986.

revenues and a very small underlying rise in outlays. The economic expansion boosted receipts, while, on the outlay side, lower interest rates in fiscal 1987 offset some of the increase in interest payments associated with the rise in the size of the national debt. In addition, the improvement in the farm sector reduced agricultural support payments, and lower inflation in 1986 held down cost-of-living adjustments for many entitlements. Spending restraint also had a noticeable effect: the rise in military spending slowed, and cuts in discretionary programs reduced outlays for education, energy, and intergovernmental assistance.

The state and local sector recorded a sizable deficit in its operating and capital accounts (which exclude social insurance funds), as expenditures expanded more rapidly than receipts. Many states took action in early 1987 to deal with eroding fiscal positions. About half of the states cut their budgets last year and two-thirds raised taxes, with many of the budget adjustments in energy and farm states. However, pressing needs to expand and upgrade schools, highways, and correctional institutions continue to squeeze many state and local budgets.

Labor Markets

Nonfarm payroll employment increased 3 million over the 12 months of 1987, as the pickup in economic activity led employers to add workers at a brisk pace. The strengthening in hiring was widespread by industry, in contrast to earlier years, when the labor market was characterized by sharp disparities across sectors. Manufacturing employment edged up over the first half of the year and then rose substantially in the second half in response to the large gains in industrial production. Expansion of jobs in the trade, service, and finance industries remained sizable during most of 1987.

The demand for labor considerably outpaced the increase in labor supply, and the civilian unemployment rate dropped nearly 1 percentage point over the year to 5¾ percent at year-end—the lowest level since 1979. The jobless rate for adult men moved down to about 4½ percent by the end of last year, reflecting strong growth in the industrial sector. The rate for adult women fell to around 4¾ percent early in the year, but changed little in the second half.

As the unemployment rate dropped sharply, wage increases, which had been

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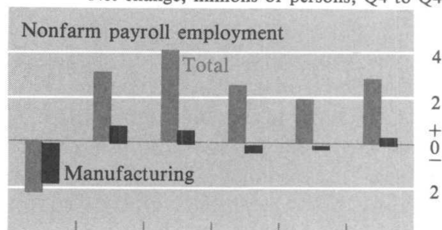
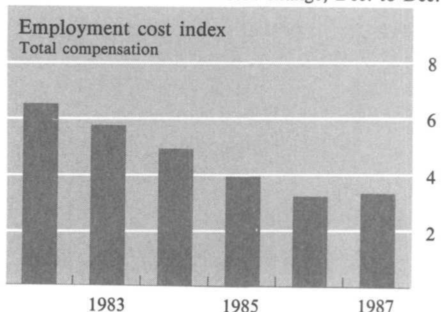
Labor Market Conditions

Net change, millions of persons, Q4 to Q4



Percent change, Dec. to Dec.



Payroll employment covers the total nonfarm sector; the employment cost index is for private industry, excluding farm and household workers. All data are from the Department of Labor.

slowing for several years, leveled out; however, they showed little sign of acceleration. Hourly compensation, as measured by the employment cost index, advanced 3¼ percent in the 12 months ended December, about the same pace as in 1986. The widespread moderate rise in compensation occurred despite a substantial pickup in consumer-price inflation. As a result, real hourly compensation fell last year and since 1984 has increased at an average annual rate of only about ½ percent.

Unit labor costs in the nonfarm business sector rose only 1¼ percent in 1987, after a 2 percent increase in 1986. The continued restraint in labor costs primarily reflected moderate growth in compensation—productivity gains for the sector as a whole have improved little from the sluggish pace of the 1970s. In contrast, manufacturers apparently have made significant progress in increasing efficiency and streamlining operations, and output per hour in this sector rose nearly 3½ percent in 1987. This advance in manufacturing productivity, coupled with continued slow growth in manufacturing wages, continued to put downward pressure on factory unit labor costs last year.

Price Developments

Inflation rebounded in 1987, largely reflecting higher energy prices and continued price hikes for imported goods. The fixed-weight price index for GNP increased about 4 percent for the year as a whole, after a 2¼ percent rise in 1986. The indexes for consumer prices and for producer prices suggested an even sharper acceleration in prices over 1987, owing to the greater importance of energy prices in those indexes. The consumer price index was up 4½ percent in the 12 months ended December, after a 1 percent rise in 1986; the producer price index, which includes only prices of domestically produced goods, rose 2¼ percent over the year, after dropping 2¼ percent in 1986.

The overall rise in energy prices in 1987 reflected both a sharp rebound in prices early in the year and an additional runup in prices around midyear. Spot prices for West Texas Intermediate crude oil (the benchmark crude oil in the United States) rose $3 per barrel in January of last year to about $18.50 in response to lower OPEC production levels. Tensions in the Persian Gulf boosted prices further during the summer, to a high of around $20 per barrel in early August. Precautionary stockbuilding during this period, coupled with higher levels of production by OPEC countries and the absence of any major disturbance in the Persian Gulf, subsequently helped put downward

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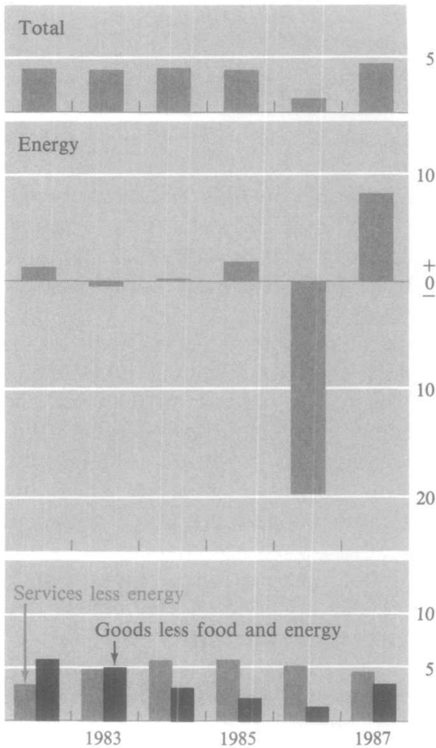
Consumer Prices



The data are from the Department of Labor.

pressure on crude oil prices, which retreated to about $17 per barrel after late summer. Retail prices for gasoline and home heating oil closely followed these movements, rising about 20 percent through August and then falling somewhat in the latter part of the year. In contrast, prices for natural gas and electricity were down or little changed last year, reflecting a further adjustment to the net decline in oil prices since 1985.

Outside of the energy area, price increases for goods picked up in 1987 while prices for nonenergy services rose about 4½ percent, a bit less than in 1986. A jump in used car prices accounted for much of the acceleration in goods prices, but further increases in import prices associated with the falling exchange value of the dollar also were evident. As a result, retail prices for many items with high import proportions, such as women's and girls' apparel, photographic equipment, and toys and music equipment, posted notable increases.

Prices for many industrial commodities also rose considerably over the course of 1987. In addition to the increase in crude oil prices, copper prices more than doubled, and steel scrap prices were up 36 percent by year-end. To some extent, the sharp rise in commodity prices reflected the influence of dollar depreciation on markets for internationally traded goods. However, temporary supply shortages for some industrial metals and the firming in U.S. industrial activity undoubtedly also had an important influence on commodity markets. In the agricultural sector, grain prices fell early in 1987 as farmers sold large amounts of grain received through government programs; prices rebounded in the latter part of the year as exports picked up in response to the falling dollar.

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Monetary Policy and Financial Markets in 1987

In 1987 the Federal Reserve continued to face the difficult task of charting policy in an environment in which considerable uncertainties clouded the relationship between the behavior of the monetary aggregates and the performance of the economy. As a result, while the Federal Open Market Committee set targets for some of the monetary aggregates, it deemed necessary the maintenance of a flexible approach in conducting its operations, looking at a broad range of information in judging when or if to adjust its basic instruments—reserve availability and the discount rate—in response to deviations in monetary growth from expected rates. Such factors as the pace of business expansion, the strength of inflation and inflation expectations, and developments in exchange markets played a major role in governing the System's actions, and in light of the behavior of these other factors, growth in the targeted aggregates, M2 and M3, was permitted to run at or below the lower bounds of the established ranges.

During episodes beginning in the spring and then again in late summer, the dollar came under sustained downward pressure, and inflation expectations appeared to be on the rise, partially in response to the dollar's weak performance. With the economy expanding at rates sufficient to produce rising rates of resource utilization, the FOMC sought some firming of pressures on reserve positions and increased the discount rate in September. When stock prices collapsed in mid-October, the resulting turmoil required that the focus of policy be on ensuring the liquidity of the financial system. Over the remainder of the year, emphasis in the conduct of open market operations shifted toward maintenance of steady and somewhat easier money market conditions to promote a return of stability to financial markets generally and to cushion the effects of the stock market decline on the economy.

At its meeting in February 1987, the FOMC established annual target ranges of 5½ to 8½ percent for both M2 and M3; both aggregates had increased a little more than 9 percent in 1986, but slower growth was expected to be consistent with the Committee's goal of sustaining business expansion while maintaining long-run progress toward price stability. The deceleration proved sharper than anticipated, and in July the Committee stated that growth for the year around the lower ends of these ranges, or even below them, might be acceptable in certain circumstances. Velocity had increased in the first half of the year, partly under the influence of rising interest rates, and the Committee agreed that if inflationary forces were to exhibit renewed strength and interest rates were to increase further in the second half of the year, continued slow money expansion might be appropriate. Rates did move upward again in the late summer, including an increase of ½ percentage point in the discount rate to counter potential inflation. And M2 growth did in fact fall substantially short of the Committee's range, at 4 percent for the year, while M3 growth, at 5½ percent, was at the lower end of its range.

The velocity of M2 has exhibited a substantial short-run sensitivity to movements in market rates of interest.

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Although deregulation permits institutions to keep rates on deposits in line with market interest rates, in practice the adjustment of rates on many instruments has been sluggish. In addition, savers apparently have become more attuned to alternative investment opportunities, responding strongly to changes in relative returns. As a result, the sensitivity of money to movements in market interest rates seems to have increased since deregulation. In 1987, as rates rose, savers had incentives to favor market instruments, and their response held down the growth of M2 and to a lesser extent M3, causing the velocities of these aggregates to rise. This outcome was in marked contrast to 1986, when falling interest rates and inflation were reflected in faster money growth and substantial declines in velocity.

Monetary Policy in 1987

During the first half of 1987, monetary policy was carried out in an atmosphere of increasing concern about the course of inflation, arising in part from heavy downward pressure on the dollar. Growth of the economy was noticeably increasing resource utilization, and inflation was picking up, reflecting the effect of a weaker dollar on import prices as well as a rebound of oil prices from low 1986 levels. When the dollar came under heavy pressure in late March, previously tranquil credit markets began to exhibit concern about the effect that declines of the dollar would have on prices. Long-term interest rates, in particular, moved up strongly. In conjunction with some easing moves abroad, the Federal Reserve sought somewhat greater restraint in the provision of reserves to the banking system. Initially, this action produced further increases in interest rates, but subsequently, financial pressures eased somewhat. In response to reductions in interest rates abroad, to some flattening in commodity prices, and to better news on the U.S. trade deficit, the dollar firmed and interest rates declined broadly, with long-term rates falling somewhat more than short-term rates.

When the FOMC met in July to review its target ranges for growth of money and credit, all of the monetary aggregates had decelerated considerably. The weakness in monetary growth did not reflect any evident weakness in the economy; rather, the slower money growth and accompanying strengthening in velocity appeared largely attributable to the rise in market rates of interest that was fostered in part by the Federal Reserve's response to adverse developments with respect to the dollar and inflation. The Committee reaffirmed its 1987 growth ranges for M2 and M3; in doing so, it anticipated some pickup in the growth of M2 over the remainder of the year, but it indicated that growth for all of 1987 near or even below the bottom of the target ranges might be acceptable for both aggregates, depending on the behavior of their velocities and other financial and economic developments, notably the evolving strength of inflationary pressures. The Committee also decided not to set a target range for M1, given the unpredictability of the behavior of this aggregate relative to economic activity.

For a short time after the July meeting, the dollar rose further, but with the release of trade data in mid-August that disappointed market participants, the dollar again came under substantial downward pressure. Yields on long-term bonds moved up sharply, as the dollar's weakness against a backdrop of strength in the economy spurred concerns about inflation and possible firming of monetary policy. Interest rates in short-term markets also increased, but

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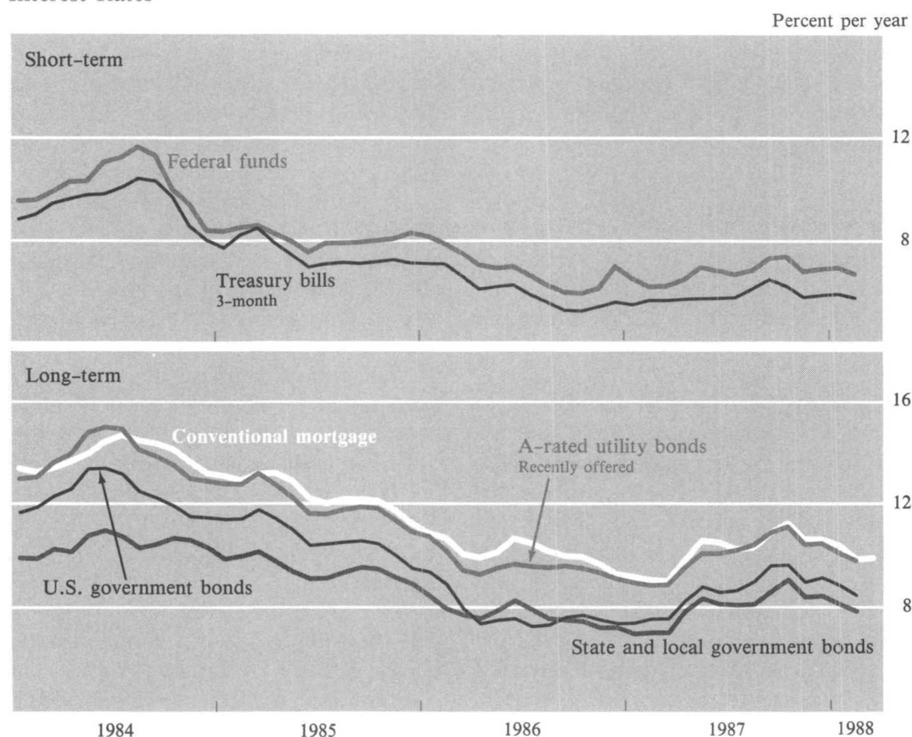
by lesser amounts. In light of the potential for greater inflationary pressures, in part related to weakness in the dollar, the Federal Reserve sought to reduce marginally the availability of reserves through open market operations; it also raised its discount rate ½ percentage point in early September to 6 percent. After the discount rate action, interest rates rose further, especially in short-term markets.

Stock prices, which had reached very high levels relative to earnings and had been falling since mid-August, plunged on October 19 in chaotic trading. Interest rates then fell markedly as investors sought refuge in the perceived safety of fixed-income assets, especially Treasury securities. Although most stock indexes recovered somewhat in the wake of the crash, financial markets remained turbulent, with bond and equity prices fluctuating widely.

In a financial environment of extraordinary turmoil and apparent fragility, the Federal Reserve shifted the emphasis in the conduct of open market transactions to providing reserves generously to en-

Interest Rates



All the data are monthly averages.

The federal funds rate is from the Federal Reserve.

The rate for three-month Treasury bills is the market rate on three-month issues on a discounted basis and is from the Department of the Treasury.

The rate for conventional mortgages is the weighted average of 30-year, fixed-rate, level-payment mortgages at savings and loan associations and is from the Federal Home Loan Mortgage Corporation.

The rate for A-rated utility bonds is the weighted average of recently offered, 30-year investment-grade bonds adjusted to an A-rated basis by the Federal Reserve.

The rate for U.S. government bonds is their market yield adjusted to 30-year constant maturity by the Treasury.

The rate for state and local government bonds is a *Bond Buyer* index based on 25 issues of 30-year revenue bonds of mixed quality.

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Reserves, Money Stock, and Debt Aggregates

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

Item	1985	1986	1987	1986	1987			
				Q4	Q1	Q2	Q3	Q4
Depository institution reserves[2]								
Total	15.3	20.1	6.1	24.3	16.4	8.0	−1.6	1.4
Nonborrowed	26.5	22.2	6.3	25.3	18.5	5.4	−.4	1.2
Required	15.1	20.3	6.3	22.8	16.5	8.4	−.5	.3
Monetary base[3]	8.8	9.8	7.9	10.8	11.1	6.9	5.1	7.7
Concepts of money[4]								
M1	12.0	15.6	6.3	17.2	13.2	6.6	.8	4.0
Currency and travelers checks	7.7	7.5	8.7	7.7	9.0	7.4	7.4	9.7
Demand deposits	8.8	11.8	−1.0	12.6	3.1	.4	−7.5	.1
Other checkable deposits	22.1	29.3	13.6	32.0	29.4	13.7	5.2	4.0
M2	8.9	9.4	4.0	9.0	6.5	2.7	2.8	4.0
Non-M1 component	7.9	7.4	3.3	6.3	4.2	1.3	3.5	4.0
MMDAs (n.s.a.), savings, and small-denomination time deposits	7.4	6.1	3.0	5.3	4.5	1.4	2.5	3.4
General-purpose and broker/dealer money market mutual fund assets (n.s.a.)	9.3	17.4	6.3	12.7	6.9	−.6	4.6	13.7
Overnight RPs and Eurodollars (n.s.a.)	19.8	16.1	4.0	25.1	13.3	−22.8	18.9	7.5
M3	7.7	9.1	5.4	7.5	6.5	4.7	4.5	5.5
Non-M2 components	3.4	8.2	10.9	1.5	6.7	13.0	11.0	11.2
Large-denomination time deposits	5.1	1.8	8.5	−6.8	1.4	9.8	7.8	14.4
Institution-only money market mutual fund assets (n.s.a.)	11.1	32.1	3.0	17.2	1.4	−12.2	2.9	20.2
Large-denomination term RPs (n.s.a.)	−4.0	31.1	29.9	35.5	18.5	71.6	25.6	−4.1
Term Eurodollars (n.s.a.)	−5.3	4.7	14.4	6.0	31.1	−2.3	16.1	10.6
Domestic nonfinancial sector debt	13.3	13.3	9.8	13.0	10.8	8.9	8.2	9.8
Federal	15.2	14.7	8.9	11.8	12.2	8.7	5.9	7.5
Nonfederal	12.7	12.8	10.1	13.3	10.4	9.0	9.0	10.6

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 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; travelers checks of nonbank issuers; demand deposits at all commercial banks other than those due to depository institutions, the U.S. government, and foreign banks and official insitutions, 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.

sure that adequate liquidity would be available to meet any unusual needs. Nonborrowed reserves grew rapidly in late October to accommodate both a large increase in reserves required against surging transaction deposits and an enlarged demand for excess reserves. An easing of pressures on reserve positions also took place which, along with some diminution of inflation expectations, led to a partial reversal of earlier increases in interest rates. These actions helped to calm the financial markets, although conditions remained somewhat

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unsettled over the rest of the year.

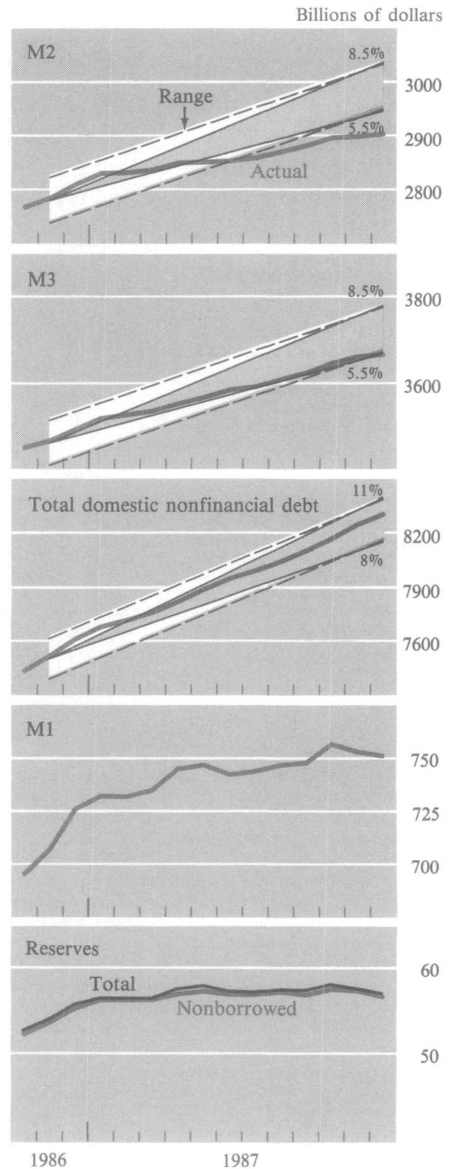
Early in 1988, as incoming data gave some signs of a softening in the economy, the Federal Reserve sought a slight additional easing in pressures on reserve positions. This action was taken against the background of a more stable dollar in foreign exchange markets, which followed a renewed agreement among major industrialized countries, highly visible exchange market intervention, and better trade news. Interest rates generally moved somewhat lower in the first few months of 1988, and stock prices trended higher, though remaining well below levels preceding the October collapse.

Monetary Aggregates

M2 increased only 4 percent in 1987, well below both the lower bound of its 5½ to 8½ percent annual growth range and its more than 9 percent rate of expansion over the preceding two years. The velocity of this aggregate picked up substantially, reversing a portion of its sharp decline in 1985–86. The rise in velocity may have reflected in part several special factors affecting the public's demand for M2 balances in 1987; among them were a much-reduced rate of saving out of income and a preference for drawing upon liquid assets—rather than using consumer credit—to finance purchases in the wake of tax reform measures reducing deductibility of nonmortgage interest payments. Much of the pickup in velocity, however, appears attributable to increases in the competing returns on other assets, which raised the opportunity costs associated with holding M2 balances.

The widening gap between market rates and offering rates was most pronounced for the more liquid retail deposits, whose rates are changed infrequently. Early in the year, opportunity

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 1986:4 to 1987:4.

The reserve aggregates have been adjusted to remove discontinuities associated with changes in reserve requirements. Nonborrowed reserves include extended credit. The difference between these two measures is adjustment and seasonal borrowing.

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costs on these accounts were still low and inflows were large. As market rates rose, however, yields on these accounts became less and less attractive and growth slowed; by late in the year, both savings and NOW accounts had net monthly outflows. Also, money market deposit accounts declined, for the first year since this component of M2 was introduced in late 1982. Expansion of money market mutual funds was sluggish.

In contrast to the very liquid retail deposits, small time deposits expanded in 1987, after two years of zero or negative growth. Depository institutions tend to keep the offering rates on these deposits fairly well in line with market alternatives of about the same maturity. With intermediate-term rates rising more than short rates in 1987, the spread between yields on small time instruments and those on more liquid retail accounts widened considerably, providing depositors with an incentive to shift funds into small time deposits from the more liquid retail instruments.

M3 was stronger than M2 over the year, expanding 5½ percent and ending the year at the bottom of its 5½ to 8½ percent annual growth range. Its faster growth reflected heavy reliance by depository institutions on large time deposits and on certain other instruments included in M3 but not in M2. Both commercial banks and thrift institutions stepped up their issuance of wholesale managed liabilities to fund more asset growth than could be accommodated by greatly reduced inflows of core deposits. Even so, M3 growth was subdued relative to earlier years, in part because overall needs for funds contracted as asset expansion at banks and thrift institutions slowed. In addition, banks relied heavily on managed liabilities obtained from non-M3 sources, especially funds borrowed from their foreign branches.

Growth of M1 slowed to 6¼ percent from the very rapid 15½ percent increase posted the previous year because of a small decline in demand deposits and a sharply lower expansion of other checkable deposits. The velocity of M1 increased slightly, after a record postwar decline in 1986. The sharp slowing of growth and the abrupt turnabout in its velocity are indicative of the increased sensitivity of M1 to movements in market interest rates that has emerged in recent years. As its comparatively larger deceleration in 1987 suggests, M1 now appears to have a greater sensitivity to changes in interest rates than the broader aggregates.

In large measure, the greater sensitivity of M1 reflects the increasing share of other checkable deposits in that aggregate. Because NOW accounts pay explicit interest, they serve as an attractive savings vehicle as well as a transaction account. The available information suggests that owners of NOW accounts are quite sensitive to changes in opportunity costs and shift savings balances between these accounts and other, less liquid retail deposits. At the beginning of 1987, market interest rates were very close to NOW account rates, and with the opportunity cost so low, depositors apparently placed unusually large amounts of interest-sensitive funds in these accounts; as market rates rose during 1987, they evidently shifted these funds out of NOW accounts in search of higher yields.

The abrupt weakening of demand deposits after two years of rapid expansion suggests that this component of M1 also is sensitive to interest rates. Higher market interest rates obviously offer incentives to economize on balances that earn no interest. Higher rates also permit business firms to reduce the balances held with banks as compensation for services provided by the banks but not paid for with fees; because banks can

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earn greater returns by investing these funds when rates are higher, they reduce the balance requirements commensurately. Substantial amounts of demand deposits are held under compensating-balance arrangements, and this helps to explain a high interest elasticity for demand deposits. Over time, however, there has been a gradual movement toward the substitution of explicit fees for compensating balances, and some reports indicate that such shifts may have accelerated in late 1987, thereby contributing to the steep declines in demand deposits near year-end. Higher mortgage rates also may have contributed to weakness in demand deposits in 1987 by slowing the pace of mortgage refinancing—an activity that tends to boost demand deposits temporarily because the amount being prepaid on an old mortgage often is placed in escrow for a time in a demand deposit.

The collapse of equity prices, which raised the average level of all the aggregates a bit in the fourth quarter, affected M1 most noticeably. Demand deposits rose sharply around the time of the crash, reflecting the increased volume of financial transactions that arose from the surge in trading activity. Other checkable deposits also registered sizable inflows, as some funds withdrawn from the stock market probably were placed initially in these accounts. Outside of M1, sizable amounts of funds were transferred from equity mutual funds into money market mutual funds, which are included in M2. The boost to the aggregates was concentrated in late October and proved temporary; deposits receded over the month of November.

Credit Market Developments

The debt of domestic nonfinancial sectors grew 9¾ percent in 1987, ending the year at about the middle of the FOMC's monitoring range of 8 to 11 percent. Debt expansion moderated considerably from the 13¼ percent pace of the two previous years but still rose faster than income. Growth of federal debt slowed in 1987, as some progress was made in reducing the federal deficit. Borrowing by state and local governments fell substantially, partly reflecting the damping effect of higher borrowing costs and the availability of unspent funds from earlier financings. In the household sector, overall growth of indebtedness slowed. Use of consumer credit was held down by sluggish spending and by a shift toward greater reliance on home equity lines of credit in response to the effects of tax reform in reducing the deductibility of interest payments on consumer debt. A brisk pace of home sales over most of the year, however, helped sustain the growth of mortgage debt at about the elevated pace of 1986. Despite some widening last year of the gap between internally generated funds and capital expenditures, overall business borrowing diminished. Businesses continued to retire equity, however, through mergers, buyouts, and share repurchases, and the credit needed to finance these retirements boosted the expansion of business indebtedness.

Despite the slower growth of debt and the overall strength of the economy in 1987 there still were some signs of strain and financial fragility in portions of the economy. While expansion of total household debt slowed, the growth of household debt still outstripped that of disposable income, and the ratio of debt to income reached new highs. For some individuals, the strains of heavy debt burdens apparently remain severe: the number of personal bankruptcies has been growing rapidly over the last three years and setting new records. On the other hand, declines last year in the de-

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linquency rate on mortgage debt have brought this indicator of financial stress more into line with historical standards.

The nonfinancial corporate sector remained highly leveraged in 1987 and thus potentially vulnerable to adverse changes in the economic and financial environment. A combination of strong debt issuance and massive net equity retirements boosted the aggregate debt–equity ratio of these corporations, measured at market values at year-end, after a two-year decline resulting from increases in stock prices. Moreover, higher interest rates along with additional debt boosted borrowing costs, keeping the net interest-coverage ratio at about the very low levels recorded during the last recession. Reflecting the weakening of the finances of some corporations, the pace of downgradings of corporate debt remained very high in 1987, and a record $9 billion of rated corporate bonds were placed in default.

In the financial sector, the banking industry was under some continuing stress in 1987, which primarily reflected the well-publicized difficulties with energy and developing-country loans and, in some parts of the country, with agricultural and real estate loans as well. Although most banks continued to be healthy and to enjoy reasonable profits, souring energy and agricultural loans in recent years have led to record numbers of bank closings, principally of smaller banks in the Midwest and Southwest; problems with the quality of agricultural loans appear to be diminishing, however, as the agricultural sector shows signs of improvement.

Provisions by large banks for losses on troubled loans led to record losses in 1987 for the banking industry as a whole and to substantial declines in the book value of shareholder equity of affected banks. Doubts about the ultimate collectibility of loans to some heavily indebted developing countries weighed down the stock prices of many large banks in 1987, but investor reaction to the second-quarter decision to make provisions for substantial losses was generally positive and, at the time, share prices rose for many banks taking this step. Difficulties persisted over the year in making progress in handling the economic and financial problems of many of the developing countries, and in the fourth quarter a number of large banks announced additional provisions for losses on such debt and, in some instances, write-offs of problem loans.

After several years of improvement, the financial condition of the thrift industry deteriorated in 1987. Aggregate earnings declined, with losses posted in the second and third quarters as a result of heavy provisions for losses on assets, including a one-time write-off of accumulated insurance payments prepaid to the Federal Savings and Loan Insurance Corporation (FSLIC).[1] However, as had been the case for some years, the aggregate condition of the industry masked extremes among individual institutions. Many are well capitalized and quite profitable, but severe problems with asset quality have left a substantial minority insolvent and suffering massive operating losses that are steadily worsening. Before the passage in 1987 of legislation authorizing a recapitaliza-

1. In March 1987 the General Accounting Office declared that the FSLIC was insolvent because it would be unable to meet all its future obligations on insured deposits at failed but not yet closed institutions. The Financial Accounting Standards Board then ruled that the prepaid assessments, which were assets on the balance sheets of individual thrift institutions, had to be written off immediately. The FSLIC recapitalization plan included in the Competitive Equality Banking Act of 1987 provides that the affected thrift institutions will recover the amount of this write-off over the next five years as new funds are raised for the FSLIC.

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tion, the FSLIC had been unable to take effective remedial action with respect to these insolvent institutions, owing to the inadequacy of its own resources. Under the terms of the recapitalization plan approved as part of the Competitive Equality Banking Act, the newly created Financing Corporation began raising the funds needed by the FSLIC through issuance of long-term debt.

The collapse of the stock market gave clear warning of the vulnerability of important elements of the financial system to sudden shocks. Although only a few small securities firms failed, the market turbulence posed significant problems for traders, specialists, and market-makers on the stock exchanges; and, more generally, financial markets gave evidence of fragility and instability that had not entirely disappeared by early 1988. Under the circumstances, it is essential that the reexamination of our market mechanisms and regulatory systems go forward, to identify any actions that may be needed to safeguard the strength of our capital markets and lower the risks of economic disruption.

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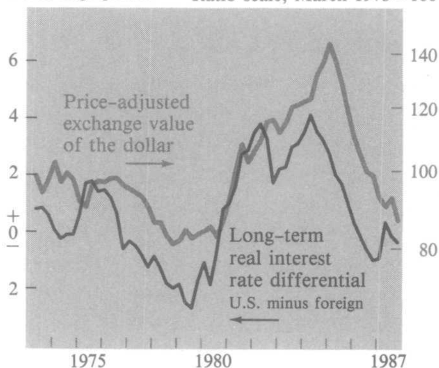
International Developments

The adjustment of external imbalances among major industrial countries that began in 1986 gained momentum in 1987. Real net exports by the United States (national income accounts, 1982 dollars) rose $16 billion, contributing ½ percentage point to the 1987 rise in gross national product. Meanwhile, real net exports by Japan and Germany declined. The weighted average rate of growth of domestic demand in 10 foreign industrial countries exceeded that of GNP in those countries, while the reverse was true for the United States. Domestic demand in that group of countries grew about 4 percent, significantly faster than in the United States. Growth in non-OPEC developing countries slowed somewhat from the preceding year but remained in the neighborhood of 4 percent.

Despite the sharp improvement in real terms, the nominal U.S. external accounts again posted record deficits for the year: $159 billion in the trade account and $161 billion in the current account. By the end of the year, however, even the nominal trade deficit was beginning to decline.

The assessment by market participants of the outlook for adjustment of the nominal U.S. external position appeared to be an important factor in exchange market developments in 1987. Market disappointment on that score contributed to a further net decline of 16½ percent in the foreign exchange value of the dollar against the currencies of 10 major industrial countries, bringing the dollar's total depreciation from February 1985 to December 1987 to 44 percent. The dollar's decline in 1987 occurred despite a net rise of more than 1 percent, in favor of the dollar, in the difference between estimated long-term real interest rates in the United States and those in major foreign countries.

Exchange Value of the Dollar and Interest Rate Differential



The exchange value of the U.S. dollar is its weighted average exchange value against currencies of other G-10 countries using 1972–76 total trade weights adjusted by relative consumer prices.

The differential is the rate on long-term U.S. government bonds minus the rate 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.

All the data are quarterly.

Also, the dollar's decline occurred despite $100 billion of net official dollar purchases by the monetary authorities of 14 major countries, including the United States. Total official dollar purchases, including some by smaller countries, may have been as high as $140 billion. U.S. monetary authorities purchased $8½ billion net, of which about two-thirds was against Japanese yen and the remainder against German marks. Much of the currency intervention arose from the February 1987 Louvre accord among the G-7 governments, reaffirmed in December, which declared the intent to

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"cooperate closely to foster stability of exchange rates around current levels."

After the turn of the year the dollar firmed significantly, aided by the publication of trade figures for November and December that showed substantially lower nominal deficits.

Foreign Economies

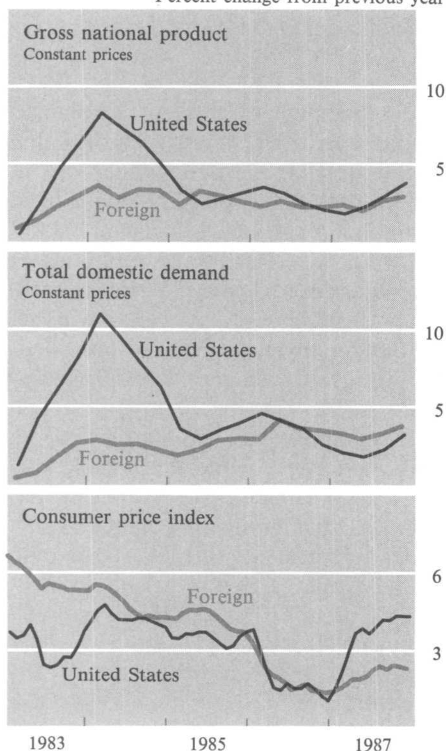
Real economic growth in the major foreign industrial countries strengthened somewhat in 1987. Economic activity was strong in Japan, Canada, and the United Kingdom, particularly in the latter half of the year. Growth was only moderate in the economies of continental Europe, with some slowing evident toward year-end.

The pattern of real growth across the major foreign industrial countries was reflected in the changes in unemployment rates. In both Canada and the United Kingdom, unemployment rates fell sharply during the year and by year-end had declined to levels not reached since 1982. In Japan the unemployment rate decreased slightly on average over the year. In contrast, unemployment rates in Germany and the other continental European countries were little changed in 1987 from rates observed during the previous year.

The rate of inflation abroad rose somewhat in 1987 as the factors that had contributed to lowered inflation in 1986, particularly declining world oil prices, were lessened or even partially reversed. Nevertheless, inflation remained at low rates in the major foreign industrial countries. In Japan and Germany, consumer prices in the fourth quarter were only slightly above their levels at the end of 1986; wholesale prices were slightly below their year-earlier levels.

In most of the major foreign industrial countries the rate of growth of money remained quite rapid in 1987. Germany and Switzerland exceeded their target ranges for the growth of specific aggregates, as did France for one of its two targeted aggregates; the rate of money growth in Japan rose from its already high 1986 pace. Fiscal policy abroad eased slightly from the generally restrained stance of 1986. Government deficits as a fraction of GNP rose a little in Germany and Japan. In the United Kingdom, unexpectedly strong growth in revenues moved the government fiscal position into surplus.

GNP, Demand, and Prices



Foreign data are multilaterally weighted averages for the Group of Ten (G-10) industrial countries, using 1972–76 total trade weights, and are from foreign official sources.

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

The GNP and domestic demand data are quarterly; the consumer price data are monthly.

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The aggregate current account surplus of the 10 major foreign industrial countries decreased about $10 billion in 1987. Larger surpluses for Germany and Japan were more than offset by deterioration in the balances of France, the United Kingdom, and Italy. Despite increases in the dollar value of their current account surpluses, the adjustment of trade volumes that began in 1986 in Japan and Germany proceeded further. Japanese export volume declined almost 2 percent, while its import volume rose more than 8 percent. During 1987, German export volume rose slightly, but import volume expanded signficantly more.

The combined trade balances and current accounts of developing countries improved nearly $30 billion in 1987. A $13 billion improvement to near balance in the combined current account of non-OPEC developing countries was achieved largely through the growth of exports. Imports expanded significantly for the first time since the onset of the debt crisis in 1982. Rising oil revenue, attributable to higher prices, and unchanged imports led to a $16 billion improvement in the aggregate current account balance of OPEC countries in 1987. Developments in the oil market had little effect on the overall current account of non-OPEC developing countries.

Rising prices of manufactures and commodities contributed to the growth of trade in non-OPEC developing countries. In addition, the large 1986 improvement in the exchange-rate competitiveness of these countries was maintained in 1987. However, Taiwan and South Korea, two of the major newly industrializing economies (NICs), increased the rate of appreciation of their currencies against the dollar. The combined current account surpluses of the four East Asian NICs—Hong Kong, South Korea, Singapore, and Taiwan—increased $9 billion despite the accelerated growth of imports. In addition, after several years of declining or slow growth, both exports and imports expanded in 1987 for the heavily indebted developing countries targeted by the debt-relief plan of Treasury Secretary Baker—their combined trade balance and current account improved about $8 billion.

Efforts to provide additional financing for the heavily indebted developing countries faced growing difficulties during 1987. Fatigue with the adjustment process increased. A key development was the February 1987 decision by Brazil to suspend interest payments to banks on its external term debt. This action contributed to an atmosphere of general concern about the prospects for continued improvement in growth and adjustment of the heavily indebted developing countries. However, in late 1987, Brazil reached a preliminary agreement on a plan to eliminate its arrearage in interest payments; the accord set the stage for a normalization of Brazil's relations with its external bank creditors, including a rescheduling and the provision of new money. Brazil resumed partial payment of interest at the end of 1987.

In May 1987, Citicorp announced a $3 billion addition to its reserves for possible loan losses, citing its decision to put its Brazilian loans on a cash basis. Most major U.S. banks and some foreign commercial banks soon followed Citicorp and announced major additions to reserves for loan losses. In December 1987, Bank of Boston initiated a round of provisions and charge-offs by U.S. regional banks against loans to developing countries. These moves raised concern about the future capacity of commercial banks to provide new loans to developing countries.

Some countries with large external

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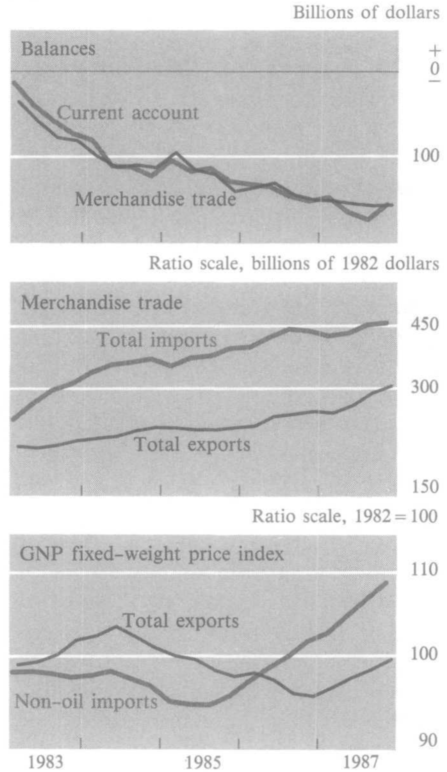
debts were able in 1987 to obtain sizable new bank loans—$7.7 billion for Mexico and $2 billion for Argentina. In addition, the groundwork was laid in 1987 for a $1 billion new-money package for Colombia that was completed in early 1988. Financing through conventional new-money packages has been complemented by the development of a menu of financing options, including debt-for-equity programs and bonds. Near the end of 1987, Mexico announced a plan to exchange a portion of its debt for a new issue backed by zero-coupon notes issued by the U.S. Treasury. The results of the auction were announced in March 1988 with $2.6 billion in new bonds issued to retire $3.7 billion in public sector debt (an average discount of about 30 percent on the old debts). Important structural reforms were undertaken or continued in a number of countries, often supported by programs of the World Bank and the International Monetary Fund. The central role of these institutions in resolving the debt crisis was reaffirmed. For example, agreement was reached on an enhancement of the IMF's Structural Adjustment Facility and a replenishment of the International Development Association. A sizable general capital increase for the World Bank is now awaiting approval by national authorities.



The data are quarterly, seasonally adjusted at annual rates, and are from the Department of Commerce.

U.S. International Transactions

The U.S. merchandise trade and current account deficits widened in 1987 as a whole but leveled off in the latter part of the year. A $27 billion increase in exports and a $41 billion increase in imports yielded a trade deficit of $159 billion for the year, compared with $144 billion in 1986. Net receipts on services transactions declined $7 billion in 1987, mainly reflecting a rise in payments of investment income to foreigners that exceeded the rise in income receipts from abroad. The current account deficit for 1987 was $161 billion, up from $141 billion in 1986.

The rise in the value of merchandise exports in 1987 largely reflected a strong increase in the volume of nonagricultural exports, which rose 20 percent from the fourth quarter of 1986 to the fourth quarter of 1987, an even stronger rate of increase than was recorded over the preceding four quarters. While there was a small pickup in economic growth in the rest of the world, much of the rise appears to be associated with an improvement in the price competitiveness of U.S. products resulting from the pre-

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U.S. International Transactions[1]

Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
			1986	1987			
	1986	1987	Q4	Q1	Q2	Q3	Q4
Current account	**-141**	**-161**	**-38**	**-37**	**-41**	**-43**	**-39**
Merchandise trade balance	-144	-159	-39	-39	-40	-40	-40
Exports	224	251	57	57	60	65	69
Imports	-369	-410	-96	-96	-100	-105	-109
Investment income (net)	21	14	4	6	2	*	7
Direct investment, net	31	35	8	9	7	6	13
Portfolio investment, net	-10	-21	-4	-4	-5	-5	-6
Other services (including military transactions)	-2	-2	*	*	*	*	-2
Unilateral transfers, private and government	-16	-13	-4	-3	-3	-3	-4
Private capital flows	**84**	**84**	**25**	**26**	**21**	**39**	**-2**
Bank-reported capital, net (outflows, -)	18	44	3	12	-1	24	9
U.S. net purchases (-) of foreign securities	-3	-4	3	-1	*	-1	-2
Foreign net purchases (+) of U.S. Treasury securities	8	-6	-3	-2	-2	-3	1
Foreign net purchases of U.S. corporate bonds	54	27	12	9	7	8	3
Foreign net purchases of U.S. corporate stocks	17	15	*	10	8	5	-8
U.S. direct investment abroad	-28	-38	-4	-10	-6	-6	-16
Foreign direct investment in United States	25	41	13	8	9	12	11
Other corporate capital flows, net	-7	5	1	1	4	*	n.a.
Foreign official assets in United States (increase, +)	**35**	**44**	**1**	**14**	**10**	*****	**20**
U.S. official reserve assets, net (increase, -)	*****	**9**	*****	**2**	**3**	*****	**4**
U.S. government foreign credits and other claims, net	**-2**	**1**	*****	*****	*****	*****	**1**
Total discrepancy	**24**	**22**	**12**	**-5**	**7**	**3**	**17**
Seasonal adjustment discrepancy	...	...	4	3	-2	-5	4
Statistical discrepancy	24	22	8	-8	9	8	13

1. Details may not add to totals because of rounding.
*Less than $500 million absolute value.

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

vious decline in the dollar. The growth in the volume of exports was spread over most major categories of trade and was especially strong in sales of machinery, particularly business machines. The volume of agricultural exports also rose as grain sales to the Soviet Union and China increased and as U.S. suppliers of soybeans increased shipments when foreign soybean production dropped off.

The increase in the value of merchandise imports for 1987 reflected both rising import prices (in response to the continuing decline in the dollar through 1987) and an increase in volume. Significant price rises were recorded for imported oil, other industrial supplies, consumer goods, and various machinery categories; however, prices of some items, notably business machines, continued to fall and thereby held down significantly the increase in the implicit deflator for imports. On a fixed-weight basis, non-oil import prices rose 7.0 percent (Q4 to Q4). Most of the increase in the volume of non-oil imports was concentrated in capital goods, especially business machines.

The value of oil imports rose in 1987 from the low levels recorded in 1986. A 21 percent increase in price (year to year) was accompanied by a 4 percent rise in volume. In 1987 the average price of oil, at $17.17 per barrel, was above the 1986 average of $14.18 per barrel but well below the $25–$35 per barrel recorded during the previous six years. In the second half of 1987, oil prices declined in response to excessive OPEC oil production and the accompanying

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stock accumulations. The volume of U.S. oil imports rose from an average of 6.2 million barrels per day in the first half of 1987 to an average of 7.3 million barrels per day in the second half of the year; much of the increase went into inventories.

The record $161 billion current account deficit for 1987 was balanced by recorded net capital inflows of $138 billion and a statistical discrepancy of $22 billion. The net capital inflows brought the U.S. net indebtedness to foreigners to about $400 billion at the end of 1987.

Official reserve holders, both U.S. and foreign, accounted for a large part of the recorded capital inflow in 1987 ($53 billion). The bulk of foreign official inflows, $44 billion, were placed in U.S. Treasury securities. However, foreign official holdings in the United States increased by only a fraction of the increase in official reserves held by these countries, as a substantial portion of the dollar proceeds of intervention in foreign exchange markets by several countries were apparently invested in the Euromarkets.

Private capital flows were dominated by net inflows reported by banks, particularly through interbank transactions. These inflows probably reflected indirectly the increased availability of funds in the Euromarkets resulting from placements by official monetary authorities. Inflows through securities transactions were down sharply from 1986. Private foreigners were net sellers of U.S. Treasury securities and their purchases of U.S. corporate bonds were down by half. On the other hand, private foreign net purchases of U.S. corporate stocks were up sharply in the first three quarters of the year, though net sales of $8 billion in the fourth quarter brought the total for 1987 below the level for 1986.

Foreign direct investment in the United States again reached record levels in 1987 with a continued large number of takeovers of major U.S. corporations by foreigners. Direct investment abroad by U.S. residents, as measured in dollars, continued to increase also, although dollar depreciation played a major role in explaining the increases. Despite large recent inflows, foreign direct investment in the United States is still smaller than U.S. direct investment abroad.

Foreign Currency Operations

Of the total $8,509 million of net intervention purchases of dollars by the Federal Reserve and the Treasury, $4,223 was for the System account. The Federal Reserve sold $2,038 million equivalent of German marks and $2,184 million equivalent of Japanese yen from its holdings of foreign currencies. The System realized profits of $1,139 million on these intervention sales. In addition, because of the rise in value of foreign currencies against the dollar, the Federal Reserve gained $665 million on its remaining foreign currency holdings. At year-end, the value of those balances, predominantly marks, amounted to $7,773 million.

The only activity on the Federal Reserve swap network in 1987 involved the final repayment, in February, of an August 1986 drawing by the Bank of Mexico. The drawing was part of a multinational bridge loan to allow Mexico time to obtain more permanent financing from the IMF and the World Bank.

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Monetary Policy Reports to the Congress

Given below are reports submitted to the Congress by the Federal Reserve on February 19 and July 21, 1987, pursuant to the Full Employment and Balanced Growth Act of 1978.

Report on February 19, 1987

Monetary Policy and the Economic Outlook for 1987

The current economic expansion in the United States has entered its fifth year, ranking it among the longest of the postwar period. While substantial imbalances and risks have emerged in the course of the expansion that must be dealt with forcefully and effectively, important groundwork also has been laid for continued growth through 1987 and beyond. Significantly, price trends thus far have remained favorable, reflecting not only the dramatic drop in crude oil prices in early 1986 but also continued restraint on labor costs in many sectors. Interest rates have moved lower and stock prices higher, reducing the cost of capital for investment and enhancing wealth. Furthermore, processes are in train that should help correct the major imbalances that have been plaguing the economy: action has been taken to cut the deficit in the federal budget, and the foreign exchange value of the dollar has moved to levels that have made U.S. firms more competitive in world markets and that should help correct the imbalance in the U.S. external accounts.

While the potential for further economic progress thus appears considerable, those gains will be secured only if there is timely and constructive action by decisionmakers in the public and private sectors. The Congress and the administration must follow up the steps already taken and make basic programmatic changes that will ensure continuing movement toward budgetary balance; failure to do so would be damaging to confidence and disruptive to the financial markets. Many of our major trading partners, which have depended greatly on external surpluses to buoy their economies over the past few years, must act to open their markets more fully and to foster sustained growth in domestic demand; without such action, prospects for world growth as well as for reducing our own trade deficit would be impaired, the risks of protectionism would rise, and prospects for the dollar would be more uncertain. And, if we are to capitalize on those trading opportunities and promote economic and financial stability at home, labor and management must avoid a return to the inflationary behavior of the past. Oil prices have firmed recently, and the sizable decline in the dollar is likely to exert upward pressure on other prices in the months ahead; the challenge is to prevent such developments from triggering a cumulative price–wage spiral.

In that context, Federal Reserve policy has a critical role to play. Monetary expansion, while adequate to support orderly economic growth, needs to be consistent with continuing progress over time in reducing the underlying rate of inflation. As the experience of recent years has demonstrated, such a policy—in part by bolstering confidence in financial markets and providing a framework of greater certainty for private decisionmaking—can make a substantial contri-

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bution to the maintenance of expansion and the reduction of unemployment. In the short run, a variety of factors—such as interest rate movements, regulatory changes, and institutional innovations, among others—may alter considerably the amount of funds the public wishes to hold in monetary form. Over time, however, expansion of the money stock measures clearly must moderate from recent rates if destabilizing pressures are to be avoided. The Federal Open Market Committee has established targets for 1987 with that fact in mind, but it will continue to interpret the movements in the monetary aggregates in light of developments in the economy and in domestic and international financial markets and the potential for inflationary pressures.

A Brief Review of the Past Year

Economic activity continued to expand moderately in 1986, at about the pace that has prevailed, on average, since mid-1984. This growth was sufficient to create 2½ million new payroll jobs, and the unemployment rate drifted down to the area of 6¾ percent at year-end.

Further progress was made in 1986 toward the objective of overall price stability. Wage and price behavior continued to be influenced by the anti-inflationary thrust of policies put in place some time ago—and by the ongoing adjustment of expectations to the new environment. Thus, while the plunge in world crude oil prices contributed importantly to the sharp slowing in inflation last year, prices outside the energy area also decelerated on average. Running counter to past cyclical patterns, labor cost pressures remained subdued, with nominal wage gains across a broad range of occupations and industries continuing to move toward less inflationary rates—rates that are more consistent with trends in labor productivity.

The Federal Reserve encouraged continued economic expansion last year by supplying ample reserves for the banking system and reducing the discount rate four times, by a total of 2 percentage points. A large portion of the reserves provided were to accommodate the strong demand for M1-type deposits. Last year, M1 grew in excess of 15 percent and its velocity—the ratio of nominal gross national product to money—declined more than 9 percent, unprecedented during the postwar years. In part, this rapid money growth reflected the public's response to changes in interest rates, which made it more attractive to hold negotiable order of withdrawal (NOW) accounts and demand deposits. However, last year's growth was well in excess of what would be expected based on past relationships among money, interest rates, and income. Growth in the broader aggregates was more in line with past experience, taking account of interest rate movements. Both M2 and M3 expanded almost 9 percent last year, ending 1986 just within the upper bound of their annual target ranges.

In the credit markets, short-term rates of interest declined about 2 percentage points through the first three quarters of the year. Since that time, short-term rates have backed up some, first reflecting pressure around the end of the year from a huge volume of tax-related transactions and more recently from investors' response to stronger-than-anticipated economic news and concerns about weakness in the dollar. Longer-term bond rates have fallen more than 2 percentage points since the end of 1985, with most of the decline occurring in the first four months of 1986 in response to an improved inflation outlook and sluggish growth in economic activity. After mid-April, Treasury bond rates fluctuated in a relatively narrow range, but

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corporate and municipal bond rates trended lower—reaching the lowest levels since the late 1970s.

The declines in interest rates contributed to the vigorous pace of household spending last year by reducing borrowing costs and boosting asset values. Housing starts, which are particularly sensitive to interest rate developments, rose a bit, despite the drag of a depressed economy in regions heavily dependent on oil and agriculture. In contrast, capital spending declined over the course of the year, largely because of the sharp cutback in oil drilling; more broadly, investment was restrained by an overhang of office and other commercial space and the weak pace of activity in major segments of the manufacturing sector.

The disparity between household spending and business investment is indicative of the imbalances that characterized the U.S. economy in 1986. Indeed, economic performance throughout the current expansion has varied considerably across industries and regions of the country. In some cases, such as agriculture, special circumstances have played a role. But more fundamentally, the imbalances are rooted in the enormous—and partly related—deficits in our external accounts and in the federal budget.

Although the foreign exchange value of the dollar has fallen sharply from its peak in early 1985—at least relative to the currencies of the major industrialized countries—the nation's trade deficit deepened last year. The increased price competitiveness of U.S. producers contributed to a sizable improvement in real export growth, but the pickup was damped by the relatively slow pace of economic activity abroad. At the same time, the volume of imports continued to rise rapidly through most of last year, in part because the pass-through of the dollar depreciation into import prices was limited by the ability of foreign exporters and U.S. distributors to absorb much of the exchange rate swing in their profit margins. Also, American buyers apparently have developed strong preferences for certain foreign goods, and the newly industrialized and developing countries continued to rely disproportionately on U.S. markets. With import penetration remaining on an uptrend, domestic production continued to expand less rapidly than domestic demand.

The federal budget deficit also remains huge, despite substantial deficit-reducing actions taken by the administration and the Congress. Official estimates suggest that the deficit for fiscal 1987 will be in the range of $175 billion—a good deal less than the record $221 billion figure of a year earlier but still equal to a historically high 4 percent of GNP. Further cuts in the federal deficit are essential, in the context of movement toward better external balance, to ensure that an adequate flow of domestic saving is available to support needed domestic investment.

Monetary Policy for 1987

As noted above, the members of the Federal Open Market Committee (FOMC) believe that a reduction in the growth of the money supply measures, over time, will be needed if the economy is to achieve noninflationary growth and external equilibrium. The precise timing and degree of that moderation in monetary expansion will depend on prevailing circumstances in the U.S. economy and in domestic and international financial markets. The Committee has established target ranges for M2 and M3 of 5½ to 8½ percent from the fourth quarter of 1986 to the fourth quarter of 1987, the same as those tentatively agreed upon in July. The ranges for M2 and M3 are ½ percentage point below those in effect

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Ranges of Growth for Monetary and Debt Aggregates

Percent change, fourth quarter to fourth quarter

Aggregate	1987	1986
M2	5½ to 8½	6 to 9
M3	5½ to 8½	6 to 9
Debt	8 to 11	8 to 11

for 1986 and are below the actual growth rates last year. Indeed, in an environment without the dramatic movements in interest rates of recent years, only small changes in the velocity of these aggregates would be anticipated. Accordingly, the Committee now expects growth of M2 and M3 this year to be in the middle parts of their ranges.

The FOMC elected not to establish a specific target range for M1 at this time because of uncertainties about its underlying relationship to the behavior of the economy and its sensitivity to a variety of economic and financial circumstances and assumptions at particular points in time. With the deregulation of deposit rates and the attendant changes in the composition of M1, the narrow money measure has become much more responsive in the short run to changes in interest rates, and possibly to other factors affecting the portfolio decisions of households. Moreover, only with the passage of time will it become possible to assess with any precision the longer-term trend in growth of M1, under current institutional arrangements, relative to nominal GNP. Given these circumstances, the appropriateness of different rates of growth of M1 cannot be assessed in isolation; rather, the movement of this aggregate necessarily will be evaluated in the light of expansion in M2 and M3, growth of the domestic economy, and emerging price pressures, which in turn are partly related to changes in the value of the dollar.

Clearly, there are circumstances in which much slower growth of M1 would be appropriate. For example, if, in the context of an expanding economy, inflationary forces appeared threatening, the dollar was exhibiting significant weakness on exchange markets, and the broader aggregates were growing rapidly, a less accommodative approach to reserve provision would be necessary. In those circumstances, monetary velocity likely would accelerate, and much slower growth of M1 would be both a natural and essential development. Conversely, it could be appropriate to accommodate, in the short run, further sizable increases in M1 in circumstances characterized by sluggish business activity and maintenance of progress toward underlying price stability and international equilibrium. As this implies, the Committee will continue to monitor M1 behavior carefully, assessing the growth of the aggregate in the context of other financial and economic developments. And, depending on circumstances, it is possible that at some time in the year the Committee might set more specific objectives for M1.

The Committee will continue to monitor the growth of debt. Growth of domestic nonfinancial sector debt in recent years consistently has exceeded both the Committee's expectations and, more important, the expansion of income by a wide margin. This is a matter of concern, for it has resulted in potential fragilities in the nation's financial structure. Although the range for the debt measure has been kept at 8 to 11 percent, the same as in 1986, that range implies a significant slowing from the almost 13 percent pace last year—but to a rate still in excess of that expected for income. With a reduced federal deficit, borrowing by the federal government will slow. Also, new constraints imposed by tax reform legislation should reduce the presence of state and local

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governments in the financial markets. Borrowing by nonfinancial business firms is expected to grow at about the same rate as last year. Tax reform should result in some reduction in the volume of equity shares retired in connection with mergers and other corporate restructurings, but such activity—and the attendant borrowing—appears likely to remain significant, in some cases undermining the financial strength of corporations as they become more highly leveraged. Moreover, firms may have a wider gap than last year between internally generated funds and investment expenditures, owing in part to higher corporate tax bills.

Growth of household debt also is expected to be about the same as last year. Growth of consumer installment credit clearly is decelerating, but growth of mortgage debt should be robust, reflecting both a good housing market and the substitution of home equity lines of credit for installment borrowing.

Economic Projections

The Committee believes that its monetary objectives are consistent with continued moderate growth in economic activity and a relatively modest upturn in inflation in 1987 that would be attributable almost entirely to higher import prices and a rebound in energy costs. As indicated in the table, the central tendency of the forecasts of Committee members and other Reserve Bank Presidents is for growth in real GNP of about 2½ to 3 percent. Such an increase in output would be expected to generate substantial gains in employment, and the jobless rate is projected to drift down a bit over the year. Prices, as measured by the implicit deflator for GNP, are expected to rise 3 to 3½ percent. It should be noted that the rise in energy and import prices likely will have a somewhat greater effect on consumer prices, so that measures such as the consumer price index may rise faster than the GNP deflator—a pattern that emerged in the second half of 1986.

The forecasts of the Committee members and the other Reserve Bank Presidents assume that the Congress will make further progress in reducing the federal budget deficit. Continuing evidence of fiscal restraint is viewed as crucial in maintaining financial conditions that are conducive to balanced growth and an improved pattern of international transactions.

In the Committee's view, orderly growth in GNP has become increasingly dependent upon a substantial improvement in real net exports. The international competitiveness of U.S. firms

Economic Projections for 1987

Percent

Measure	FOMC members and other FRB Presidents		Administration	Congressional Budget Office
	Range	Central tendency		
GNP, change from fourth quarter to fourth quarter				
Nominal	4½ to 7½	5¾ to 6½	6.9	6.5
Real	2 to 4	2½ to 3	3.2	3.0
Implicit deflator	2½ to 4	3 to 3½	3.6	3.4
Unemployment rate, average level in the fourth quarter	6½ to 6¾[1]	6½ to 6¾[1]	6.5	6.6[1]

1. Civilian unemployment rate.

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clearly has benefited from the decline in the dollar, and this should bolster export growth and help curb the expansion in imports. But there still is considerable uncertainty about some of the other factors affecting the external sector. In particular, the increase in exports is contingent on a satisfactory pace of economic activity abroad over time, on continued progress in handling international debt problems, and on enhanced access to foreign markets. On the import side, the improvement is predicated on a substantial rise in the relative price of foreign goods. That unfortunately carries with it some domestic inflationary risks, underscoring the need for prudent fiscal and monetary policies.

Slower growth of domestic demand is expected to release resources to the external sector in 1987. Consumer spending is projected to rise less rapidly than in 1986, given that the saving rate has fallen to an extremely low level and real income gains in 1987 are likely to be damped by rising energy and nonpetroleum import prices. And while the sharp rise in the value of financial assets should continue to buoy household spending, debt burdens remain troublesome for many families. Housing activity overall is expected to be well maintained, even though multifamily building will be inhibited by high vacancy rates and adverse tax changes. Nonresidential construction also will be depressed by a sizable overhang of office space; the recent firming in oil prices may well signal an end to the sharp contraction in oil drilling, but relatively little improvement seems likely at current price levels. In contrast, equipment spending by industry generally is anticipated to be supported by the continuing need to modernize and to cut costs, as well as by the improved sales prospects associated with a more positive foreign trade outlook.

The effect of the dollar depreciation on prices is likely to be felt more strongly in 1987. In addition, crude oil prices have rebounded in the past few months, reversing part of the sharp drop that occurred early last year. However, the favorable trend in wages and other costs, combined with sizable productivity gains in manufacturing, provides the opportunity for absorbing these short-run price shocks while maintaining a sense of progress toward greater underlying price stability. The Committee's projections anticipate that neither significant capacity constraints nor strong labor market pressures will develop and that domestic firms will not squander the opportunity to regain markets in a short-sighted effort to expand profit margins unduly as demand for their products increases.

The central tendency projections of real GNP and inflation are slightly lower than the forecasts of the administration. However, given the uncertainty of economic forecasting, the differences are not significant, and, in fact, the administration projections are well within the full range of expectations among Committee members and other Reserve Bank Presidents.

The Performance of the Economy During the Past Year

The economy completed a fourth consecutive year of expansion in 1986, with real gross national product increasing about 2¼ percent. The rise in overall activity last year was similar to the gains that have been recorded, on balance, since mid-1984 and was sufficient to create 2½ million new payroll jobs. The jobless rate for civilians continued to edge down and, at year-end, was 6¾ percent.

Inflation slowed sharply in 1986, with virtually all broad measures of price

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trends showing their smallest increases in many years. Although the sharpness of the deceleration owed much to specific developments in the markets for oil and other commodities, the favorable inflation performance also represented at a fundamental level the continuation of trends in wage and price behavior fostered by policies in place since the early part of the decade.

Although output continued to grow in 1986, the economy still was characterized by pronounced imbalances. These were reflected in marked disparities in economic performance across industries and regions of the country. In particular, domestic oil exploration and investment was cut back sharply, and only massive federal subsidies sustained many farm enterprises faced with sharply lower crop prices. In addition, major segments of the industrial sector continued to struggle with intense foreign competition, and relatively low rates of capacity utilization—along with a glut of office space—depressed capital spending.

The most serious imbalances continue to be in the external sector and in the federal budget—developments that are linked. Although the foreign exchange value of the dollar against the other G-10 currencies has declined roughly 40 percent over the past two years, the nation's trade balance continued to deteriorate in 1986. Growth in the volume of exports did pick up in response to the enhanced international competitiveness of U.S. firms, although the rebound was damped somewhat by the relatively slow growth of the economies of our major trading partners. However, import volumes continued to expand rapidly through most of the year, in part because much of the swing in exchange rates apparently was absorbed in the profit margins of foreign exporters and U.S. distributors, thereby limiting increases in the prices of imported goods. As a result, the current account deficit continued to widen, reaching the $150 billion range in 1986.

The federal budget deficit also increased, hitting $221 billion in fiscal 1986; the deficit vastly exceeded official targets, as underestimates of program costs and shortfalls in revenues offset the deficit-reducing actions taken by the administration and the Congress. Recent estimates suggest that the deficit for fiscal year 1987 will decline to the $175 billion neighborhood, which is a good deal less than that of a year earlier, but considerably above the Gramm–Rudman–Hollings target of $144 billion.

The Household Sector

The household sector was the major contributor to overall growth again last year. Consumer spending increased a robust 4 percent in real terms, even though income growth was only moderate, on average, for the second year in a row. Real disposable income soared in the first half because of the plunge in energy prices, but dropped after midyear, as wage and salary gains remained sluggish and farm and interest income declined. Consequently, the personal saving rate fell to around 4 percent, the lowest annual average in nearly 40 years.

Consumer spending has been bolstered by lower interest rates, which have reduced borrowing costs and boosted asset values. Rising stock prices alone have added several hundred billions of dollars to household wealth since late 1985. Household debt also increased further last year, in part reflecting the desire of consumers to liquify the gains in their asset values. The rise in debt was somewhat smaller than in the preceding few years, but still large enough to push measures of debt burdens to new highs. For a sizable number of families, especially in parts of the

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country hard hit by economic adversities, servicing these debts became more difficult, as evidenced by higher consumer loan delinquencies and charge-offs and high mortgage delinquencies.

The growth in consumption last year was paced by strong gains in purchases of durable goods, while spending on nondurables and services was up at about the same rate as in the preceding few years. Within the durables category, sales of new cars rose to around 11½ million units. Effective prices of new cars were held down by a series of below-market finance incentive programs for domestic makes and by the introduction of low-priced imports from Korea and Yugoslavia. At the same time, sales of Japanese and European models remained brisk, despite appreciable increases in their sticker prices. Outlays for other durables also rose substantially last year, as purchases of home electronics products advanced sharply and sales of furniture and appliances were supported in part by the robust pace of home sales in recent years.

Housing activity continued to expand in 1986. Total housing starts edged up to 1.8 million units for the year as a whole, their highest level since the late 1970s. Single-family homebuilding increased about 10 percent, bolstered not only by a sizable decline in mortgage rates—which brought fixed-rate loan rates back to single-digits for the first time since 1978—but also by continuing favorable demographic trends. In contrast, multifamily activity dropped off considerably over the course of the year. In part, the slowdown reflected the restraining influence of record-high vacancy rates on rental units, especially in key markets in the South. Also, several provisions of the recent tax legislation have reduced the profitability of building rental housing.

The Business Sector

Business spending on plant and equipment declined 5½ percent in real terms in 1986. Much of the drop in investment was attributable to the sharp cutback in oil and gas well drilling, which fell almost 50 percent over the year. But investment outside the energy sector also was generally lackluster, as many firms —especially in the tradable goods sector —trimmed expansion plans in light of relatively low rates of utilization of existing capacity and continuing uncertainties about future sales trends. Investment in computers and other office machines remained on the reduced growth path that has been evident since the fading of the high-tech spending boom in 1985, reflecting in part concerns about the productivity-enhancing potential of some of these products. More broadly, transitory tax considerations also helped to depress equipment spending in 1986. In late 1985, the widely anticipated elimination of the investment tax credit prompted many firms to accelerate spending from early 1986; although there also was some tax-related speedup of spending in late 1986, it appears to have been comparatively small. Outlays for nonresidential structures outside the energy area, which rose extraordinarily rapidly over the first few years of the expansion, fell in 1986. The decline in office construction, for which vacancy rates have reached extraordinarily high levels, was especially sharp.

Inventory investment generally remained subdued in 1986. In an environment of sluggish orders and stable or falling prices, manufacturers continued to trim their stocks. In the retail and wholesale trade sector, inventories of goods other than automobiles increased moderately for the second year in a row; however, at year-end such stocks ap-

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peared to be roughly in line with near-term sales prospects. At auto dealers, there were sharp fluctuations in stocks, but little net change over the course of the year; drops in inventories coincided mainly with the timing of special incentive programs that pushed sales to record levels as well as with a burst in sales in December in anticipation of tax changes in 1987.

Aftertax economic profits in the nonfinancial corporate sector, although at fairly high levels relative to GNP, were essentially unchanged overall from 1985 levels. There was considerable diversity in the performance of individual industries. The petroleum industry experienced a sharp drop in profits associated with the fall in oil prices. On the other hand, petroleum-using industries such as chemicals and plastics fared relatively well.

Given these movements in business investment and corporate earnings, internal funds in the aggregate were nearly sufficient to meet the basic financing needs of nonfinancial corporations. However, some firms continued to borrow heavily to fund massive retirements of equity in association with mergers, buyouts, and share repurchases. At the same time, the drop in long-term interest rates to the lowest levels in a decade afforded businesses the opportunity to improve their financial positions by selling bonds and retiring older, high-coupon securities or short-term debt.

The External Sector

Widening U.S. trade and current account deficits have aroused deep concern because of their implications both for the orderly expansion of the domestic economy and for international financial stability. The foreign exchange value of the dollar, which had declined about 20 percent against a weighted-average of the currencies of other Group of Ten (G-10) countries from February 1985 to December 1985, has fallen an additional 20 percent since that time. Because the U.S. inflation rate over the past two years was approximately the same as the average inflation rate in other G-10 countries, the decline in the real value of the dollar (that is, adjusted for relative inflation rates) was similar to the nominal decline. As measured by broader exchange-rate indexes, which include the currencies of major developing countries as well, the real decline in the value of the dollar was somewhat smaller, in part because some of those countries allowed their currencies to depreciate as part of an effort to improve their external positions. On such broader measures, the appreciation of the dollar in real terms through early 1985 also was smaller.

The decline in the dollar over the past year was associated with a fall in interest rates on dollar-denominated assets relative to rates on assets denominated in other currencies. Moreover, some correction of the dollar's external value was seen to be an essential element in the process of reducing over time the huge U.S. current account deficit—which widened to the $150 billion range in 1986—and restoring better balance in the United States and world economies. The apparently muted response of the current account to the dollar's depreciation through most of 1986 contributed to sharp downward pressure on the dollar in early 1987.

The volume of merchandise imports rose sharply in 1986, with increases widespread across products and countries of origin. Petroleum imports surged as prices plunged and domestic production contracted, and nonpetroleum imports continued to grow at about the rapid 1985 pace. In part, the sustained

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strength of nonpetroleum imports reflected the relatively moderate increase to date in prices of these goods. As measured by the index compiled by the Bureau of Labor Statistics, prices of nonpetroleum imports were up 8½ percent over the year, with sizable increases for products such as automobiles, other consumer goods, and some types of capital equipment. Nonetheless, the rise in the overall index was somewhat smaller than historical patterns would suggest, given the typical lags between movements in exchange rates and import prices. The weak response of import prices was attributable in part to the ability of exporters to the United States, whose profit margins had widened substantially during the period of dollar appreciation in the early 1980s, to absorb initially a large proportion of the dollar's depreciation. In some cases where prices of imported goods have risen, U.S. distributors have absorbed some of that increase. Also, since early 1985, the dollar has appreciated in real terms relative to the currencies of Canada and some developing countries, which account for almost half of U.S. nonpetroleum imports.

Meanwhile, the volume of merchandise exports picked up last year. This improvement mainly reflected the enhanced international competitiveness of U.S. goods in foreign markets that stemmed from the decline in the dollar, as the pace of foreign economic activity generally remained sluggish. Growth last year for the major industrialized countries as a group was slower than in 1985, in part because of a pronounced deceleration in Japan, while activity in many developing countries was damped by subdued growth in the industrialized world and the continuing pressures associated with the need to meet external debt-servicing obligations. Weakness in world commodity prices also has aggravated the financial difficulties of many developing nations, including oil-exporting countries.

The Government Sector

Even though the administration and the Congress have taken significant actions in the past few years to reduce the federal budget deficit, it has remained huge. In fiscal year 1986, the fiscal imbalance hit a record $221 billion, exceeding the previous year's figure by more than $8 billion. Revenue growth last year was restrained by the relatively moderate rise in nominal income, while demands on a number of programs, especially in the agriculture and health areas, were strong. Although the budgetary program put in place for FY 1987 was nominally consistent with the Gramm–Rudman–Hollings deficit target of $144 billion, the administration and the Congressional Budget Office recently have published estimates in the $175 billion range, equal to about 4 percent of GNP —still a high ratio historically.

Excluding changes in farm inventories held by the Commodity Credit Corporation (CCC), federal purchases of goods and services rose appreciably last year. Over the course of 1986, defense purchases in real terms grew about 7 percent, similar to the increases that have been recorded since the early 1980s. Excluding CCC purchases, real nondefense outlays, which have shown little net change in recent years, were essentially flat.

Purchases of goods and services by state and local governments rose briskly last year, mainly reflecting a surge in construction activity. An upswing in the school-age population in recent years has led to a step-up in school building, and numerous programs are under way to expand and improve basic infrastructure. The growth in overall outlays has been sustained despite concerns about

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the financial condition of the sector. Excluding some special one-time inflows —such as previously escrowed oil lease payments—the combined surplus of operating and capital accounts for the sector as a whole fell to near zero in 1986. Many states, including most of those in the energy and agricultural regions, have responded to budgetary pressures by raising taxes and cutting spending.

Labor Markets

Nonfarm payroll employment increased 2½ million in 1986, about the same as the robust 1985 pace, and continued strong in January of this year. Hiring in trade and services again was quite vigorous, with especially large increases for business and health services. In contrast, manufacturing employment contracted over the first three quarters of 1986. However, factory hiring picked up in the autumn in response to an apparent firming in industrial activity. Employment gains in nondurable industries, in which output has risen steadily, have been widespread in recent months; meanwhile, hiring at firms producing durable goods has remained spotty.

The growth in jobs last year slightly exceeded the rise in the labor force. As a result, the civilian unemployment rate edged down, to 6¾ percent at year-end. Labor force participation maintained its upward trend; women continued to enter the workforce in large numbers, in part responding to expanding job opportunities, and participation rates for adult men held steady. Overall, the number of persons employed relative to the working-age civilian population reached 61 percent—a new high.

Wages continued on a path of moderation in 1986. Hourly compensation in the nonfarm private sector, as measured by the employment cost index, rose about 3¼ percent, ¾ percentage point less than in 1985. The deceleration in wages reflected the continued slack in labor markets as well as the reduction in price inflation, and was widespread across industries and occupations. In the unionized sector, wage increases have been especially small, and a number of alternative, more flexible compensation arrangements—including the substitution of lump-sum payments for general wage increases—have been adopted. Compensation for white-collar workers, although continuing to rise more rapidly than for other groups, also moderated in 1986.

Unit labor costs in the nonfarm business sector were well contained last year, given the relatively moderate increase in wages and a small advance in labor productivity. Gains in output per hour, however, have averaged less than 1 percent per year since 1984, suggesting that the underlying trend in productivity for the business sector as a whole has improved only slightly from the very low pace of the 1970s and remains well below the pace of earlier in the postwar period. In contrast, productivity in manufacturing over the past three years has increased about 3½ percent per year, in part because intense foreign competition has induced many producers to modernize their factories and streamline their operations.

Price Developments

The fixed-weighted price index for GNP rose about 2½ percent in 1986, down from an increase of 3½ percent in 1985. The increase was the smallest in more than two decades. Some other popular measures of prices decelerated even more markedly. The consumer price index for goods and services rose only about 1 percent, and the producer price index for finished goods actually fell 2½ percent.

The greater deceleration in the CPI

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and PPI than in the GNP price measure is a reflection of the greater importance of energy prices in those indexes. The movements in energy prices over the past year or so have been striking. World crude oil prices dropped from $26 per barrel in late 1985 to the $11 per barrel range around midyear; these prices trended up over the second half and recently have risen to around $18 per barrel in the wake of the agreement on production limits reached at the meeting of the Organization of Petroleum Exporting Countries in late December. The drop in crude oil prices in the first half was reflected fairly rapidly in prices of gasoline and home heating oil, which fell around 30 percent over the course of the year. There also were declines in charges for electricity and natural gas, but they were much smaller than those on refined petroleum products. On balance, retail energy prices declined 20 percent last year. The effects of the recent firming in oil prices are already evident in general indexes: the PPI jumped 0.6 percent in January, owing largely to the rebound in gasoline and heating oil prices.

Price increases outside the energy area generally remained moderate in the past year. Retail food prices rose 4 percent, a bit more than in 1985, reflecting the effects of last summer's heat wave in the Southeast. However, prices of retail goods excluding food and energy continued to slow and, on balance, were up only 1½ percent. The influence of the depreciating dollar on consumer goods prices was highly variable across sectors and relatively small overall. There were sizable increases in dockside prices for foreign cars and for some types of home electronic and photographic equipment, and retail prices of such goods have accelerated. But there was little evidence of any significant aggregate impact on other consumer goods. Prices for nonenergy services also slowed somewhat last year but still rose around 5 percent, boosted by continued large increases for medical services and higher premiums for various types of insurance.

Prices for many basic industrial commodities continued to decline over the first three quarters of 1986. Excess capacity in some basic industries and the generally abundant world supplies of many primary commodities contributed importantly to the weakness in these prices. Sluggish industrial activity in the United States and other large economies also was a factor. Prices in a number of these markets have turned up in recent months, possibly in response to the firming in U.S. industrial activity. Nonetheless, industrial commodity prices still are well below the most recent peaks reached in mid-1984.

Monetary Policy and Financial Markets in 1986

The Federal Reserve faced continuing challenges in 1986, not only in discerning the underlying trends in a complex domestic and international economic setting, but also in specifying appropriate policy actions in a financial environment marked by a rapid pace of structural change. As in previous years, and in keeping with the Full Employment and Balanced Growth Act, money and credit aggregates were used as a means of assessing and characterizing policy. At the same time, however, in targeting and interpreting these aggregates, and in reaching operational decisions with respect to the degree of reserve pressures and the discount rate, the evaluation of signals provided by a broad range of economic and financial indicators played a large role.

At its meeting in February 1986, the Federal Open Market Committee estab-

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lished target growth ranges, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 3 to 8 percent for M1 and 6 to 9 percent for both M2 and M3. The associated monitoring range for growth of domestic nonfinancial debt was set at 8 to 11 percent. Based on the experience of recent years, the Committee recognized that the relationship between M1 and economic activity was subject to particularly great uncertainty. Accordingly, the FOMC agreed to evaluate movements in M1 in light of their consistency with the patterns in other monetary aggregates, developments in the economy and financial markets, and potential inflationary pressures.

M1 was well above its annual target range at the time of the July FOMC meeting. The available evidence suggested that the rapid growth of M1 reflected shifts in portfolios toward liquid assets in the context of declining market interest rates rather than excessive money growth with potential inflationary consequence. Against this background, the Committee concluded that M1 growth above the existing range would be acceptable, provided the broader aggregates expanded within their target ranges, price pressures remained subdued, and the economy continued to expand at a moderate pace. The Committee reaffirmed the target ranges for M2 and M3 at its July meeting. Data at that time showed that both of these aggregates had expanded near the midpoints of their ranges, and Committee members felt that growth within those ranges for the year was still consistent with the overall policy objectives of reducing inflation further, promoting sustainable growth in output, and contributing to an improved pattern of international transactions. In the first half of the year, the growth of domestic nonfinancial debt exceeded both its monitoring range and the growth of nominal GNP, as it had in previous years. The Committee was concerned about the burdens and potential instabilities associated with the persistence of rapid debt growth and felt that raising the monitoring range for debt would create an inappropriate benchmark for evaluating long-term trends. As such, the existing range was maintained, but the FOMC thought that debt growth could well exceed its upper bound.

The growth of M2 quickened in the second half of the year, and M3 expanded at a somewhat faster pace as well. However, both of the broader aggregates ended the year within—although near the upper bounds of—their target ranges. The growth of M1 accelerated further in the second half of the year, resulting in a record postwar decline in velocity for 1986. The growth of nonfinancial debt slowed slightly in the second half of the year, but still exceeded its monitoring range by nearly 2 percentage points.

Pressure on reserve positions of depository institutions, as reflected in a relatively low volume of borrowing at Federal Reserve Banks, changed little over the course of 1986. The broadly accommodative thrust of policy also was manifest in the four reductions in the discount rate between March and August. In part, the discount rate cuts were intended to keep this rate in line with the yields on short-term market instruments, but they also were taken in the context of hesitant worldwide economic growth, an improved inflation outlook, and growth of the broader monetary aggregates within their annual target ranges.

In setting monetary policy the FOMC focused considerable attention on the nation's trade deficit and on the foreign exchange value of the dollar. The Committee members generally viewed the narrowing in the trade deficit as a key to

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achieving a sustainable and more even expansion of activity across the economy. At the same time, however, the Committee was concerned that an unduly precipitous decline of the dollar against the currencies of our major trading partners could contribute to inflationary pressures in the United States. To help limit the effect on the value of the dollar, the first reduction in the discount rate was a coordinated action with other major central banks; similarly, the reduction in April was accompanied by a cut in the Bank of Japan's discount rate.

Money, Credit, and Monetary Policy
M2 expanded almost 9 percent in 1986, placing this aggregate near the upper bound of its annual growth target. Although in recent years this aggregate has exhibited a tighter relationship with nominal GNP than M1, M2 velocity still registered a decline of 4 percent last year and reached its lowest level in decades. The buildup of M2 balances relative to income probably reflected incentives to place savings in various components of the aggregate whose offering rates were falling more slowly than market interest rates.

The slowest adjustments in rates on retail deposits last year were made in short-term accounts. Depository institutions have been reluctant to adjust savings deposit rates downward because many of these accounts have represented a stable, profitable source of funds for many years. Rates on NOW accounts also have fallen only slightly. Much larger declines were registered on time deposits, reflecting not only quicker adjustment to market rates but also the pattern of rate movements in the credit markets, where long-term rates fell much more than short-term rates in late 1985 and early 1986. The changing structure of deposit rates at banks and thrift institutions has led to a pronounced shift in the composition of M2: inflows to transaction deposits, savings deposits, money market deposit accounts, and money market mutual fund shares were very strong last year, while small time deposits ran off, marking the second consecutive year of zero or negative growth.

The weakness in small time deposits in 1985 and 1986 also could reflect "rate shock." As existing time deposits matured, savers with high-yielding deposits acquired several years ago were unable to reinvest the funds at comparable returns. A sizable portion of maturing deposits evidently was placed in liquid instruments in M2 while savers searched for other investment opportunities. Yield-conscious investors also may have been lured from time deposits by attractive returns on some nondeposit instruments. For example, stock and bond mutual funds grew rapidly in 1985 and 1986 after stagnating during most of the 1970s and early 1980s, and the issuance of savings bonds was strong in the summer and fall before their minimum yield was lowered from 7½ to 6 percent.

M3 also ended 1986 near the upper bound of its annual range, increasing 8¾ percent over the year. Growth of M3 close to that of M2 is not surprising, given that M2 constitutes four-fifths of the larger aggregate. The remaining share is dominated by large time deposits and certain other managed liabilities of depository institutions. Credit growth at banks and thrift institutions remained quite strong last year, but with the exception of the first quarter, the use of managed liabilities in M3 was light as growth of core deposits largely was sufficient to fund asset expansion. Large CDs expanded only 3 percent on balance in 1986, with commercial banks paying down their outstanding CDs during much of the year and thrift institutions also doing so in the fourth quarter. The

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weakness in CDs was widespread as institutions relied more on other managed liabilities, such as term repurchase agreements (RPs), included in M3, and advances from Federal Home Loan Banks, not included in M3.

The broad shift to liquid assets greatly affected the behavior of M1. The narrow monetary aggregate expanded more than 15 percent in 1986, marking the second consecutive year of double-digit growth. The velocity of M1 fell 9½ percent last year, compared with a decline of 5¼ percent in 1985. Since 1981 the velocity of M1 has declined 16 percent—a remarkable development in view of its tendency to climb about 3 percent per year in the previous two decades.

Much of the rapid growth in narrow money over the past two years appeared to be related to the effects of the sharp decline in market interest rates on incentives to hold both NOW accounts and demand deposits. Since their peak in the latter part of 1984, short-term market interest rates have fallen about 5 percentage points, to their lowest levels in nine years, while NOW account rates have changed considerably less. Although more rapid money growth generally would be expected in an environment of declining rates, the expansion of M1 last year and in 1985 was in excess of what would be indicated by the historical relationships among money, interest rates, and income.

About half of the growth of M1 in both 1985 and 1986 occurred in interest-bearing checkable deposits. Because depository institutions have adjusted the rates paid on NOW accounts only sluggishly, the spreads between the rates on these deposits and those on substitutes have narrowed substantially. For example, between the first quarter of 1986, when interest rates on NOW accounts were fully deregulated, and the fourth quarter of last year, the spread between the three-month Treasury bill rate and the average rate on NOW accounts at commercial banks shrank from 135 basis points to 53 basis points. Similarly, the average rate on NOW accounts late last year was not far below that on six-month small time deposits.

The growth of demand deposits also accelerated last year, amounting to nearly 12 percent from the fourth quarter of 1985 to the fourth quarter of 1986. As with other checkable deposits, lower short-term interest rates are an important influence on the growth of demand deposits because they reduce incentives to economize on transaction balances. Also, some demand deposits are held by business firms in exchange for services provided by banks, and these compensating balance requirements typically are enlarged as market rates decline.

Growth of Money and Debt[1]

Percentage change at annual rate

Period	M1	M2	M3	Domestic non-financial sector debt
Fourth quarter to fourth quarter				
1979	7.9	8.2	10.4	12.2
1980	7.3	8.9	9.6	9.6
1981	5.1 (2.4)[2]	9.2	12.3	9.9
1982	8.6	9.1	9.9	8.9
1983	10.2	12.1	9.8	11.5
1984	5.4	7.9	10.7	13.9
1985	12.1 (12.7)[3]	8.8	7.7	13.5
1986	15.2	8.9	8.8	12.9
Quarterly growth				
1986: 1	8.8	5.3	7.7	15.4
2	15.5	9.4	8.7	10.3
3	16.5	10.6	9.7	12.0
4	17.0	9.0	7.8	11.5

1. M1, M2, and M3 incorporate effects of benchmark and seasonal adjustment revisions made in February 1987.

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

3. M1 figure in parentheses is the annualized growth rate from the second to the fourth quarter of 1985.

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While these effects were important elements behind the expansion of demand deposits throughout 1986, the apparent response to declining interest rates was much larger than would be expected from historical experience.

Another element in the growth of demand deposits apparently was the large volume of financial transactions that occurred in 1986. For example, because of certain payment procedures—such as funds held in escrow accounts and transferred by officer's check rather than by wire—the massive volume of mortgage originations and prepayments last year could have influenced the movement of demand deposits. In addition, a flurry of financial transactions around year-end, induced in part by impending tax law changes, temporarily boosted demand deposits sharply.

Domestic nonfinancial debt expanded almost 13 percent last year, a slightly slower pace than in the two previous years but still above both the Committee's monitoring range and the growth of nominal GNP.[1] Debt issuance by the state and local sector dropped off substantially from the pace set in 1985, when it was boosted by borrowing in anticipation of tax reform restrictions. In the household sector, mortgage borrowing strengthened, but a marked decrease in the expansion of consumer installment credit from the elevated rates in previous years contributed to a moderation in overall growth of household indebtedness. A continuation of corporate financial restructurings buoyed expansion of business debt, despite the maintenance of a moderate gap between capital spending and internal funds. Growth of federal sector debt remained strong.

In implementing policy in 1986, the FOMC generally accommodated through open market operations the strong demand for reserves associated with the rapid growth of transaction balances. In the context of prospects for slow growth of real economic activity, disinflationary trends in wages and prices, and growth of the broader monetary aggregates within their target ranges, four reductions in the discount rate were implemented between March and August.

Early in the year, all the monetary aggregates slowed sharply, with M2 dropping below its annual target range. Also, evidence suggested that the economy was growing sluggishly, and the outlook for inflation improved as oil prices fell. In this environment, market interest rates began to decline in mid-February, and the Federal Reserve reduced the discount rate ½ percentage point to 7 percent in early March. At the time, there was concern that unilateral action to lower interest rates might cause an excessive reaction in the foreign exchange market, where the dollar had been under downward pressure. Accordingly, the reduction was timed to correspond with similar actions by the central banks of West Germany, Japan, and several other industrialized nations.

With the economy expanding slowly and underlying price pressures continuing to moderate, interest rates fell further throughout March and into April. By mid-April, most market interest rates had reached their lowest levels since the late 1970s. At that time, the Federal Reserve instituted another reduction in the discount rate to catch up with and to ratify the declines in market rates.

After mid-April, interest rates rose for a short time as market participants fo-

1. When measured from the end of December to the end of December, domestic nonfinancial debt expanded 11½ percent last year. The fourth-quarter-to-fourth-quarter growth cited in the text is higher because of the surge in debt at the end of 1985 and the arithmetical effects of quarterly averaging.

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cused on an upturn in oil prices, an acceleration in the growth of the monetary aggregates, and a further decline in the foreign exchange value of the dollar. By the end of June, however, a steady flow of weak statistics began to reveal anemic growth in real economic activity in the second quarter. An improvement in activity had been expected by the FOMC for the second half of the year, but the rebound now appeared likely to be less vigorous than previously anticipated and perhaps delayed because of continued disappointing movements in our trade position and the effects of pending tax reform legislation on business investment. Accordingly, shortly after the July FOMC meeting, the Board approved another cut of ½ point in the discount rate to 6 percent.

The final reduction in the discount rate last year took place after the August FOMC meeting. The last two reductions in the discount rate in 1986 were adopted without similar action by foreign central banks. Unilateral action to lower interest rates carried the risk of adding to the downward pressure on the dollar and possibly feeding a source of inflationary pressure. However, the Federal Reserve thought that prevailing economic and financial conditions warranted such a risk, realizing that the provision of reserves could be tightened through open market operations if adverse developments were to arise.

While the value of the dollar fluctuated considerably after the reduction in the discount rate in August, it showed no distinct downward movement until around year-end. Short-term interest rates declined about 1 percentage point over the summer months, moving either in anticipation of, or in response to, the reductions in the discount rate. Long-term rates were about unchanged on balance over the summer, but more concern about interest rate prospects developed in early fall. Economic indicators began signaling a pickup in the pace of economic activity, and rising prices of oil and precious metals, along with the potential effects of the cumulative decline in the value of the dollar, seemed to raise concerns about the outlook for inflation. Over that period and through the remainder of the year, the FOMC attempted to keep a steady degree of reserve pressure, and market interest rates fluctuated within a fairly narrow range.

Even so, short-term interest rates moved higher as the year-end approached, owing, in part, to the exceptional volume of tax-related transactions. As firms rushed to complete mergers and buyouts, and households stepped up their sales of assets to realize capital gains, the demand for transaction balances and business loans surged. This heavy volume of financing also was reflected in unusually strong reserve demands by depository institutions. The System added reserves freely to accommodate this demand, but the pressure nevertheless showed through to short-term rates. Shortly after the turn of the year, short-term rates moved back toward their earlier levels. The dollar, however, was under substantial downward pressure in early 1987; disappointing figures on the U.S. trade deficit prompted selling of the dollar on exchange markets, and this pressure intensified with reported suggestions by some U.S. policymakers that, particularly in the absence of more growth-oriented policies abroad, further dollar depreciation might be necessary to correct the nation's external imbalance.

Other Developments in Financial Markets

As long-term interest rates declined last spring to their lowest levels in eight years, the volume of corporate bond issuance surged to record levels. Indeed,

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the volume of domestic corporate bonds sold last year was nearly twice the previous record set in 1985. Much of the bond issuance last year was used to refund higher-cost debt or to pay down short-term credit. With the stock market continuing to register impressive gains last year, new equity issuance also reached record levels. Of the gross proceeds from new equity issues sold last year, about 30 percent was raised by firms issuing stock in the public market for the first time.

The retirement of high-coupon bonds, the reduced dependence on short-term credit, and the issuance of new equity shares tended to improve conventional measures of corporate balance sheet strength. However, massive volumes of outstanding equity were retired through mergers, acquisitions, buyouts, and other restructurings, resulting in the third consecutive year of large net equity retirements. Reflecting the financing patterns in recent years, the aggregate debt–equity ratio of nonfinancial corporations, on a "book" basis, swelled to a record level. When stated at market values, however, the robust gains in share prices have kept debt–equity ratios well below levels that generally prevailed during the 1970s. With interest rates trending down in recent years, interest-coverage ratios have crept up, suggesting that the ability of firms in the aggregate to service their debt has not deteriorated. These modest gains, however, have been achieved in relatively benign market and economic circumstances.

Because of the large paydown of equity, the ability of some corporations to weather economic shocks has waned. The weak financial structures of some firms, along with strains in certain industries, led to more than $3 billion of corporate bond defaults in 1986, an amount that dwarfs the experience in nearly every other year of the postwar period. Concern that other firms also may have problems in meeting their financial obligations is reflected in the pace of bond downgradings, which last year totaled more than three or four times that of the late 1970s.

Firms with downgraded debt typically find their securities trading at higher interest rates in the secondary market. In general, however, quality spreads between private debt securities of different grades have been relatively stable in recent years, suggesting that investors have not been alarmed at the credit quality of corporations in the aggregate and have not attempted to limit their portfolios to higher-rated issues.[2] During the first half of 1986, spreads between the yields on corporate bonds and Treasury securities widened considerably, but this appeared to be related to the heavy volume of corporate issues and a revaluation of call and refunding provisions on long-term obligations. A narrowing of these spreads early in 1987 has reversed much of the earlier increase.

The expansion of household debt slowed last year as the growth of consumer installment credit receded to about 12 percent from the 15 to 20 percent pace of recent years. Nevertheless, installment debt continued to grow faster than income, and the ratio of such debt to income established another record. With mortgage debt expanding rapidly, the ratio of overall household debt to

2. The interest rate spreads between investment-grade and speculative issues widened about 50 basis points for a short time after the bankruptcy filing by LTV Corporation in July. Low-rated or unrated bonds also experienced substantial yield increases for a time later in the year, when concerns about the liquidity of that market segment surfaced in connection with the insider trading scandal; that widening has been reversed since the beginning of 1987.

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income also reached a new high. While assets of the household sector have increased sharply in recent years, many individuals have experienced difficulty in meeting their financial commitments. The number of personal bankruptcies accelerated dramatically in 1985 and 1986, with bankruptcies last year surging well beyond the historical experience. Strains were particularly evident in the area of credit card debt, as delinquency rates on revolving balances increased appreciably. Delinquency rates on other categories of installment debt and mortgage loans fell some last year, although they were at much higher levels than in previous expansions. For some households, debt-servicing burdens were reduced last year by the refinancing of high-rate mortgages or the decline in interest payments on their adjustable-rate mortgages.

While the economy has grown continuously for more than four years, the expansion has been uneven and has left certain sectors under severe strains. The problems faced by firms in the mining, energy, agricultural, and many manufacturing industries are well known, as are those of a number of heavily indebted developing countries. The difficulties in these areas are feeding through to the financial intermediaries supplying them credit. Last year, for example, 136 commercial banks failed—compared with a total of only seven in 1981. Many of these institutions had heavy credit exposures to the oil industry, while more than 40 percent of the failed banks held large amounts of agricultural loans.

The impact of the distress in the farm sector also has been severe for the Farm Credit System, the government-sponsored agency that holds about 25 percent of outstanding farm debt in the United States. The losses of the banks in the System probably exceeded $2 billion last year, largely reflecting provisions for loan losses, and the System's capital surplus soon will be exhausted if losses do not abate. The Congress last fall approved regulatory accounting procedures for the Farm Credit System that will allow the banks to report higher net income figures than generally accepted accounting principles would permit. The higher reported income may ease some of the problems within the System relating to the preservation of capital and help to justify charging borrowers more competitive rates. By themselves, however, the accounting procedures do not provide substantive relief.

The financial condition of the thrift industry as a whole has improved markedly since the early part of the decade, but the difficulties of many institutions have intensified. As interest rates fell from their elevated levels in 1981 and 1982, the average cost of funds at thrift institutions declined much more rapidly than the average yield on their assets. The industry as a whole returned to profitability in 1983, and aggregate earnings have jumped since then. Net income for the industry in 1986 probably was strong again, although it is likely to have been below that of 1985.

At the same time, asset quality problems have become increasingly important for a sizable number of these institutions. While some of these problems are associated with economically distressed regions of the country, overly aggressive investment strategies of some institutions certainly have contributed heavily. For 1986, about one-quarter of the thrift industry will report negative net income, and the long-term prospects for many of these institutions are unfavorable. Moreover, the Federal Savings and Loan Insurance Corporation has inadequate resources to manage these problems effectively.

While the many stresses and financial vulnerabilities are not amenable to cor-

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rection through general monetary policy, they do influence the economic environment and represent a potentially disruptive and destabilizing element in financial markets. The Federal Reserve has been called upon to play a positive role through its regulatory and supervisory functions. For example, steps have been taken to reduce the risks associated with large payments made by wire transfer, and several proposals have been made to ensure the capital adequacy of commercial banks. Many of the financial and sectoral stresses will take considerable time to alleviate, and will require a stable monetary environment, redress of the imbalances in the nation's federal budget and international trade positions, and—importantly—prudent private behavior, encouraged as necessary by sound regulation.

Report on July 21, 1987

Monetary Policy and the Economic Outlook for 1987 and 1988

The economy expanded at a somewhat accelerated pace in the first half of 1987, and the civilian unemployment rate declined over the period to 6.1 percent in June, the lowest level in this decade. Moreover, the pattern of activity has exhibited encouraging signs that a turnaround in the trade sector is under way. An improvement in net exports in real terms appears to be providing a lift to activity in the industrial sector, offsetting slower growth of domestic spending and sustaining a moderate rise in overall domestic production. However, the process of restoring balance to the U.S. external accounts has involved a sizable increase in the prices paid for imported goods. These price increases have occurred at the same time that a rebound in world oil prices was carrying inflation rates above last year's modest pace.

Although some of the elements necessary for sustaining economic growth are now beginning to fall into place, the economic outlook continues to be clouded by a number of imbalances, risks, and uncertainties. The experience of the first half underscored, in particular, the dangers associated with a loss of market confidence in the dollar and the related potential for a rekindling of inflation expectations. The Federal Reserve, in implementing monetary policy, was sensitive to these dangers, while it continued to provide support for sustainable economic growth. During the first part of the year, growth in money and credit slowed from the rapid pace of 1986, even though pressures on the reserve positions of depository institutions remained mild. Those pressures were increased somewhat in late April and May, however, as the dollar fell sharply against other key currencies, inflation expectations flared up, and long-term interest rates jumped to higher levels. In response to these steps, and to complementary policy actions taken abroad, the dollar has stabilized, and interest rates have retreated somewhat from their May highs.

If the nation is to achieve an orderly transition to better external balance, one marked by a minimum of financial or inflationary pressures, responsible action by many parties—in addition to the Federal Reserve—will be necessary. Further progress in reducing our federal budget deficit is essential: a failure to achieve this often-stated objective could only damage confidence in our ability to deal with our economic problems and contribute to imbalances in financial markets and the economy. In addition, satisfactory growth in the other major industrialized countries is crucial, as are efforts on all sides to maintain and improve the openness of the international marketplace. The private sector also

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must play a constructive role by remaining sensitive to wage and price practices that promote the international competitiveness of American business.

Economic and Financial Background

The economic expansion has now progressed well into its fifth year. Real GNP rose at a 4¾ percent annual rate in the first quarter. However, much of the increase in production reflected a rebuilding of business inventories that had been drawn down late in 1986, and real GNP appears to have increased at an appreciably more moderate pace in the second quarter. Nonetheless, growth remained strong enough to sustain a downtrend in unemployment.

Beneath these solid gains in aggregate economic activity have been welcome improvements in the fortunes of sectors that have failed to participate in the increasing prosperity of the past several years. As suggested above, the most significant development has been the emerging improvement in the nation's trade performance, which has begun to close the gap between the pace of growth in the industrial sector and the rest of the economy; indeed, some segments of manufacturing have reached relatively high levels of capacity utilization and strong profitability. Economic strains also appear to be easing in other troubled sectors. Oil-well drilling, while still at depressed levels, has turned up as a consequence of the firming of world oil prices. Agricultural income was quite high last year, although it continued to be heavily dependent on government support; farmland values seem to have stabilized, and the amount of delinquent farm loans has begun to decline.

While the external sector has been strengthening, in real terms, in recent quarters, growth in domestic demand has moderated considerably. To some extent, the slower rise in household and business purchases in the early months of this year was a reflection of the acceleration that had occurred at the end of 1986, motivated by tax considerations. However, consumers, in particular, have shown signs of less exuberance in their expenditure patterns after a period of several years in which their willingness to spend increasing proportions of their income provided considerable thrust to business activity. A moderation of domestic spending growth is, of course, a fundamental ingredient in achieving better external balance without putting excessive strains on available resources.

A key element in the recent trade developments has been the steep drop in the foreign exchange value of the dollar —almost 40 percent on a trade-weighted basis against other G-10 currencies—since early 1985. That decline, in conjunction with notable restraint on labor costs, has greatly enhanced the competitiveness of U.S. producers in international markets. At the same time, though, the depreciation has caused prices of imported goods to increase—sharply in some cases—and exacerbated a bulge in prices coming from higher energy costs. The rise in consumer prices, averaging more than 5 percent at an annual rate over the first five months of this year, was a disturbing departure from recent experience. Moreover, as the dollar exhibited continued weakness in the early spring, and with progress toward improvement in the U.S. current account slower than many had anticipated, concerns mounted about inflation prospects. This was reflected for a time in rising prices of precious metals and other actively traded commodities, an event that only served to reinforce the inflation fears that simultaneously were unsettling U.S. securities markets.

In these circumstances, and with the economic advance evidencing reason-

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able momentum, the Federal Reserve in late April and May adjusted its open market operations to impose a somewhat greater, but still quite limited, degree of pressure on the reserve positions of depository institutions. This step was reassuring to the markets. Coupled with complementary actions by monetary authorities abroad and more favorable news on prices and U.S. merchandise trade flows, the firming of money market conditions contributed not only to a turnaround in the dollar on exchange markets but also to a rally in bond prices. On balance, however, short-term interest rates currently are about one-half percentage point above their levels at the time of the Board's February monetary policy report to the Congress, and long-term rates are up about a full percentage point.

The rate of growth of the money stock measures M2 and M3 has been well below that of last year and close to, or below, the lower end of the target ranges adopted in February. This has been viewed as acceptable by the Federal Open Market Committee (FOMC), given the inflation and exchange rate developments described above, as well as indications of greater than anticipated strength in the velocity of money (that is, the ratio of nominal GNP to money). M2 rose at an annual rate of only 4 percent between the fourth quarter and June, appreciably below the 5½ to 8½ percent growth range for the year, while M3 grew at a 5¼ percent rate, a shade below the lower bound of its identical range.

The marked deceleration of monetary growth, and accompanying rise in M2 and M3 velocity after two years of decline, reflected a variety of influences. Some unwinding of the buildup in balances that occurred late last year in connection with a huge volume of tax-related transactions may have been involved; tax reform also may have damped growth in money as individuals reduced their additions to deposit holdings rather than using consumer credit, on which interest is no longer fully tax-deductible. Capital constraints on the growth of bank and thrift institution assets may have limited the depositories' efforts to seek funds, an effect likely to express itself most fully at the level of M3, which encompasses a broad range of depository-institution liabilities.

But it is another factor that appeared most important, particularly in the case of M2. Changes in deposit rates have lagged changes in market rates—a behavior exhibited quite consistently in the period since most restrictions on deposit rates were removed. With market rates rising, financial assets other than those included in M2 became relatively more attractive to the public, the opposite of developments in 1985 and 1986. This same phenomenon, reinforced by the normal downward adjustment of compensating balance requirements as rising interest rates enable banks to earn more on business demand deposits, had a marked effect on M1 growth as well, which slowed to a 10 percent annual rate between the fourth and second quarters (and a 7¾ percent rate between the fourth quarter and June); M1 velocity appears to have changed little in the second quarter, after more than two years of steep decline.

Reflecting in large part the diminution of the federal deficit and a slowing in state and local government borrowing, influenced by the Tax Reform Act, aggregate credit expansion in the economy has slowed noticeably this year. The debt of domestic nonfinancial sectors is estimated to have expanded at about a 9¾ percent annual rate through June, still high relative to the growth of nominal GNP, but less rapid than in the past several years and within the 8 to 11

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percent monitoring range specified by the Federal Open Market Committee.

Ranges for Money and Credit Growth in 1987 and 1988

At its meeting earlier this month, the FOMC did not change the 1987 ranges for money and credit growth that it had established in February. As indicated at that time, operating decisions will continue to be made not only with due regard to the behavior of these aggregates, but also in light of evidence on emerging trends in economic activity and inflation and developments in domestic and international financial markets. At this juncture, given the actual growth achieved in the first half, it seems likely that, absent major movements in interest rates that alter the incentives to hold monetary assets, expansion in M2 and M3 around the lower ends of their 5½ to 8½ percent annual ranges may well be appropriate. Indeed, should the recent tendency toward a strengthening in velocity, which has been particularly noticeable in the case of M2, persist, or if inflationary pressures appear to be mounting, some shortfall from the annual ranges might well be appropriate. With regard to the domestic debt aggregate, the FOMC anticipated that the slower pace of debt growth in the first half would continue and that the aggregate would end the year well within the 8 to 11 percent monitoring range.

Consistent with the objective of maintaining progress over time toward general price stability, while supporting sustainable growth in economic activity, the FOMC decided to adopt on a tentative basis lower growth ranges for money and credit in 1988. The target growth ranges for M2 and M3 were reduced ½ percentage point, to 5 to 8 percent, measured from the fourth quarter of 1987 to the fourth quarter of 1988. At the same time, the monitoring range for growth of nonfinancial sector debt also was tentatively reduced by ½ percentage point, to 7½ to 10½ percent.

Ranges of Growth for Monetary and Debt Aggregates

Percent change, fourth quarter to fourth quarter

Aggregate	1987	1988, tentative
M2	5½ to 8½	5 to 8
M3	5½ to 8½	5 to 8
Debt	8 to 11	7½ to 10½

The Committee noted that M1 has continued to exhibit considerable sensitivity to changes in interest rates, among other factors, as illustrated by its sharp deceleration in the first half of this year. In view of this, and the still-limited experience with the behavior of deregulated transactions accounts, the Committee decided not to set a specific target range for M1 for the second half of 1987, and no tentative range was adopted for 1988. In its policy deliberations over the remainder of the year, the FOMC will take account of M1 growth in light of the behavior of its velocity, incoming information about the economy and financial markets, and the degree of emerging price pressures.

Economic Projections

As noted above, the Committee believes that the monetary objectives that it has set are consistent with restraint on inflation in the context of continued moderate growth in economic activity and progress toward a sustainable external position. As is indicated in the table on the next page, the central tendency of the forecasts of Committee members and other Reserve Bank presidents is for growth in real GNP of 2½ to 3 percent in 1987 and 1988. Between now and the end of next year, this pace of activity is expected to generate jobs in about suffi-

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cient number to match the expansion of the work force. Consequently, the civilian unemployment rate is not expected to change appreciably from the 6¼ percent average of the second quarter, although recent experience suggests that the projected growth of real GNP might lead to somewhat lower unemployment.

Real net exports of goods and services are expected to strengthen further while the growth of domestic demand remains relatively subdued. The improved competitive position of U.S. producers resulting in large part from the dollar depreciation of the past two years has only begun to be reflected in trade flows, and further improvement in the nation's external position should be realized in coming quarters. Household spending is expected to grow slowly, but stronger increases in business investment, especially in equipment, are anticipated as industrial firms respond to more favorable sales trends.

Prices, as measured by the implicit deflator for GNP, are expected to rise 3½ to 4 percent over the four quarters of 1987—slightly more than the central tendency range reported to the Congress in February. For 1988, projections of the increase in the GNP deflator center on 4 percent. Assuming world oil prices are more stable, there should be no repetition of the rebound in domestic energy prices that raised the general rate of inflation earlier this year. However, the acceleration in prices of non-oil imported goods that is occurring in the wake of the decline in the foreign exchange value of the dollar likely will continue for a time to provide some impetus to inflation, even if the dollar is more stable over the period ahead, as assumed. The size of further increases in import prices resulting from the depreciation to date will depend on the aggressiveness with which foreign exporters and U.S. distributors seek to restore profit margins that have been squeezed in the past two years. The view that inflation next year will not rise significantly from the pace projected for 1987 is grounded in a belief that recognition of the potential for losses of market share and job opportunities will continue to influence wage- and price-setting behavior.

While restraint on inflation is crucial in achieving an orderly adjustment as our massive external imbalance is corrected, so too is continued progress in reducing the federal budget deficit. Inflows of foreign capital will shrink in step with the reduction in our current account deficit, and in that context excessive federal borrowing requirements,

Economic Projections for 1987 and 1988[1]

Percent

Measure	FOMC members and other FRB Presidents	
	Range	Central tendency
	1987	
GNP, change from fourth quarter to fourth quarter		
Nominal	5¾ to 7¼	6¼ to 7
Real	2 to 3¾	2½ to 3
Implicit deflator	3 to 4¼	3½ to 4
Civilian unemployment rate, average level in the fourth quarter	6.1 to 6.5	6.2 to 6.4
	1988	
GNP, change from fourth quarter to fourth quarter		
Nominal	5 to 8	5¾ to 7
Real	1 to 3	2½ to 3
Implicit deflator	2½ to 5	3¾ to 4¼
Civilian unemployment rate, average level in the fourth quarter	5.9 to 6.8	6 to 6.5

1. The administration has yet to publish its midsession budget review, but spokesmen have indicated that earlier forecasts will be revised. As a consequence, the customary comparison of FOMC forecasts and administration economic goals has not been included in this report.

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as they put pressure on financial markets, pose a threat to the ability of our economy to fund necessary private capital formation.

Finally, the members of the Committee and other Reserve Bank presidents also view the prospects for a healthy U.S., and world, economy as depending significantly on the avoidance of further protectionist measures here and abroad and on satisfactory economic growth in other major industrial countries.

The Performance of the Economy During the First Half of 1987

The economy continued to expand in the first half of 1987, and, in contrast to the pattern of the preceding four years, the composition of activity appeared to be moving toward a better balance between domestic spending and domestic production. The overall growth in output during the first six months of the year led to a net gain in jobs of around 1¼ million, a faster pace of hiring than during 1986. Moreover, the civilian unemployment rate, which had hovered close to 7 percent throughout most of last year, moved down to 6.1 percent by June.

Inflation picked up early this year, with most broad indexes of prices posting increases substantially above those of the past several years. In large part, the acceleration reflected developments in oil markets, where prices have retraced part of last year's decline. But rising prices for other imported goods also began to surface at the retail level, and, at the producer level, prices paid for raw materials and other supplies clearly turned up. Wage trends, however, have remained both stable and restrained.

Higher inflation rates have been, in part, a consequence of the ongoing adjustment of the U.S. economy to a lower foreign exchange value of the dollar. Prices of non-oil imports, particularly for finished consumer goods and capital equipment, have been rising at rates in excess of domestic prices in recent quarters, damping the demand for imported goods. At the same time, goods produced in the United States have become more competitive in world markets. The volume of exports, which began to pick up noticeably in the second half of 1986, continued to expand in early 1987, although the rebound likely has been limited by slow economic growth abroad.

Toward the end of 1986, some manufacturing industries—notably those producing textiles, apparel, steel, chemicals, and paper—began to experience a firming in demand apparently associated with improved trade conditions. In the first six months of 1987, production of office equipment and some other high-tech capital goods as well as several categories of industrial machinery also picked up. Moreover, domestic energy output stabilized, after having been a serious drag on industrial production last year. On the whole, the pace of activity in the goods-producing sector moved back into line with the overall rise in GNP. The index of industrial production increased at a 3 percent annual rate between the third quarter of 1986 and the second quarter of 1987, after little change during the preceding year.

The External Sector

The dollar depreciated further against other major currencies in the first half of 1987, with most of the adjustment concentrated in one episode early in January and in another during a period of unsettled markets in the early spring. Since mid-May the dollar has retraced part of its recent decline, but, on a trade-weighted basis against other G-10 currencies, remains about 6 percent below its average level in December 1986, and

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almost 40 percent below its peak in February 1985. The underlying downward pressure on the dollar during the first half was fueled by perceptions that progress in reducing the U.S. current account deficit had been slow and by disappointment concerning prospects for policy adjustments, here and abroad, aimed at restoring better balance in the world economy. An offsetting factor until recently was the widening of interest rate differentials between the United States and the other major industrialized countries, as rates rose in the United States while declining abroad.

The U.S. current account deficit stood at just under $150 billion in the first quarter of 1987, little changed, in nominal terms, from the deficit in the second half of 1986. The volume of merchandise imports of goods other than oil has been about flat in recent quarters, after rising steadily for three and one-half years. Demand has leveled off for a wide range of imported industrial materials, consumer goods, and capital equipment. This adjustment, however, occurred as dollar prices for these goods began to pick up, and, thus, the value of non-oil imports has continued to edge higher. Demand for imported petroleum products dropped back early this year, but with world oil prices higher, the U.S. oil import bill stayed at about its 1986 level.

At the same time, the expansion in the volume of merchandise exports that began in mid-1986 extended into early 1987. The improvement in foreign sales has been broadly based; in particular, shipments abroad of industrial materials and capital goods, which account for the bulk of U.S. merchandise exports, both were up about 10 percent in real terms in the first quarter from the average in the first half of 1986. The volume of agricultural exports also firmed somewhat recently, as sharply reduced support prices appear to be combining with the lower dollar to boost foreign demand for some U.S. farm products.

The adjustment in the U.S. trade position to date has occurred without much impetus from economic expansion abroad. Growth of real GNP in other industrial countries averaged less than 2½ percent last year; moreover, economic activity began to slow in the second half of the year, and, at least in Europe, the weakness continued into early 1987. Export and import volumes in Europe and Japan have begun to adjust to the exchange rate movements of the past two years, cutting into the growth generated by their external sectors. While growth in domestic demand has been maintained above the rate for domestic production, it, too, has slowed and has not taken up the slack from a weak external sector.

Outside of the industrial countries, average growth last year was quite uneven and, on balance, provided only a limited offset to slower economic activity in Europe and Japan. Weakness in oil markets held down OPEC growth while the newly industrialized countries in Asia continued to expand strongly. In Latin America, which is an important market for U.S exports, output rose close to 4 percent for a third year, a marked turnaround from the 1982–83 period when the onset of external financing difficulties seriously disrupted trade. Internal pressures to maintain reasonably strong growth persist in these countries; such growth could be facilitated by an improved performance of the industrial economies as a group.

The Household Sector

Consumer spending weakened considerably in the first half of 1987, after three years in which real gains averaged 3¾ percent per annum. In particular, households cut back sharply their purchases of durable goods and outlays for nondur-

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ables flattened out; spending for services, however, continued to trend up. Slower sales of new automobiles contributed importantly to the overall deceleration in consumer spending. During the first half, sales of new cars averaged 10 million units at an annual rate, down from a record 11½ million units in 1986. The slackening in demand was most noticeable for domestic makes and persisted despite the continuation of special incentive programs on a wide range of models.

The deceleration in consumer outlays, especially for durables such as motor vehicles, furniture, and home appliances, followed a period of several years during which a variety of factors were working to encourage households to increase their holdings of big-ticket items: relatively moderate increases, or even decreases, in the prices of many home goods; declines in interest rates; and pent-up demands from the period of economic weakness in the early 1980s. As those influences dissipated, and with the personal saving rate reaching an historically low level by late 1986, consumers apparently became more cautious in their buying patterns. Nonetheless, survey evidence still suggested that households' evaluations of market conditions for major purchases and of their personal finances remained generally positive.

During the first five months of 1987, growth in nominal disposable income picked up from its 1986 pace; but, with consumer prices rising more rapidly, income growth in real terms was little different from the 2 percent pace of the preceding two years. However, the aggregate balance sheet of the household sector showed further improvement early this year. Asset holdings were bolstered especially by gains in stock prices, while debt accumulation slowed. Growth of mortgage debt dropped back from the extraordinary pace of late 1986, despite the popularity of home equity loans, and growth of consumer credit dropped sharply. To some extent, the deceleration in consumer debt, as well as the slowdown in spending on durable goods, may be a consequence of the rapid rise in household debt burdens during the past several years. In addition, the new tax law diminished the incentive to finance expenditures with installment credit. Despite the slower growth of consumer and mortgage debt, some indicators suggest that a considerable number of households still are having problems servicing existing liabilities. Although some loan delinquency rates dropped a bit, others rose in the first quarter, as did personal bankruptcies.

Spurred by a decline in mortgage interest rates, which reached a nine-year low at the end of March, starts of new single-family homes averaged 1¼ million units at an annual rate from January through April, the highest level since the late 1970s. Sales of single-family homes, which had been boosted by tax considerations at the end of 1986, also remained brisk through April. Subsequently, the backup in mortgage rates to early-1986 levels resulted in some reduction in single-family homebuilding, to around the pace that prevailed last fall. In the multifamily market, the downtrend in activity that began in early 1986 continued through the first half of 1987. In the second quarter, multifamily starts were one-third below last year's peak. Despite the adjustment thus far to overbuilding and the reduced after-tax profitability of multifamily housing investment, rental vacancy rates nationwide are still close to record highs.

The Business Sector

Business spending on plant and equipment fell sharply in the first quarter of 1987. For equipment, the weakness was

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concentrated in January and followed a tax-induced bunching of purchases in late 1986. In subsequent months, shipments of nondefense capital goods recovered, leaving the average level for April and May, in nominal terms, 1¾ percent above the third quarter of last year. New orders for nondefense capital goods also dipped at the beginning of the year, but then strengthened noticeably as bookings for aircraft and for office and computing equipment rose sharply. The recent level of orders appears consistent with a continuation in the near term of the moderate uptrend in spending on equipment that has prevailed over the past two years. According to private survey responses concerning business capital spending plans for the year as a whole, firms still intend to direct the bulk of these purchases toward modernization and cost-saving improvements in their production lines.

In contrast, the environment for expansion of plant facilities and office space is still generally unfavorable. Large amounts of vacant and underused space in both office buildings and factories began to take a toll on nonresidential construction last year. And, less favorable treatment of commercial structures under the new tax code reinforced the tendencies toward a lower level of activity in this sector. As a result, spending for commercial and industrial buildings dropped further in the first quarter of 1987, to a level about 20 percent below a year earlier. The decline in spending for these types of buildings accounted for the overall weakness in nonresidential structures early this year, in the face of an upturn in oil drilling and some increases in other categories.

A sizable swing in business inventories around the turn of this year was associated with sharp, tax-induced fluctuations in sales. The surge in consumer and business spending at the end of 1986 was met to a considerable extent by drawing down stocks, which were then rebuilt at the beginning of this year. This spring, inventory-sales ratios generally were not indicating serious imbalances, with the notable exception of the auto industry. Domestic car makers boosted production in early 1987 in excess of slackening sales, leading to a substantial backlog of unsold cars on dealer lots. By June, a scaling back of assemblies had stemmed further accumulation, but the industry entered the summer with stocks that were quite large by historical standards.

Before-tax profits of nonfinancial corporations, which had slipped a bit relative to GNP since 1984, rose in the first quarter. After-tax profits relative to GNP were up as well, although the rise was damped by increases in corporate tax liabilities associated with the new tax law. Corporations paid out a slightly larger share of earnings as dividends in the first quarter; nonetheless, internally generated funds remained sizable relative to investment outlays.

The Government Sector

A substantial reduction in the federal budget deficit for fiscal year 1987 appears in train, with the most recent estimate from the Congressional Budget Office at $161 billion, compared with $221 billion in fiscal 1986. Growth in receipts has been extremely rapid; this reflects, in large part, a one-time surge in tax payments this April from individuals who realized capital gains last December, taking advantage of lower tax rates under the old tax code. But more fundamental progress in reducing spending growth also appears to have been made in the wake of the Gramm–Rudman–Hollings legislation. Total outlays have been rising at a rate of around 2 percent in the current fiscal year, a marked slowing from 8 percent per year

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during the preceding five years. Although entitlements spending is still increasing steadily, agricultural support payments and interest outlays have leveled off. Moreover, military spending has begun to respond to reductions in defense authorizations and has slowed to about half its 1986 rate of increase. In addition, there has been continued budgetary restraint on discretionary domestic programs. On balance, these developments have held down the growth of federal purchases, which account for about a third of total federal expenditures; excluding changes in farm inventories held by the Commodity Credit Corporation, real federal purchases were little changed between the second quarter of 1986 and the first quarter of this year.

Real purchases of goods and services by state and local governments rose at a 4 percent annual rate in the first quarter of 1987, close to the brisk pace of the past several years. The growth in outlays continues to be boosted by efforts to upgrade basic infrastructures. This rise in spending has outpaced growth in receipts, however, and the sector's combined operating and capital accounts (that is, excluding social insurance funds) moved into deficit in the first quarter of this year. In many instances, a current deficit does not signal any fundamental financial problem, as capital expenditures are financed through bond issues. Nonetheless, a good many units are experiencing a degree of difficulty, with oil-producing states under the most stress. Many states are responding with plans to trim their general funds budgets; some are considering tax increases or are planning to retain the extra receipts generated by changes in federal tax laws.

Labor Markets

Employment accelerated early in 1987, and, despite a slowing in recent months, the average monthly increase in nonfarm payroll employment of just over 200,000 so far this year exceeds the pace of hiring in 1986. The improvement in labor demand has been fairly broadly based. In manufacturing, a two-year string of cutbacks in durable goods industries ended late last year, and hiring picked up a bit in the nondurable goods sector. As a result, factory employment, overall, edged higher over the first six months of 1987. In addition, the number of jobs in oil and gas extraction stabilized after the sharp retrenchment in 1986. At the same time, the expansion of jobs in the trade, services, and finance industries, despite some recent slowing, remained sizable.

The combination of strong gains in employment and declining numbers of unemployed workers over the first half lowered the civilian jobless rate to 6¼ percent on average in the second quarter from just under 7 percent at the end of last year. The rate for adult men (aged 25 years and over), which had been stuck at around 5½ percent from mid-1984 to late 1986, moved below 5 percent this spring; further improvement also occurred for adult women, whose unemployment rate in the past year has moved below that of their male counterparts.

Despite falling unemployment, available measures of labor compensation showed little sign of acceleration early this year. Hourly compensation, as measured by the employment cost index, rose 3.1 percent in the 12 months ending in March, the same as the year-over-year changes in the second half of 1986 and down nearly three-quarters of a percentage point from a year earlier. A wide gap persisted between the size of pay increases for white-collar workers and those in blue-collar occupations. Nonetheless, the slowing in wage inflation compared with a year earlier was rela-

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tively widespread by industry and occupational group. An exception is the Northeast region where wages showed no deceleration in the year ending in March and increases were still outpacing those in other parts of the country by a sizable margin.

The moderation in hourly compensation increases has been the principal factor holding down labor costs, as productivity continues to be quite sluggish. After declining in the second half of 1986, output per hour in the nonfarm business sector rebounded in the first quarter of 1987, but remained little different from its year-earlier level. Since 1984, productivity gains in the nonfarm business sector have averaged less than 1 percent per year. The trend has been much more favorable in the manufacturing sector, where firms apparently have had some success in their efforts to boost the efficiency of their production processes; indeed, productivity gains in U.S. manufacturing between 1985 and 1986 outstripped those recorded by other major industrial countries.

Price Developments

As expected, inflation rates have been higher so far this year, largely reflecting a rebound in energy prices. The GNP fixed-weighted price index, a broad measure of inflation for goods and services produced by the United States, increased at about a 4 percent annual rate in the first quarter; it had risen 2½ percent during 1986. Sharper accelerations occurred in the consumer price index, which was up at a 5½ percent rate over the first five months of the year, and in the producer price index for finished goods, which rose at a 4½ percent annual rate over the six months ended in June.

The rebound in energy prices began in January when spot prices of crude oil jumped about $3 per barrel in response to the reductions in output to which OPEC had agreed late in December. Higher crude oil costs were quickly passed on to end-users, and by May consumer prices for gasoline and fuel oil had risen about 15 percent, retracing half of last year's decline. Spot prices of petroleum products moved up a bit further early in the summer as inventories tightened, and these increases were supported subsequently by the renewal of OPEC's agreement to control production.

In addition to the developments in energy markets, the influence of a lower value of the dollar, as well as trade restrictions, on the prices of imported goods became increasingly evident at the retail level in the first part of this year. The dockside prices of non-oil imports turned up in 1986 after several years in which stable or declining import prices had helped to restrain domestic inflation. Although price changes have varied considerably among different categories of imported goods, some of the largest increases have been reported for consumer commodities, including autos. Retail prices for a number of items with higher-than-average import proportions—such as apparel, footwear, and some other home goods—have shown markedly faster increases than during the past several years. These increases contributed to a sharp acceleration in the consumer price index for goods other than food and energy between December and May compared with 1986 while the rise in prices of nonenergy services over the same period was slightly less rapid than last year.

At the domestic producer level, prices of finished consumer goods and capital equipment other than food and energy rose at less than a 2 percent annual rate over the first six months of the year. At earlier stages of processing, however, prices of domestically produced inter-

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mediate materials other than food and energy rose at a 4 percent annual rate, after two years of essentially no change. This acceleration reflected a sharp rise in the prices of industrial chemicals and some other petroleum-related materials as well as increases in a number of other categories.

Prices of primary commodities other than petroleum also have increased so far in 1987. In the agricultural sector, crop prices have retraced part of last year's decline that occurred when farmers sold large amounts of the grain they had received from the government in lieu of cash payments. Prices of cattle and hogs also were up markedly into the spring, but, with supplies improving, cattle prices have retraced much of their advance, and hog futures prices point to declines later this year. Prices of industrial materials, with the exception of a brief period early this year, have been rising fairly steadily since the early autumn of 1986. Spot prices for precious metals have been particularly sensitive to developments in foreign exchange markets and renewed market concerns about inflation; after climbing sharply into May, they fell back a bit with the subsequent firming of the dollar.

Monetary Policy and Financial Markets in the First Half of 1987

The Federal Open Market Committee at its meeting in February established 1987 target ranges, measured from the fourth quarter of 1986 to the fourth quarter of 1987, of 5½ to 8½ percent for both M2 and M3. It also set a 1987 monitoring range for domestic nonfinancial debt of 8 to 11 percent. The M2 and M3 ranges represented a ½ percentage point reduction from last year's target ranges, and the Committee expected growth to be well within the ranges, especially in the absence of dramatic movements in interest rates. The range for debt was unchanged from 1986 but below the actual outcome in that year and other recent years; thus, the Committee anticipated that debt growth also would slow this year.

The Committee viewed a substantial slowing in money and credit growth from the rapid pace of 1986 as likely to be consistent with continuation of sustainable economic expansion and conducive to further progress over time toward reasonable price stability. Growth of M1 also was expected to moderate considerably this year. However, the Committee in February elected not to set a target range for M1 for 1987 because of the continuing uncertainties about the relationship of this aggregate to the economy. These uncertainties partly reflected the substantial sensitivity of its velocity to changes in financial conditions that had been evident in recent years, capped by a record postwar decline in the velocity of M1 over 1986. Instead, the FOMC decided to continue evaluating movements in this aggregate in light of the behavior of its velocity, the rate of economic expansion, inflationary pressures, and developments in financial markets.

Over the first half of 1987 monetary policy was conducted against a backdrop of heightened concerns about inflation, stimulated in part by substantial downward pressure on the dollar in foreign exchange markets. At the same time, growth of money and credit aggregates moderated considerably and the velocities of the broader monetary aggregates turned upward after several years of rapid money growth and falling velocities. Measured from the fourth quarter of 1986, M2 in June was below the lower end of its target growth range, while M3 was around the lower end of its range. Meanwhile, growth in M1 slowed to a 7¾ percent pace and debt expansion

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moderated to a 9¾ percent rate. As pressures on the dollar and inflation worries intensified in April and May, interest rates began to rise substantially, especially in long-term markets. In late April and May the Federal Reserve adopted a somewhat less accommodative stance with respect to the provision of reserves through open market operations. These actions, together with monetary easing moves by key industrial trading partners, helped to stabilize the dollar and calm inflation fears, contributing to some decline in long-term interest rates and strengthening of the dollar.

Money, Credit, and Monetary Policy

In its conduct of policy thus far this year, the Federal Reserve has given a good deal of weight to a number of considerations in addition to the monetary aggregates—principally recurrent episodes of heavy downward pressure on the dollar, indications from long-term securities and commodity markets of heightened inflationary expectations, and evidence that the economy continued to advance at a pace sufficient to produce rising levels of resource utilization. Under these circumstances, interest rates tended to move higher, and the patterns of rapid money growth and declining velocities of the last several years, when inflation and interest rates were moving down, began to be reversed. Growth of the broad aggregates remained around the lower bounds of their growth cones through most of the first half of the year, although M2 dropped well below its long-run range later in the period. Growth of both M2 and M3 was considerably below the pace of recent years, and their velocities increased. Expansion of M1 also slowed markedly, while growth of domestic nonfinancial sector debt moderated.

Through the early spring of this year, System open market operations were conducted to keep pressures on the reserve positions of depository institutions unchanged from last year. In January, strong credit and money demands associated with a burst of tax-related financial activity in late 1986 began to abate, and short-term interest rates eased; however, these rates remained above levels prevailing in the fall of last year.

In foreign exchange markets, the dollar had begun to decline in late December, after a period of some stability. The drop continued through January, amid market concerns about the prospects for correcting U.S. and foreign external imbalances. In late February, the statement in Paris by the ministers of finance and central bank governors of six major industrial countries that they "agreed to cooperate closely to foster stability of exchange rates around cur-

Growth of Money and Debt

Percentage change at annual rate

Period	M1	M2	M3	Domestic non-financial sector debt
Fourth quarter to fourth quarter				
1979	7.9	8.2	10.4	12.2
1980	7.3	8.9	9.6	9.6
1981	5.1 (2.4)[1]	9.3	12.3	9.9
1982	8.6	9.1	9.9	8.9
1983	10.2	12.1	9.8	11.5
1984	5.4	7.9	10.7	13.9
1985	12.1	8.8	7.7	13.4
1986	15.3	8.9	8.8	13.2
1986:4 to 1987:2	9.9	4.5	5.3	9.8[e]
1986:4 to June 1987	7.7	4.0	5.3	9.8[e]
Quarterly average				
1986: 1	8.8	5.3	7.7	15.5
2	15.5	9.4	8.7	10.2
3	16.5	10.6	9.7	12.5
4	17.0	9.2	8.0	12.1
1987: 1	13.1	6.3	6.3	10.4
2	6.4	2.5	4.1	9.0[e]

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

e estimated

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rent levels," along with a discount rate cut by the Bank of Japan, seemed to stabilize the dollar for a time.

The spread between private short-term rates and Treasury bill rates widened after Brazil announced a suspension of interest payments to banks in February, and subsequently widened further as the Treasury's paydown of bills, which began early in the year, picked up and foreign official institutions purchased bills with the proceeds of dollars acquired in exchange market intervention. Reflecting the somewhat higher private short-term interest rates and concomitant increases in funding costs, commercial banks raised the prime rate by ¼ percentage point on April 1.

Long-term rates, which had not been much affected by the transitory credit demands of late 1986, continued to drift down in the early months of 1987, displaying little short-term volatility. The placid conditions in long-term markets were abruptly changed in late March, primarily by developments in the international sphere. Announcements of trade sanctions by the United States, persisting weakness of the dollar, and disappointing trade figures all raised questions about continuing private demands for dollar assets, prospects for inflation, and the response of monetary policy. The dollar dropped sharply in the last three weeks of March, and between late March and late April yields on 30-year government bonds rose about 1 percentage point on balance. The exchange and bond markets became highly volatile during this period, as the dollar continued to drop and inflation fears appeared to be intensified by the publication of adverse price data. Mortgage rates and yields on mortgage pass-through securities reacted very promptly to the deterioration in the bond markets and, indeed, rose more than most other long-term rates as many investors shied away from these instruments subject to substantial prepayment risk.

The effects of these developments also were evident in short-term credit markets, where rates rose in April partly in anticipation that monetary policy would have to firm to contain pressures on prices and the dollar. In late April and again in May, the Federal Reserve did move to tighten the availability of nonborrowed reserves through open market operations. Short-term interest rates rose about ½ to ¾ percentage point during April and May, and the prime rate was raised twice more, on May 1 and May 15, in ¼ point increments. The System's firming actions, along with complementary moves abroad, helped to stabilize the dollar and ameliorate the concerns about the inflation outlook.

Along with some better price news and evidence of improvement in our trade deficit, this policy appeared to impart an improved tone to short-term and, especially, long-term credit markets over the latter part of May and June. Since May, most short-term rates have posted declines of ¼ percentage point or more. Longer-term markets generally have registered greater gains, and in early July long rates were off ½ to ¾ percentage point from their May highs. The dollar, meanwhile, has shown more dramatic improvement, regaining the ground it lost in April and May.

As interest incentives favoring market instruments over monetary assets became more pronounced in the first half of the year, growth of the monetary aggregates slowed. M2 decelerated in both quarters, expanding at only a 2½ percent annual rate in the March to June period. In addition to the influence of rising interest rates, tax reform may have weakened the public's demand for M2 assets, particularly household-type deposits, to the extent that it induced indi-

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viduals to pay down consumer debt or to finance expenditures out of liquid assets rather than with credit. The velocity of M2 is estimated to have risen in the first and second quarters after declining in 1985 and 1986.

The slowing of M2 growth was accompanied by a marked change in the composition of deposit inflows away from transactions and other highly liquid instruments and toward longer-term retail deposits. This reversal of the pattern of portfolio shifts in 1985 and 1986 occurred as rates on time deposits adjusted more promptly to rising market rates than did yields on more liquid monetary components and the deposit rate curve steepened.

Growth in transactions instruments fell in the first half to a pace not seen since 1984, the last time interest rates rose on a sustained basis. Demand deposits, along with other checkable deposits (OCDs), were boosted smartly in April as individuals prepared to pay tax liabilities, which were swollen by capital gains taken in 1986 to avoid higher rates under tax reform. On balance, however, demand deposits have exhibited no sustained strength since late last summer. Among other factors, the rise in interest rates reduced the volume of demand deposits that businesses need to hold as compensating balances for bank services. As rates on time deposits and market instruments rose, OCDs became a less attractive savings vehicle. The progressive slowing this year of OCD growth, which had averaged close to 30 percent during most of 1986, was interrupted only by the April surge. With demand deposits and OCDs both running off in June, growth in M1 for the second quarter was down to a 6½ percent rate. The velocity of M1 in the second quarter is estimated to have been little changed after declining in each quarter since 1984.

Growth in other liquid balances also has been falling. Savings deposits, after expanding at around a 30 percent rate since the late summer of last year, slowed in the second quarter and advanced at only a 10 percent rate in June, and money market deposit accounts have been particularly weak this year. By contrast, small time deposits which had run off over much of last year in an environment of falling short-term rates, expanded significantly in June for the first time since April 1986. Small time deposit growth this year has been especially strong at thrift institutions, reflecting elevated offering rates and, in certain cases, shifting to deposits in denominations under $100,000, as some of these institutions have encountered difficulties in issuing large time deposits.

Even with weak inflows to core deposits, the need among commercial banks to tap wholesale managed liabilities was limited by a moderation in demands for credit. M3 growth was further damped in the first half as banks obtained funds from sources not encompassed by the monetary aggregates, including borrowing from their foreign branches and a sharp rise in Treasury deposits. Federal Home Loan Bank advances to thrifts also were strong, although below the pace of last year. M3 growth fell below that of income in the first half and its velocity apparently rose in both quarters, the first sustained increase in three years.

Credit flows were reduced in the first half of 1987, with total domestic nonfinancial sector debt expanding at around a 9¾ percent annual rate, compared with rates in excess of 13 percent in each of the preceding three years. Even so, expansion of both the private and public components of the debt aggregate continued to outstrip growth of income, as generally has been the case in the 1980s.

Overall business credit demands con-

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tinued to be buoyed in the first half by heavy net share retirements associated with mergers, buyouts, and other corporate restructurings. With long-term rates subdued in the first three months of the year, firms concentrated their borrowings in bond markets and short-term business credit contracted. However, as long-term markets deteriorated in April, bond issuance abated and business credit demands focused on the commercial paper market. By June, with some improvement in long-term markets, these financing patterns reversed again as bond issuance picked up and growth of short-term business credit came to a halt.

Growth of consumer installment credit was considerably diminished during the first half. The reduced deductibility of consumer interest payments under the new tax code encouraged this development. The tax law change made use of mortgage credit relatively more attractive, and the active promotion by lenders of home equity lines of credit reinforced tendencies toward substitution. In addition to credit taken down under home equity lines, mortgage growth in the first half was maintained by heavy volumes of new and existing home sales.

Federal government credit needs in the first half were held down by unusually strong tax payments stemming from the retroactive repeal of the investment tax credit and, principally, capital gains realized late last year. The budget showed a small surplus in the April to June period, after a $59 billion deficit in the first quarter. Net borrowing from the public nevertheless rose in the second quarter on a seasonally adjusted basis as the Treasury replenished its cash balances, which had been drawn down sharply in the initial months of the year. The Treasury ran off bills in both quarters, but continued to issue coupon securities in volume. Federal debt expanded at a 9¾ percent annual rate in the first half of the year, down from the pace of 1986.

Borrowing by state and local governments has fallen off this year. Issuance of municipal debt for new capital has been slowed considerably by provisions of tax reform that narrowed the definition of public-purpose debt and constrained private-purpose offerings. In addition, issuance of refunding bonds, which was strong in the first quarter, slackened after April owing to higher interest rates.

The financial system has continued to evidence strains in 1987. Indications that the agricultural sector is beginning to stabilize have emerged, with loan delinquencies declining, land prices bottoming out, and export volume firming; the failure rate among agricultural banks seems likely to have peaked. However, the Farm Credit System, the nation's largest farm lender, lost considerable sums in 1985 and 1986, and many of its units continue to struggle with troubled loan portfolios.

In addition to difficulties with agricultural loans, commercial banks have been saddled with persisting problems in their energy and developing country loan portfolios. Although some banks remain highly profitable, 19 percent lost money last year, compared with about 3 percent as the decade began; loan loss provisions were the main cause of the earnings problems. The banking system is likely to post record losses this year owing to huge reserve provisions taken by large banks primarily as a consequence of developments in the international debt area. Despite the shrinkage in the book value of shareholder equity recognized by these actions, share prices rose at many banks announcing large increases in loan loss reserves.

Net operating income before taxes for solvent thrift institutions rose last year as

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interest margins widened with falling market rates, and thrifts overall have raised their ratio of net worth to total assets by taking advantage of strong stock prices to issue large volumes of equity. Nonetheless, at a significant minority of thrifts, already negative net worth positions have been aggravated by continued losses. Moreover, the problems of some troubled institutions intensified this year as the real estate market in certain areas of the country remained depressed and interest rates backed up.

The difficulties of the thrift industry are mirrored in the situation of the Federal Savings and Loan Insurance Corporation. Estimates indicate that current and potential claims against the FSLIC exceed its reserves by significant amounts. With premiums levied on member institutions already at a statutory maximum, some action clearly is called for to strengthen the FSLIC and bolster its ability to deal with problem institutions. Plans currently under study by Congress would involve using retained earnings from the Federal Home Loan Banks to capitalize a financing corporation which, in turn, would issue obligations and invest the proceeds in FSLIC capital stock. At this stage, these plans call for a maximum capacity to issue debt of $8½ billion. This would be repaid over an extended period of time through FSLIC assessments on member institutions.

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Part 2
Records, Operations, and Organization

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Record of Policy Actions of the Board of Governors

Regulation D (Reserve Requirements of Depository Institutions)

December 2, 1987—Amendment

The Board amended Regulation D to increase (1) the amount of transaction account balances to which the lower reserve requirement applies and (2) the amount of reservable liabilities subject to a zero percent reserve requirement.

Votes for these actions: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley.[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, the Board set reserve requirements at 3 percent of an institution's first $25 million in transaction balances and 12 percent on balances above that level. The act directs the Board to adjust the amount subject to the lower reserve requirement to reflect changes in transaction balances nationwide. By the beginning of 1987, this amount was $36.7 million. Recent growth in such balances warranted an increase of $3.8 million. The Board, therefore, amended Regulation D to increase to $40.5 million the amount of transaction accounts to which the lower 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 deposit growth nationwide. Recent growth in deposits warranted an increase in the amount subject to a zero percent reserve requirement from $2.9 million to $3.2 million, and the Board amended Regulation D accordingly.

The amendments are effective with the reserve computation period beginning on December 29, 1987, and with the corresponding reserve maintenance period beginning on or after December 31, 1987.

Regulation D (Reserve Requirements of Depository Institutions) and Regulation Q (Interest on Deposits)

December 9, 1987—Revision and Rescission of Interpretations and Technical Amendments

The Board approved revisions to certain published interpretations of Regulation Q and the rescission of others and made technical amendments to Regulation D and related interpretations.

Votes for these actions: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell and Kelley. Absent and not voting: Mr. Heller.[1]

The expiration in 1986 of the Depository Institutions Deregulation Act of 1980 removed the authority of the Board (and that of the other federal agencies regulating financial institutions) to set ceilings on the rates of interest paid on

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

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deposits. Provisions in Regulations D and Q had been used to enforce ceilings on interest rates and to make distinctions between classes of deposits. With the expiration of the act, the Board removed those provisions in the regulations. The Board now has rescinded the interpretations of Regulation Q that were made obsolete by the expiration of the act and the related regulatory changes and has revised other provisions. Where appropriate, the Board has revised interpretations concerning distinctions between classes of deposits and, in some cases, has moved them to Regulation D.

Of the 47 interpretations of Regulation Q, 34 were rescinded, 3 were revised, 3 were left unchanged, and 7 were moved to Regulation D. The amendments to Regulation D remove obsolete references to Regulation Q and make technical changes and clarifications to the regulation and certain interpretations. The technical amendments are effective December 31, 1987.

Regulation E (Electronic Fund Transfers)

August 5, 1987—Amendments

The Board amended Regulation E to eliminate, under certain circumstances, the requirements for periodic statements for those organizations that offer electronic fund transfer (EFT) services but do not hold consumer accounts.

> Votes for this action: Mr. Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley. Absent and not voting: Mr. Volcker.[1]

Previously, organizations that offered EFT services but did not hold consumer accounts had to comply with most of the requirements of Regulation E. The regulation established specific requirements for organizations, such as retailers, that provide EFT services to consumers by issuing debit cards or other devices for making point-of-sale transactions or by allowing consumers to use other cards to gain access to deposit accounts. Those requirements included sending periodic statements of EFT transactions to consumers.

The Board amended Regulation E to eliminate the periodic statement requirements for those who provide EFT services to consumers but do not hold consumer accounts, provided they (1) issue debit cards that indicate the name and address or telephone number that should be used to contact the service provider; (2) furnish institutions with specified information by which they can identify transactions; (3) extend the time within which consumers must report lost or stolen debit cards; (4) include their address and telephone number on receipts; and (5) give certain other disclosures. Also, the amendments require account-holding financial institutions to describe the EFT transactions on the periodic statements they send to their customers.

The Board took this action because of concern that the high cost of sending the periodic statements was impeding the growth of EFT systems using automated clearing houses and was hampering the development and widespread use of point-of-sale systems. The Board believed that the changes would simplify recordkeeping for consumers because they would receive one statement of all transactions for which they used a debit card, rather than receiving a statement from each establishment at which the card was used. The amendments continue existing consumer protections and allow the reduction of costs of the overall payment system, to the benefit of account-holding institutions, service providers, and consumers.

The amendments are effective November 15, 1987, except for the periodic statement requirements for account-holding institutions, which are effective

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July 1, 1990, for institutions with less than $25 million in assets. Also, other account-holding institutions are not required to comply with certain of the periodic statement requirements of the regulation until July 1, 1990.

Regulation F (Securities of State Member Banks) and Regulation H (Membership of State Banking Institutions in the Federal Reserve System)

December 18, 1987—Rescission and Amendments

The Board amended its securities reporting requirements, effective January 1, 1988, by eliminating certain reports that banks had been required to file with the Board and replacing them with similar reports prescribed by the Securities and Exchange Commission (SEC). The reporting requirements had been in Regulation F; the Board rescinded Regulation F, however, and amended Regulation H to include the revised requirements for disclosure and reporting.

Votes for these actions: Mr. Johnson, Ms. Seger, Messrs. Angell and Kelley. Absent and not voting: Messrs. Greenspan and Heller.[1]

The Securities Exchange Act of 1934 requires publicly held companies, including all those with more than 500 shareholders and more than $1 million in assets, to make certain public disclosures and to file with the SEC various reports regarding changes in ownership or tender offers for their securities. The act also authorizes the Board to adopt similar requirements for reporting and disclosure for state member banks and to issue regulations substantially similar to those of the SEC.

The amended Regulation H requires that state member banks file information with the Board in the same format required by the SEC for publicly held companies. A bank with no foreign offices and with less than $150 million in assets now may substitute its quarterly reports of condition and income for three of the four quarterly reports normally filed with the SEC on Form 10-Q. The amendments eliminate the need for regulatory revisions whenever the SEC amends its requirements for reporting or disclosure. The new requirements are effective with the first reports filed after January 1, 1988.

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

January 21, 1987—Amendment

The Board amended Regulation H, effective April 27, 1987, to implement provisions of the Anti–Drug Abuse Act of 1986.

Votes for this action: Mr. Johnson, Ms. Seger, Messrs. Angell and Heller. Absent and not voting: Mr. Volcker.[2]

The Anti–Drug Abuse Act of 1986 directed the Board and the other federal agencies that regulate banks to require banking organizations under their jurisdiction to establish procedures ensuring compliance with the Bank Secrecy Act. The Bank Secrecy Act requires institutions to keep records on certain customer deposit activities, currency transactions, and movements of monetary instruments outside the United States, particularly if those activities involve cash transactions of $10,000 or more. The Anti–Drug Abuse Act required that the agencies promulgate regulations by January 27, 1987, and that institutions establish

2. On this and subsequent pages, footnote 2 indicates that there were two vacancies on the Board when this action was taken.

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compliance procedures within three months.

The amendments to Regulation H require member banks to have by April 27, 1987, written procedures that, at a minimum, establish compliance procedures; designate an individual to be responsible for overseeing and monitoring compliance; and provide for appropriate employee training regarding the requirements of the act. The act also authorizes agencies to issue cease and desist orders or to assess penalties against institutions that fail to establish compliance procedures or to correct problems cited in an examination.

October 28, 1987—Amendment

The Board amended Regulation H, effective November 9, 1987, to permit banks to amortize losses on certain qualified agricultural loans and other assets.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley.[1]

The Competitive Equality Banking Act of 1987 permits a bank to amortize losses on qualified agricultural loans reflected on its financial statements between December 31, 1983, and January 1, 1992. A bank also may amortize losses incurred as a result of an appraisal of other assets related to a qualified agricultural loan that it owned at any time between January 1, 1983, and January 1. 1992. The act directs the federal banking agencies to issue implementing regulations no later than November 9, 1987.

The statute establishes criteria for determining whether an institution's losses are eligible for amortization. The statute requires that a bank (1) have deposit insurance and be in satisfactory condition; (2) be located in an area whose economy is dependent on agriculture; (3) have assets of $100 million or less; (4) have at least 25 percent of its loans invested in qualified agricultural loans; (5) be in need of capital restoration; and (6) have a plan to restore its capital by the end of the amortization period. Losses resulting from fraud or criminal abuse do not qualify for amortization.

The Board's implementing rule describes the procedures and standards applicable to state member banks seeking to amortize losses under the statute and the manner in which such amortizations are to be taken. The rule is effective in November; thus, the first financial statement that banks file under the new procedures is the 1987 year-end call report. The other two federal banking agencies have adopted substantially similar regulations for the institutions they regulate.

Regulation K (International Banking Operations)

August 10, 1987—Amendment

The Board amended Regulation K to permit U.S. banking organizations to make certain investments abroad using debt-for-equity swaps.

Votes for this action: Messrs. Volcker and Johnson, Ms. Seger, Messrs. Heller and Kelley. Absent and not voting: Mr. Angell.[1]

The Board amended Regulation K to provide additional investment flexibility to U.S. banking organizations abroad by liberalizing the availability of debt-for-equity swaps of foreign loans for equity investments. Swaps are useful primarily in a country that has restricted or prohibited foreign creditors from expatriating its currency.

Previously, Regulation K had permitted U.S. banking organizations to hold up to 20 percent of the shares of nonfinancial companies and all of the shares of financial companies. The Board amended the regulation to eliminate the 20 percent restriction in certain cases.

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Regulation K now permits a U.S. banking organization to acquire all the shares of a nonfinancial company in a debt-for-equity swap, provided the following conditions are met: (1) the company must be in the process of being transferred from public ownership to private ownership; (2) the company being acquired must be located in a heavily indebted country; (3) the shares being acquired in the swap must be held by the bank holding company or its subsidiary, and not by a bank; and (4) the shares must be divested within five years after the acquisition, unless the Board grants an extension for up to five additional years.

Regulation T (Credit by Brokers and Dealers)

August 20, 1987—Amendment

The Board amended Regulation T, effective August 27, 1987, to permit brokers and dealers to extend credit on a good-faith basis on any mortgage-related security.

> Votes for this action: Messrs. Greenspan, Johnson, Angell, and Heller. Absent and not voting: Ms. Seger and Mr. Kelley.[1]

The Secondary Mortgage Market Enhancement Act attempts to facilitate participation by the private sector in the secondary market for mortgages by providing preferential treatment for mortgage-related securities. The Board amended Regulation T by revising the definition of an over-the-counter margin bond to include any mortgage-related security. The revision permits a broker–dealer to extend credit in any margin account, on a good-faith basis, for any mortgage-related security that is privately placed, provided the security represents ownership in a residence and is rated in one of the two highest rating categories by a nationally recognized rating service.

December 18, 1987—Amendment

The Board amended Regulation T, effective January 25, 1988, to permit brokers and dealers to assist in the exercise of employee stock options.

> Votes for this action: Mr. Johnson, Ms. Seger, Messrs. Angell and Kelley. Absent and not voting: Messrs. Greenspan and Heller.[1]

Previously under Regulation T, investors could not pay for the purchase of a security from a cash account with the proceeds of the sale nor withdraw funds from a margin account if the withdrawal would lower the investor's equity in the account. The Board amended Regulation T to provide a simplified procedure by which broker–dealers can temporarily finance the acquisition of stock under employee stock-option programs. A broker–dealer now may advance funds for the exercise of an employee stock option, for a short period of time, if the broker has evidence of the employee's entitlement to the security and assurance of the company's prompt delivery of the security.

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

September 16, 1987—Amendment

The Board amended Regulation U, effective September 23, 1987, to exempt banks when extending margin credit in an amount of $100,000 or less from executing Form FR U-1.

> Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley.[1]

The amendment exempts a bank that makes a loan of $100,000 or less, secured directly or indirectly by margin

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stock, from the requirement that it obtain a purpose statement (Form FR U-1) from the borrower.

Regulation Y (Bank Holding Companies and Change in Bank Control)

June 10, 1987—Amendment

The Board amended Regulation Y, effective immediately, to implement amendments in the Change in Bank Control Act required by the Anti–Drug Abuse Act of 1986.

Votes for this action: An action committee of Mr. Johnson, Ms. Seger, and Mr. Heller. Absent and not voting: Messrs. Volcker and Angell.[2]

A provision in the Anti–Drug Abuse Act imposed new requirements on those who seek to acquire control of a bank or bank holding company, as well as on the federal agencies that oversee the institutions being acquired. The act requires that the federal agency receiving notice of a proposed change in control publish notice of the acquisition in the communities where the organizations to be acquired are located. The notice must invite public comment on the proposed change in control, indicate where such comments should be directed, and name all parties to the proposed acquisition and organizations to be acquired. Also, the Board must investigate the competence, experience, integrity, and financial ability of each person named in a notice of a change in bank control. To complete the required investigations, the Board may delay action on those proposals.

The Board amended Regulation Y to implement the new publication requirements. The Board required that parties filing a notice of a change in control publish an announcement of the proposed acquisition in a newspaper of general circulation in the communities served by the institution to be acquired. The amendment specifies the information to be included in the published announcement and requires that the newspaper announcement appear within 10 days before or after the notification of the Federal Reserve of the proposed change in bank control. If a public offering of securities will occur in connection with the change in control, however, the Federal Reserve may delay publication of the notice to coordinate with the publication requirements of federal securities laws.

The amendment also provides that the Board will publish notice of a proposed change in control in the *Federal Register* and will provide a public comment period of at least 15 days. The Board may decide not to publish the notice in the *Federal Register*, or it may waive the requirement for newspaper publication if it determines that such action would jeopardize the safety or soundness of the organization being acquired, such as when a bank is in danger of failing.

Regulation Z (Truth in Lending)

November 5, 1987—Amendment

The Board amended Regulation Z, effective December 9, 1987, to implement a provision in the Competitive Equality Banking Act of 1987 requiring creditors to set a maximum rate of interest that will be charged on an adjustable-rate mortgage loan.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley.[1]

A provision of the Competitive Equality Banking Act states that any adjustable-rate credit contract—whether open-end or closed-end—entered into on or after December 9, 1987, that is secured by the borrower's dwelling must include

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a limitation on the amount of interest that may be charged during the life of the loan contract. The legislation does not limit interest rates on such loans; rather, it requires that lenders disclose the maximum rate that might be charged during the term of the loan.

December 18, 1987—Amendment

The Board amended Regulation Z, effective October 1, 1988, to expand the disclosure requirements for closed-end adjustable-rate mortgages.

Votes for this action: Mr. Johnson, Ms. Seger, Messrs. Angell and Kelley. Absent and not voting: Messrs. Greenspan and Heller.[1]

For some time, the Board had been working with the other members of the Federal Financial Institutions Examination Council to develop uniform disclosure requirements for adjustable-rate mortgage (ARM) loans. The agencies had been concerned that some consumers were not fully informed of the range of possible adjustments to their mortgage loans. Moreover, differences in disclosure requirements among agencies for the varying institutions they supervise made comparisons of adjustable-rate programs difficult. The agencies believed that uniform disclosure requirements would facilitate consumers' shopping for loans and were necessary to ensure that consumers receive (1) adequate information about adjustable-rate mortgages during the loan-application process and (2) comparable information from all lenders to which they apply.

The amendments to Regulation Z require that a creditor provide consumers with a handbook describing adjustable-rate mortgages in general terms and also with detailed disclosures about the lender's ARM programs. The requirements apply to closed-end credit contracts of one year or longer that are secured by the consumer's principal dwelling and to loans for purchasing a home. The amendments require that the disclosures clearly explain the formula or index that the lender will use to determine when and how the rate will be adjusted, as well as other important features about the loan program, including the timing and frequency of adjustments in the interest rate or payments; any limitation on the rate that can be charged or on payment adjustments; and the presence or absence in the credit contract of a demand feature allowing the creditor to require immediate payment in full. Also, the lender must provide an illustration of how the interest rate, payment, and balance on a $10,000 mortgage loan would have been adjusted, using actual changes in the appropriate index or formula since 1977, if the rate had been administered under one of the lender's ARM loan programs. (Lenders are required to provide a history of the changes in the formula or index used for a particular ARM program and to update the data annually until a 15-year table is available.) The disclosures and historical information must be provided when a consumer receives an application form or before the consumer pays a nonrefundable application fee, whichever is earlier.

In adopting these amendments, the Board stated that creditors could begin operating under the new rules immediately. Compliance will be mandatory beginning October 1, 1988.

Policy Statement

April 22, 1987—Statement on the Responsibility of Bank Holding Companies to Act as Sources of Strength for Their Subsidiary Banks

The Board authorized issuance of a policy statement, effective immediately, to remind bank holding companies of their

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responsibility to serve as sources of strength for their subsidiary banks.

Votes for this action: Messrs. Volcker and Johnson, Ms. Seger, Messrs. Angell and Heller.[2]

The statement reaffirmed a long-standing Board policy that holding companies should use their available resources to provide adequate capital funds to their subsidiary banks during periods of financial stress or adversity. The Board issued the policy statement to remind holding companies of its expectation that they provide financial and managerial strength to their subsidiary banks.

Because it reiterated an existing policy, the statement was effective immediately. The Board indicated, however, that it would accept comments on the policy through July 1, 1987.

1987 Discount Rates

The Board approved one change in the basic discount rate during 1987, an increase in early September from 5½ percent to 6 percent. During the year the Board also turned down four requests for increases or decreases of ½ percentage point in the basic rate submitted by individual Federal Reserve Banks. As described below, the Board renewed its temporary, simplified seasonal credit program for 1987 and also approved a new, simpler structure of rates, including a flexible rate, for loans made under the extended credit program.

The reasons for the Board's decisions are reviewed below. Those decisions were made in the context of the policy actions of the Federal Open Market Committee and of general economic and financial developments that are covered in more detail elsewhere in this REPORT. A listing of the Board's actions on the discount rate during 1987, including the votes on those actions, follows this review.

Actions on the Basic Discount Rate

During the first several weeks of the year, the Board discussed but took no action on requests by a number of Federal Reserve Banks to reduce the basic discount rate by ½ percentage point. A rate of 5½ percent had been in effect since the second half of August 1986. In the Board's judgment a lower rate was not then warranted by conditions in financial markets or the behavior of the monetary aggregates. The Board also was concerned about the weakness of the dollar in the foreign exchange markets. Nonetheless, with the outlook for economic activity and prices subject to a great deal of uncertainty, the Board decided to defer action rather than to approve or deny the pending reductions.

Information that became available over the course of the first quarter suggested on balance that business activity was expanding at a faster pace than in the latter part of 1986, and concerns about the outlook for inflation appeared to be growing. Concurrently, the dollar remained under downward pressure in foreign exchange markets. Against that background all of the requests for a lower rate were withdrawn by mid-February, and no further requests for a change in the rate were submitted until after mid-April.

Over a period of several weeks after mid-April, a number of Federal Reserve Banks proposed increases of ½ percentage point in the basic rate. Broad measures of consumer and producer prices and commodity prices indicated a rising rate of inflation in this period. The greater inflation was induced primarily by higher prices for energy and non-oil imports. And, as evidenced in part by

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developments in financial markets, inflationary expectations appeared to be intensifying, and the dollar remained under considerable downward pressure. In its discussions during this period the Board noted that economic and financial conditions might be evolving in a direction that could call for a higher discount rate, but with the overall expansion in business activity still relatively sluggish and conditions in domestic financial markets somewhat unsettled, the members wanted to proceed with caution. In particular, a majority of the members did not feel that a higher discount rate was needed then to reinforce the firming actions initiated in late April and during May through open market operations. Accordingly, no action was taken on the pending requests for a higher discount rate.

By late June, with measured inflation rates slowing and concerns about the outlook for inflation and the dollar apparently subsiding, all of the requests for a higher discount rate had been withdrawn. During July, one Reserve Bank proposed a reduction of ½ percentage point in the rate against the background of weaknesses in the regional economy and uncertainties about the broader outlook for the national economy. The proposed reductions were disapproved by the Board at meetings in mid-July and late July. The Board concluded that prevailing economic and financial conditions did not warrant a lower discount rate.

In mid-August and again late in that month, the Board turned down requests by one Reserve Bank to increase the basic rate by ½ percentage point. After review the Board concluded that, while a higher rate might well become desirable in the near term, current economic and financial developments and the behavior of the monetary aggregates did not call for an immediate increase. Subsequently, in early September, the Board approved an increase of ½ percentage point in the basic rate, to 6 percent. A sharp rise in long-term interest rates, notably in the early days of September, along with increasing commodity prices and some indications of stronger economic growth had raised questions about the outlook for inflation. The dollar was also under renewed downward pressure in foreign exchange markets. In these circumstances the Board concluded that the increase would be desirable as a signal of the System's intent to deal effectively and in a timely way with potential inflationary pressures. In particular, the increase might be helpful as a means of moderating inflationary expectations and relieving pressures on the dollar in foreign exchange markets, with beneficial implications for domestic long-term interest rates and the sustainability of the expansion.

Following the sharp decline in stock prices in mid-October, one Reserve Bank requested a reduction of ½ percentage point in the basic rate while the other Reserve Banks indicated a preference for maintaining the existing rate. In its review of the proposal for a lower rate, the Board took account of the potentially adverse but quite uncertain effect that unsettled conditions in financial markets might have on the economic expansion. The lower stock prices were associated with sizable declines in market interest rates after mid-October, and on balance, despite some continuing volatility in equity and debt markets, financial conditions appeared to have little discernible influence on overall business activity during the closing weeks of the year. In the circumstances, with the dollar also remaining under downward pressure, the Board decided to take no action on the proposed rate reduction, which remained pending through the end of the year.

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Renewal of Temporary Seasonal Credit Program

On January 28, 1987, the Board approved the renewal for 1987 of its temporary, simplified seasonal credit program. This program was originally approved and implemented in 1985 as a means of making funds available at the discount window to agricultural banks experiencing unusually strong loan demands. The program was intended to complement the longstanding regular seasonal credit program and thereby to help ensure that small- and medium-size banks did not face liquidity constraints in accommodating their farm borrowers over the planting and production cycle. Under this temporary program, eligible banks could borrow from the Federal Reserve to fund one-half of their loan growth in excess of 2 percent over a base level; such borrowing could not exceed 5 percent of their deposits. The borrowings are available under either a fixed-rate or variable-rate option.

Extended Credit Program

On June 10, 1987, the Board, in the interest of simplification, approved a restructuring of the interest rates that are charged for credit advanced to depository institutions for an extended period for other than seasonal purposes. The structure then existing involved a mixture of fixed and flexible rates that depended on the amount of time the credit had been outstanding and the amount that was borrowed. The new, simplified structure uses the basic discount rate for the first 30 days of borrowing and a flexible rate for any period after 30 days. The flexible rate is to be somewhat above the rates on market sources of short-term funds to depository institutions but at least 50 basis points above the basic discount rate.

The new structure of rates took effect on July 30, 1987; over the balance of the year the flexible rate was adjusted biweekly and ranged from 7.15 percent to 8.50 percent.

Structure of Discount Rates

The basic discount rate noted in this report is the rate charged on loans to depository institutions for short-term adjustment credit.[3] The basic rate also applies to most seasonal credit, including the regular seasonal program; under that program, credit may be provided for periods longer than those permitted under adjustment credit to assist smaller institutions in meeting regular needs arising from certain seasonal movements in their deposits and loans. Credit is also provided at the basic discount rate under the variable-rate option of the temporary seasonal program and at a rate ½ percentage point above the basic rate under the fixed-rate option of the temporary seasonal program.

Another category of discount-window credit relates to loans made over extended periods to depository institutions that are under sustained liquidity pressure. Such extended credit may also be provided when exceptional circumstances or practices adversely affect a particular depository institution. As noted above, the interest rate on extended credit is set at the basic rate for the first 30 days of borrowing and becomes a higher, market-related rate thereafter.

As of December 31, 1987, the structure of discount rates was as follows: a basic rate of 6 percent for short-term adjustment credit and for credit under the regular seasonal program. A small

3. However, on exceptionally large adjustment-credit borrowings that arise from computer breakdowns or other operating problems, the rate charged will be the highest established for loans to depository institutions, unless the operating problem clearly is beyond the reasonable control of the borrowing institution.

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volume of loans was outstanding at the basic rate under the temporary seasonal program at year-end. That rate also applied to the first 30 days of borrowing on an extended basis. The flexible rate on extended credit of more than 30 days was 7.70 percent at the end of 1987. No borrowings were outstanding under the large-borrowings program 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 Federal Reserve Banks are required to establish rates on loans to depository institutions at least every 14 days and to submit such rates to the Board of Governors for review and determination. Since late July 1987, Reserve Bank actions on the discount rate have included requests initially to establish and then to renew the formula for calculating the flexible rate on extended credit. The Board votes listed below are those that involved changes in the basic discount rate, the renewal of the temporary seasonal credit program, and the simplification of the extended credit program. Votes involving the reestablishment of existing rates or the setting of market-related rates under the extended credit program are not shown. All of those votes were unanimous.

Votes on the Basic Discount Rate

July 13, 1987. The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on July 9 to reduce the basic discount rate from 5½ percent to 5 percent.

Votes for this action: Mr. Volcker, Ms. Seger, Messrs. Angell, Heller, and Kelley. Votes against this action: None. Absent and not voting: Mr. Johnson.[1]

July 27, 1987. The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on July 23 to reduce the basic discount rate to 5 percent.

Votes for this action: Messrs. Volcker and Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley. Votes against this action: None.[1]

August 17, 1987. The Board disapproved an action taken by the directors of the Federal Reserve Bank of Cleveland on August 13 to increase the basic discount rate to 6 percent.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, Messrs. Angell, Heller, and Kelley. Votes against this action: None.[1]

August 31, 1987. The Board disapproved an action taken by the directors of the Federal Reserve Bank of Cleveland on August 27 to increase the basic discount rate to 6 percent.

Votes for this action: Messrs. Greenspan, Johnson, Angell, and Kelley. Votes against this action: None. Absent and not voting: Ms. Seger and Mr. Heller.[1]

September 4, 1987. Effective September 4, 1987, the Board approved actions taken by the directors of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Atlanta, Chicago, and Kansas City to raise the basic discount rate from 5½ to 6 percent.

Votes for this action: Messrs. Greenspan, Johnson, Angell and Kelley. Votes against this action: None. Absent and not voting: Ms. Seger and Mr. Heller.[1]

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Bank of Richmond effective September 5; Minneapolis effective September 8; Boston, St. Louis, and San Francisco effective September 9; and Dallas effective September 11, 1987.

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Vote on Seasonal Credit Program

On January 28, 1987, the Board renewed the temporary, simplified seasonal credit program for 1987.

Votes for this action: Messrs. Volcker and Johnson, Ms. Seger, Messrs. Angell and Heller. Votes against this action: None. Absent and not voting: None.[2]

Vote on Extended Credit Program

On June 10, 1987, the Board approved a new, simplified structure of interest rates on borrowings on an extended basis, including use of the basic discount rate for the first 30 days on such borrowing and a flexible rate somewhat above market rates for borrowing beyond 30 days.

Votes for this action: Messrs. Volcker and Johnson, Ms. Seger, Messrs. Heller and Kelley. Votes against this action: None. Absent and not voting: Mr. Angell.[1]

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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.

The pages that follow contain entries relating to the policy actions at the meetings of the Federal Open Market Committee held during the calendar year 1987, 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 1987 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, the Committee 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 1987. 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, 1987

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:

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(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;

(b) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

(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 bases set forth in paragraph 1(a) under 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.

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Domestic Policy Directive

In Effect January 1, 1987[1]

The information reviewed at this meeting suggests that economic activity continues to grow at a moderate pace in the current quarter. Total nonfarm payroll employment grew appreciably further in October and November, and employment in manufacturing also rose after declining on balance in previous months. The civilian unemployment rate remained at 7.0 percent in November for the third consecutive month. Industrial production picked up considerably in November. Total retail sales rose moderately last month after changing little on balance over September and October. Housing starts have weakened and business capital spending generally appears to have remained sluggish. Preliminary data for the U.S. merchandise trade deficit in October suggest a moderate narrowing. Broad measures of prices have firmed somewhat in recent months due to developments in food and energy markets. Labor cost increases this year have remained moderate compared with other recent years.

Growth of M2 slowed substantially in November, while growth of M3 remained moderate. Expansion of these two aggregates for the year through November has been just below the upper end of their respective ranges established by the Committee for 1986. In November growth of M1 accelerated to a very rapid rate. Expansion in total domestic nonfinancial debt remains appreciably above the Committee's monitoring range for 1986. Short-term interest rates have risen somewhat since the November 5 meeting of the Committee, while long-term rates have declined on balance. In foreign exchange markets the trade-weighted value of the dollar against other G-10 currencies has declined moderately on balance since the November meeting.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 established in February for growth of 6 to 9 percent for both M2 and M3, measured from the fourth quarter of 1985 to the fourth quarter of 1986. With respect to M1, the Committee recognized that, based on the experience of recent years, the behavior of that aggregate is subject to substantial uncertainties in relation to economic activity and prices, depending among other things on the responsiveness of M1 growth to changes in interest rates. In light of these uncertainties and of the substantial decline in velocity in the first half of the year, the Committee decided that growth of M1 in excess of the previously established 3 to 8 percent range for 1986 would be acceptable. Acceptable growth of M1 over the remainder of the year would depend on the behavior of velocity, growth in the other monetary aggregates, developments in the economy and financial markets, and price pressures. Given its rapid growth in the early part of the year, the Committee recognized that the increase in total domestic nonfinancial debt in 1986 may exceed its monitoring range of 8 to 11 percent, but felt an increase in that range would provide an inappropriate benchmark for evaluating longer-term trends in that aggregate.

For 1987 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1986 to the fourth quarter of 1987, of 5½ to 8½ percent for M2 and M3. While a range of 3 to 8 percent for M1 in 1987 would appear appropriate in the light of most historical experience, the Committee recognized that the exceptional uncertainties surrounding the behavior of M1 velocity over the more recent period would require careful appraisal of the target range at the beginning of 1987. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1987.

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 over the period from November to March at an annual rate of about 7 percent. Growth in M1 will continue to be appraised in the light of the behavior of M2 and M3 and the other factors cited below. Slightly greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on the behavior of the aggregates, taking into account 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

1. Adopted by the Committee at its meeting on Dec. 15–16, 1986.

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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 4 to 8 percent.

Authorization for Foreign Currency Operations

In Effect January 1, 1987

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 $10.0 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:

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 non-market 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

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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 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive

In Effect January 1, 1987

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.

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Meeting Held on February 10–11, 1987

Domestic Policy Directive

The information reviewed at this meeting suggested on balance that economic activity was continuing to grow at a moderate pace. Nonfarm payroll employment expanded sharply in January, partly reflecting unusual seasonal developments. Industrial production rose considerably in December and over the fourth quarter as a whole. However, consumer spending in real terms changed little during the last quarter of 1986 and business capital spending generally appears to have remained sluggish. Activity in the housing sector picked up toward year-end. The deficit in the merchandise trade balance apparently increased slightly in the fourth quarter; however, net exports of goods and services, after adjusting for changes in prices, improved somewhat during the quarter. Basic trends in wage and price inflation still appear to have been moderate in recent months, although prices of oil and some other industrial commodities have turned up.

Total nonfarm payroll employment rose almost ½ million further in January, after picking up in the latter part of the year. Service-producing industries were responsible for much of this growth. Outside the service-producing sector, the construction industry accounted for the balance of job growth in January, reflecting favorable weather conditions during the survey reference week. Manufacturing employment was essentially unchanged in January, after some improvement in the fourth quarter. The civilian unemployment rate held at 6.7 percent.

The industrial sector of the economy expanded appreciably in the latter part of the year. The index of industrial production rose 0.5 percent in December and for the fourth quarter as a whole increased at an annual rate of 3¼ percent, the largest quarterly advance since late 1984. Recent gains were widespread, with particularly sharp increases in home goods and in defense and space equipment. Production of business equipment, however, remained lackluster. Capacity utilization in manufacturing, mining, and utilities rose 0.2 percentage point in December to 79.6 percent, but was still below its level at the end of 1985.

Consumer spending declined slightly in real terms in the fourth quarter as new car and truck sales slumped. Auto sales revived temporarily in December, when consumers took advantage of sales tax deductions that were to be eliminated after year-end, but fell dramatically in January. Consumer expenditures on items other than autos continued to rise somewhat at the end of 1986 but at a pace considerably slower than that experienced earlier in the year.

Business investment appears to have remained sluggish. On the equipment side, capital outlays were depressed in the fourth quarter by the drop in motor vehicle purchases. However, that drop was almost offset by a pickup in spending on other equipment, which was motivated in part by efforts to take advantage of the favorable depreciation schedules for some types of equipment placed in service before January 1, 1987. Leading indicators of investment spending suggested that overall outlays will remain sluggish in the early months of 1987. New orders for nondefense capital goods other than aircraft dropped in the last quarter of 1986. Also, outlays for nonresidential construction have continued to trend down in recent months, and the value of construction put-in-place in December was more than 10 percent below a year earlier.

Activity in the housing sector picked

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up at the end of the year. Housing starts rose to an annual rate of 1.8 million units in December, after drifting lower since late spring. Single-family starts were near the pace recorded earlier in the year. In addition, sales of both new and existing homes rose in December partly in response to lower mortgage interest rates. Multifamily starts rebounded in December, but declined for the fourth quarter as a whole as high vacancy rates and recent tax changes constrained construction of rental housing.

Price and wage increases remained relatively moderate in the latter part of 1986, although the prices of a number of commodities, including oil, have posted large gains in recent months. Consumer prices rose 0.3 percent in November and 0.2 percent in December, remaining within the range of monthly increases evident since last summer. World crude oil prices rose in mid-December following the latest agreement by the Organization of Petroleum Exporting Countries (OPEC) to restrict output, and that rise pushed retail energy prices up in December. At the same time, increases in consumer food prices slowed after several months of sharp advances. Consumer prices, apart from food and energy, continued to rise about in line with the pace registered for 1986 as a whole. Wage increases slowed in 1986 from the rates in other recent years.

The trade-weighted value of the dollar against other G-10 currencies declined about 7¾ percent, on balance, since the December 15–16 FOMC meeting. Since that meeting, the dollar has depreciated 10 percent against the mark and about 6 percent against the yen. Over the period, exchange rates were affected in part by data on the U.S. trade balance for November. However, the announcement by the German Federal Bank in late January of a cut in the discount rate and the improvement in U.S. trade figures shown when preliminary December data were released, along with indications of a stronger U.S. economy, tended to relieve downward pressures on the dollar, which had rebounded from its lows in late January. Indicators of economic activity in the major foreign industrial countries still showed low rates of expansion. Available data for the U.S. merchandise trade deficit in the fourth quarter suggested a slight increase from the third quarter as nonpetroleum imports increased more than exports. However, after allowing for price changes, net exports of goods and services improved somewhat during the quarter.

At its meeting in December, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. This action was expected to be consistent with growth in both M2 and M3 at an annual rate of about 7 percent from November to March. The Committee agreed that the growth in M1 would continue to be evaluated in light of the behavior of the broader monetary aggregates and other factors. The members also decided that slightly greater or somewhat lesser reserve restraint would be acceptable depending on the behavior of the monetary aggregates, taking into account the strength of the business expansion, developments in foreign ex-

1. These growth rates and all subsequent data on the monetary aggregates reflect annual benchmarks and seasonal factors as published on February 12, 1987.

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 de-

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change markets, progress against inflation, and conditions in domestic and international credit markets. The intermeeting range for federal funds was maintained at 4 to 8 percent.[1]

Growth of M2 and M3 accelerated in December before slowing a little in January. Expansion of these two aggregates for 1986 as a whole was near the upper end of their respective ranges established by the Committee for the year. M1 growth slowed in January from an exceptionally rapid pace in late 1986. Growth of the monetary aggregates was boosted by an unusually large volume of transactions around year-end prompted in part by incentives to complete certain types of transactions before the new tax law took effect at the start of 1987. As a result of these transactions, demand deposits rose at an unprecedented rate from mid-December through early January; by late January the bulge in such deposits had run off. In addition, banks stepped up their issuance of managed liabilities, especially CDs, over the past two months to help fund the rise in credit.

Paralleling the bulge in transaction balances around year-end, growth in total reserves surged in December, but then subsided during January. Excess reserves also increased rapidly in December. The federal funds rate rose sharply at year-end and adjustment plus seasonal borrowing averaged around $900 million in the statement period ending December 31. Borrowing receded to $290 million in the first half of January but bulged again in the second half, reflecting another rise in excess reserves. The federal funds rate dropped back to 6 percent or a little above after early January.

Most other short-term rates rose around year-end as credit demands intensified and the federal funds market tightened, but subsequently those increases were largely reversed. On balance, rates on short-term Treasury securities were up about 25 basis points over the intermeeting period, while rates on private obligations were narrowly mixed. In long-term markets, yields on Treasury securities also were higher than at the time of the December meeting, reflecting market reactions to incoming economic data, but rates in corporate and mortgage markets declined into more typical alignment with Treasury rates. Stock prices soared to new highs over the intermeeting period.

The staff projections presented at this meeting suggested that real gross national product would continue to grow at a moderate rate through the end of 1987. A key element shaping the forecast continued to be the prospects for an improvement in real net exports of goods and services. Export growth was expected to accelerate and import growth to slow as U.S. competitiveness increased. At the same time, the growth in domestic demand was expected to be moderate, primarily reflecting the damping influence of higher import prices on real income gains, a less expansive fiscal policy, and the weakness in nonresidential construction. In contrast, equipment spending was projected to grow moderately as domestic production expanded, and residential construction was expected to provide some stim-

posit 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.

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ulus to economic activity over the projection horizon. The rate of inflation was anticipated to rise somewhat as a result of the depreciation of the dollar and a firming in world oil prices. However, the remaining margins of slack in labor and product markets were expected to exert a moderating influence on prices and wages during the year.

In the Committee's discussion of the economic situation and outlook, most of the members viewed recent developments as pointing on balance toward continuing expansion at a moderate pace, in line with that experienced on average over the past two to three years. The members generally agreed that special factors—the delayed effects of the dollar's depreciation and the turnaround in oil prices—were likely to contribute to a modest upturn in the rate of inflation during 1987. The members acknowledged that there were appreciable risks that economic activity and prices might deviate significantly from current expectations, especially given the uncertainties stemming from persisting—though hopefully diminishing—imbalances in the federal budget and the balance of trade. Financial strains associated with weaknesses in important sectors of the economy such as agriculture and energy and generally rising debt burdens also were cited as sources of vulnerability in the economy.

In keeping with the usual practice at 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 the overall level of prices. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the forecasts for growth of real GNP had a central tendency of 2½ to 3 percent and a full range of 2 to 4 percent. Forecasts of nominal GNP centered on growth rates of 5¾ to 6½ percent and ranged from 4½ to 7½ percent. Estimates of the civilian rate of unemployment in the fourth quarter of 1987 were in a range of 6½ to 6¾ percent. With regard to the rate of inflation, as indexed by the GNP deflator, the projections centered on rates of 3 to 3½ percent and had an overall range of 2½ to 4 percent. In making these forecasts, the members took account of the Committee's objectives for monetary growth in 1987. The members also assumed that future fluctuations in the foreign exchange value of the dollar would not be of sufficient magnitude to have any significant effect on the projections. In addition, the members anticipated that considerable progress would be made in reducing the size of the federal budget deficit.

As they had at previous meetings, members emphasized that sustained economic expansion would depend to an important extent on the achievement of significant improvement in the nation's balance of trade. While indications of some improvement in net exports were multiplying, the members expressed a range of views regarding prospects for the year ahead. On the export side, several observed that the outlook for relatively sluggish economic activity in key industrial nations—and indeed around the world more generally—suggested that continuing gains in exports might be relatively limited. Nonetheless, reports from many parts of the country indicated that the depreciation of the dollar and the concomitant improvement in the competitive position of U.S. firms were being reflected in new exporting opportunities, if not in a substantial increase in actual exports to date.

With regard to imports, some members saw considerable potential for the substitution of domestic goods for

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foreign imports as prices of the latter rose. In this view the more recent depreciation of the dollar would tend to be felt more fully in import prices because foreign suppliers had less room than earlier to absorb a depreciated dollar through reductions in their profit margins. Other members were less optimistic about the outlook for imports. In their view, foreign competitors would tend to hold down their prices to maintain their sales, especially given the ample availability of production resources worldwide. Moreover, the import penetration into U.S. markets had become embedded in contractual and other trading arrangements that were difficult to change, and competitive gains against imports would be restrained to the extent that domestic producers responded to rising import prices by raising their own prices, as had already occurred in a major U.S. industry. However, as in the case of exports, a growing number of business contacts were reporting increasing opportunities to compete with imports on the basis of price, including examples of actual or prospective sales to domestic firms that previously had tended to look abroad to meet their outsourcing requirements.

With regard to domestic developments bearing on the outlook, several members commented that the evidence of the last few months suggested, on the whole, that the expansion retained momentum despite its comparative longevity. To some extent, the favorable year-end statistics undoubtedly reflected tax-related spending that had been moved up from 1987 into late 1986, and a number of members observed that the recent statistics should therefore be viewed with a degree of caution. Looking ahead, members observed that overall demands from domestic sectors might moderate over the year. They referred in particular to the possibility that growth in consumer spending, which had been a mainstay of the expansion, might provide less stimulus, especially in the context of an already low saving rate. One member noted that the underlying demand for new automobiles appeared to be relatively weak, after allowing for the year-end surge related to tax considerations and for the impact of temporary sales incentive programs. Another commented, however, that reduced withholdings of personal income taxes were seen by some business firms as a positive development for retail sales.

In the Committee's discussion of the prospects for inflation, the members generally agreed that the outlook remained basically favorable even though rising import prices and the apparent turnaround in oil prices could be expected to result in somewhat higher average prices over the next several quarters. Price competition remained intense in many industries, notably those subject to competition from abroad, and recent labor contract settlements continued favorable in terms of holding down business costs. Moreover, many business firms were still making vigorous efforts to improve their operating efficiencies and otherwise to curb costs. Nonetheless, several members suggested that the risks of a deviation, if any, from current inflation forecasts appeared to be in the direction of more inflation. Some referred to the risk that rapid monetary growth and buildup of liquidity might exert a delayed impact on future prices, though there was no current evidence of such an impact. One member expressed the view that a key uncertainty in the outlook for inflation was not so much the direct effects of rising import prices, but the price responses of competing domestic producers. Members also noted that for technical reasons the rise in import and

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oil prices, to the extent that they occurred, would have a relatively large effect on consumer prices. The latter, because of their high visibility, could exacerbate inflationary expectations, with adverse implications for future price and wage decisions. Disappointing progress toward reducing the federal budget deficit also could tend to fuel inflationary sentiment.

At this meeting the Committee completed the review, begun at the December meeting, of the ranges for growth in the monetary and debt aggregates in 1987; those ranges had been set on a tentative basis in July in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act).[2] The tentative ranges included growth of 5½ to 8½ percent for both M2 and M3 for the period from the fourth quarter of 1986 to the fourth quarter of 1987. In the case of M1 the Committee had indicated in July on a more tentative basis than usual that it might retain the 1986 range of 3 to 8 percent for 1987, but there had been considerable sentiment against using any numerical range for M1 at the December meeting. The associated range for growth in total domestic nonfinancial debt had been set provisionally in July at 8 to 11 percent for 1987.

During the Committee's discussion of appropriate ranges for growth of M2 and M3 in 1987, most of the members expressed a preference for retaining the tentative range of 5½ to 8½ percent for both of the broader aggregates. That range represented a reduction of ½ percentage point from the one that had been targeted for 1986. Several members stressed the importance of some moderation in money growth and the desirability of adopting reduced ranges from the standpoints of both the substance and the perception of an appropriately anti-inflationary monetary policy. Moreover, a substantial slowing in money growth—perhaps to around the middle of the ranges—could well be consistent with satisfactory economic performance, given the assessment of the economy by Committee members and assuming considerably less movement in interest rates than had been experienced in recent years. Members also commented that the ranges in question were likely to provide adequate room for any policy adjustments that might be needed during the year, assuming that developments bearing on policy formulation did not diverge greatly from current expectations.

While a range of 5½ to 8½ percent for M2 and M3 was acceptable to all of the members, there was some sentiment for slightly higher or lower ranges. Retention of the slightly higher 6 to 9 percent ranges employed in 1986 would accommodate more comfortably the possibility of another sizable decline in the velocities of the broader aggregates (that is, the ratios of nominal GNP to the aggregates). Such a decline might be induced if substantial further reductions in interest rates were needed to sustain economic expansion. On the other hand, slightly lower ranges would provide more leeway on the downside in the event that velocity growth rebounded from the previous marked declines. Insofar as the risks were on the side of greater inflation, a rebound in velocity appeared more likely and in such circumstances a lower range could provide needed scope for a policy designed to maintain progress toward price stability.

Turning to M1, the members recognized that its prospective behavior remained subject to exceptional uncertain-

2. The review for 1987 was prepared as a Monetary Policy Report pursuant to this legislation and transmitted to the Congress on February 19, 1987.

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ties. To a greater extent than for the broader aggregates, the demand for M1 balances had become highly sensitive to movements in interest rates over the course of recent years; this development evidently reflected in considerable measure the deregulation of deposit rate ceilings and a related increase in the interest-bearing components of M1 as a repository for savings as well as for transactions funds. Adaptations to deregulation were probably not completed and in conjunction with an accelerated pace of other financial innovations and a surging volume of financial transactions, it had become very difficult to assess or predict the implications of specific rates of M1 growth for the future course of business activity and the rate of inflation.

Accordingly, while most members clearly wished to take account of changes in M1 in reaching policy judgments, they felt the meaning of fluctuations in M1 could only be appraised in the light of other economic developments. Consequently, they did not want to specify a numerical target range for this aggregate, at least at this time. Some slowing in 1987 was expected and was felt to be necessary to sustain progress toward price stability, but the appropriate amount of slowing was difficult to predict, given the uncertainties about velocity behavior. These members felt that it would not be meaningful to establish a range that was so wide that it would cover all foreseeable circumstances or a conventional range that might well need to be exceeded in either direction. For example, relatively slow growth in M1 might be desirable—and might require some firming of reserve conditions—if in the context of expanding economic activity, inflation appeared to be worsening, possibly because of a weakening dollar, and the broader monetary aggregates were growing rapidly. Conversely, relatively rapid expansion in M1 might be indicated—and accommodated—in a situation in which economic activity was relatively sluggish, progress was being maintained toward achieving eventual price stability and a sustainable pattern of international transactions, and interest rates were declining.

A few of the members preferred that a specific, numerical range be established for M1 growth in 1987, although they also wanted to make clear that growth outside the range might be desirable or acceptable under some circumstances. These members gave considerable emphasis to the possible usefulness of targeting on a narrow monetary aggregate, as well as on the broader aggregates, in underscoring the System's longer-run commitment to an anti-inflationary policy. They also felt the Committee might well want to increase emphasis on M1 in the future, and that a current target would represent appropriate continuity. Moreover, a specific range would have the advantage of indicating the Committee's best judgment regarding appropriate M1 growth if economic and financial conditions did not deviate markedly from current expectations. In contrast, one member felt that M1 provided little or no useful information at present and a more predictable relationship between Ml and economic performance was not likely to be reestablished. Consequently, the Committee should concentrate instead on other broad financial aggregates including the measure for liquidity.

After discussion, the members agreed that the Committee would need to monitor and evaluate M1 developments closely in the light of the behavior of its velocity, the performance of the economy, including the nature of emerging price pressures, and conditions in domestic and international financial mar-

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kets. While the precise circumstances under which M1 developments might directly influence operating decisions could not be predicted, the members contemplated the possible desirability of reintroducing M1 explicitly during the year as a benchmark, along with the broader monetary aggregates, for making short-run operating decisions. For now, the Committee would indicate in broad terms that the operational significance of M1 could only be judged in the perspective of concurrent economic and financial developments, including the behavior of M2 and M3.

The Committee members also agreed on the desirability of continuing to monitor the growth of total domestic nonfinancial debt. The growth in total debt had exceeded the expansion in nominal GNP by substantial margins in recent years, and some members expressed concern about the resulting increase in the financial vulnerability of the economy. One member observed that under some circumstances a further rapid growth in debt might lend some weight toward implementing some policy restraint that also was deemed to be advisable for other reasons. The growth in total domestic nonfinancial debt was expected to moderate considerably in 1987, but it appeared likely to remain in excess of the expansion in nominal GNP. The members agreed that the tentative range of 8 to 11 percent contemplated last July for 1987 continued to encompass likely developments.

At the conclusion of the Committee's discussion, all of the members indicated that they favored, or could accept, the ranges for M2 and M3 and the monitoring range for total debt that had been adopted on a tentative basis in July. No numerical range would be established for M1 growth in 1987, but M1 developments would receive careful evaluation in the context of emerging economic and financial conditions and the behavior of the broader monetary aggregates. It was understood that under some circumstances M1 might again be targeted explicitly during the year to provide a guide, along with M2 and M3, for the short-run implementation of monetary policy.

Thereupon, the Committee approved the following paragraphs relating to its objectives for monetary and debt aggregates in 1987:

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee established growth ranges of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in the light of its sensitivity to a variety of influences, the Committee decided not to establish a precise target for its growth over the year as a whole at this time. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circum-

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stances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year, might target appropriate growth in M1 from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Melzer, Morris, and Ms. Seger. Votes against this action: None. Absent and not voting: Mrs. Horn. Mr Keehn voted as alternate for Mrs. Horn.

In the Committee's discussion of policy implementation for the weeks immediately ahead, most of the members indicated that they were in favor of directing open market operations, at least initially, toward maintaining the existing degree of pressure on reserve positions. One member preferred to move promptly toward somewhat firmer reserve conditions. A number of others observed that they would be prepared to accept some firming later if recent indications of some strengthening in economic activity were to persist in the context of further rapid monetary expansion and signs of growing inflationary pressures. However, these members felt that the desirability of an immediate move toward restraint had not been established. In particular, they felt that economic and financial developments in the period around the year-end needed to be interpreted with caution, especially because of the tax effects that were probably involved, and that confirming evidence should be awaited before any adjustments in policy implementation were undertaken.

The members anticipated that current conditions in reserve markets were likely to be associated with slower growth in M2 and M3 over the period ahead than the average pace in recent months. To a considerable extent, the anticipated slowing would represent a reversal of special factors that had contributed to faster expansion—including a bulge in M1—around the year-end. Because of the distortions created by year-end developments, the members generally agreed that use of a January base, instead of November as in the previous directive, or December, would convey more meaningful information regarding the Committee's expectations for growth of the broader aggregates through the remainder of the first quarter. Given the uncertainties that were involved and in keeping with the Committee's decision on the longer-run targets, the members accepted a proposal not to indicate a numerical expectation for the growth of M1 over the period immediately ahead, but to note in a general way that the expansion of this aggregate was likely to moderate substantially. Over a longer perspective, the growth of the aggregates, especially M1, might display a moderating trend as the effects of earlier declines in interest rates subsided.

With regard to possible adjustments during the intermeeting period, the members generally felt that policy implementation should be especially alert to the potential need for some firming of reserve conditions. In this view, somewhat greater reserve restraint would be warranted if monetary growth did not slow in line with current expectations and there were concurrent indications of intensifying inflationary pressures against the background of stronger economic data. One indicator of the possibility of potential pressures on prices might be a further tendency for the dollar to weaken. One member preferred a directive that did not contemplate any easing during the weeks ahead, but most of the members did not want to rule out the possibility of some slight easing dur-

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ing the intermeeting period, although they did not view the conditions for such a move as likely to emerge.

At the conclusion of the Committee's discussion, all but one member indicated that they could vote for a directive that called for no change in the current degree of pressure on reserve positions. The members expected this approach to policy implementation to be consistent with some reduction in the growth of M2 and M3 to annual rates of about 6 to 7 percent over the two-month period from January to March. Over the same interval, growth in M1 was expected to moderate substantially from an extraordinarily high rate in the closing months of 1986. The members indicated that somewhat greater reserve restraint would be acceptable, and slightly less reserve restraint might be acceptable, over the intermeeting period depending on the behavior of the monetary aggregates, taking into account 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. 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 4 to 8 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 on balance that economic activity continues to grow at a moderate pace. Total nonfarm payroll employment grew sharply in January in part reflecting unusual seasonal developments. The civilian unemployment rate remained at 6.7 percent in January. Industrial production increased considerably in December and over the fourth quarter as a whole. Total retail sales rose substantially in December, largely reflecting a year-end surge in automobile sales, but were little changed on balance in the fourth quarter. Housing starts also strengthened in December after trending lower since late spring. Business capital spending generally appears to have remained sluggish. Available data for the U.S. merchandise trade deficit in the fourth quarter suggest a slight increase from the third quarter; however, after allowing for price changes, net exports of goods and services improved somewhat during the quarter. In late 1986 consumer and producer prices generally were continuing to rise at moderate rates, although prices of crude oil and some other industrial commodities firmed. Labor cost increases were more restrained in 1986 than in other recent years.

Growth of M2 and M3 picked up substantially in December before slowing a little in January. For 1986 as a whole, expansion of these two aggregates was near the upper end of their respective ranges established by the Committee for the year. Growth of M1 slowed in January from an exceptionally rapid pace in late 1986. Expansion in total domestic nonfinancial debt remained appreciably above the Committee's monitoring range for 1986. Although short-term interest rates generally firmed around year-end, on balance interest rates have shown small mixed changes since the December 15–16 meeting of the Committee; rates on Treasury securities, including bonds, have risen a little over the period while rates on most private obligations have declined slightly. In foreign exchange markets the trade-weighted value of the dollar against the other G-10 currencies has declined substantially on balance since the December meeting.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee established growth ranges of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activ-

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ity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in the light of its sensitivity to a variety of influences, the Committee decided not to establish a precise target for its growth over the year as a whole at this time. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circumstances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year, might target appropriate growth in Ml from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

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 over the period from January through March at annual rates of about 6 to 7 percent. Growth in M1 is expected to slow substantially from the high rate of earlier months. Somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on the behavior of the aggregates, taking into account 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 4 to 8 percent.

Votes for the short-run operational paragraph: Messrs. Volcker, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Morris, and Ms. Seger. Vote against this action: Mr. Melzer. Absent and not voting: Mrs. Horn. Mr. Keehn voted as alternate for Mrs. Horn.

Mr. Melzer favored some tightening of reserve conditions. He noted the strong growth in bank loans in the November through January period and the firm federal funds rate that had prevailed despite the extraordinary pace of reserve growth. In addition, he cited the recent declines in the foreign exchange value of the dollar. Finally, looking ahead, he pointed out the potential for a further rise in inflationary expectations and, accordingly, he believed that prompt action toward restraint might avert the need for more substantial tightening later.

At a telephone conference on February 23, the Committee heard a report from the Chairman regarding the deliberations in Paris during the previous weekend of the Ministers of Finance and Central Bank Governors of several major industrial countries. The Committee members discussed the possible implications of the decisions reached in Paris for U.S. intervention in the foreign exchange markets.

Meeting Held on March 31, 1987

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity has risen at a faster pace so far this year than in the fourth quarter of 1986, while the rate of price increase has accelerated slightly. The expansion in output apparently has reflected a rebuilding of inventories and some improvement in the external sector. Important components of domestic final demands seem to have

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eased off in the early months of 1987 after a surge late in 1986. The pickup in inflation primarily has reflected a rebound in crude oil prices; wage pressures have remained subdued.

Data on employment and production suggested a sizable advance in output in early 1987. Total nonfarm payroll employment rose more than 300,000 per month over the first two months of the year, appreciably faster than in 1986; large gains were reported in construction, trade, and services. In addition, the average workweek has lengthened, and total hours worked by production and nonsupervisory personnel have risen sharply from the fourth quarter. The civilian unemployment rate was 6.7 percent in February for the third consecutive month as increases in the labor force matched the strong expansion in employment.

The index of industrial production rose 0.5 percent in February to a level about 1 percent above its fourth-quarter 1986 average. Increased production of motor vehicles accounted for most of the gain, but output of defense and space equipment, construction supplies, and nondurable materials also posted further appreciable increases. Reflecting the recent strengthening in the industrial sector, the capacity utilization rate increased 0.2 percentage point in February to 79.8 percent.

On the demand side, both consumption and business fixed investment have been relatively weak. Purchases of automobiles, after a sharp drop in January, have recovered somewhat over the past two months, but are still well below the fourth-quarter pace. Automakers have trimmed assembly schedules and have renewed sales incentive programs, but dealer inventories have been building up. Consumer spending on goods other than autos has advanced at a moderate rate. Business investment spending appears to have weakened in recent months. Shipments of nondefense capital goods fell on balance over the first two months of the year after the tax-related surge in equipment outlays late last year. New orders also have moved lower and outlays for nonresidential construction fell further in January, maintaining the downtrend that began early last year.

The large fluctuations in final sales that occurred around the turn of the year have been mirrored in changes in inventories. Stocks rose sharply in January, after being drawn down late last year. Notable swings in inventories occurred for autos and machinery, where tax incentives may have had a greater effect on the timing of purchases than on production. In addition, some stockbuilding was evident in manufacturing industries in which production has been relatively strong.

Activity in the housing sector remained vigorous in January and February, with starts averaging more than 1.8 million units at an annual rate in both months. The strength in starts appeared to reflect unusually good weather in the Midwest. Single-family starts have been particularly robust. Multifamily starts, by contrast, have remained weak because of high vacancy rates and a less favorable tax environment for construction of rental units.

Inflation picked up early this year, largely reflecting the pass-through of higher crude oil prices into prices of final energy products. The CPI rose 0.4 percent in February, after a 0.7 percent increase a month earlier. Prices of gasoline and fuel oil posted further sizable increases last month. Consumer food prices in February continued to rise at the pace that has prevailed since last September. Excluding food and energy, increases in consumer prices slowed a bit in February. Spot prices for industrial materials have essentially leveled off in

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recent weeks after rising late last year. Wage increases have remained moderate so far this year.

Economic activity in major foreign industrial countries remained generally weak in the fourth quarter of 1986 and early 1987, except in the United Kingdom. Debt-servicing problems beset several important developing countries but progress was made in the negotiations of a number of such countries with commercial banks.

The trade-weighted value of the dollar against other G-10 currencies changed little in the period following the February 10–11 meeting of the Committee until mid-March. The stability apparently was fostered to a considerable extent by the announcement that the major industrial countries at a meeting in Paris on February 22 had agreed to support the prevailing structure of exchange rates. Since mid-March, however, the dollar has come under strong downward pressure, particularly against the Japanese yen, apparently triggered in part by intensified trade frictions between the United States and Japan. An improved fiscal picture for the United Kingdom contributed to a sharp rise in sterling. As a result, the Bank of England cut its lending rates around mid-March; several other European countries also lowered official lending rates as their currencies strengthened against the German mark.

At its meeting in February, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. M2 and M3 were expected to grow at annual rates of about 6 to 7 percent from January through March, while growth in M1 was expected to slow substantially from the high rates of previous months. The members decided that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on the behavior of the aggregates, taking into account developments in the economy and in foreign exchange and domestic credit markets. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Growth of the monetary aggregates slowed sharply in February and March, and over the two months expansion in M2 and M3 was somewhat below the Committee's expectations. In March, these aggregates appeared to be around the lower bounds of the 5½ to 8½ percent ranges established by the Committee for the year. Some of the slower growth in the aggregates so far this year appears to be related to a reversal of the bulge in deposits and bank lending associated with the surge in transactions before year-end, but a more general moderation in the expansion of money balances also might be associated with completion of portfolio adjustments to earlier declines in interest rates. Total and nonborrowed reserves fell slightly over the past two months, as required reserves leveled off after the year-end bulge in transaction deposits, and excess reserves edged lower in line with their usual seasonal pattern. In the three complete reserve maintenance periods after the February FOMC meeting, adjustment plus seasonal borrowing averaged about $280 million. At the same time, the federal funds rate edged off from 6¼ percent to around 6 percent or a bit higher.

Other interest rates changed little over most of the intermeeting period before firming somewhat recently. Over the past few days concern about the dollar contributed to some pressure on rates, particularly in long-term markets in which Treasury bond yields have risen about 20 basis points. On balance, private short-term rates rose about 15 basis points over the intermeeting period, while Treasury bill rates were about unchanged to 20 basis points lower; the

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differential probably reflected heightened concerns about credit quality relating to debt-servicing problems of developing countries and a paydown of bills by the Treasury. Equity prices rose markedly over the period.

As at other recent meetings the staff projections suggested that real GNP would grow at a moderate rate through the end of 1987. The rise in net exports remained critical to sustaining growth. In response to the increased competitiveness of U.S. goods, growth in exports was expected to continue to boost demands on domestic production and growth of imports was anticipated to slow. Gross domestic purchases were expected to be sluggish, reflecting in part the effects of a less expansive fiscal policy and the influence of rising import prices on real income growth and consumption. Business equipment spending was projected to resume a moderate uptrend; however, construction of single-family homes was expected to edge down from the current pace, and activity in office building and multifamily housing could weaken substantially in response to overbuilding of such structures in many areas and the effects of the new tax law. Inflation was likely to pick up reflecting the effects of the recent rebound of crude oil prices as well as the projected acceleration of import prices. However, remaining margins of slack in product and labor markets were expected to limit overall inflationary pressures.

In their discussion of the economic situation and outlook, Committee members generally agreed that recent developments on the whole were consistent with continuing expansion at a moderate pace. Comments on business conditions in several parts of the country tended to support a somewhat brighter picture than had been reported at earlier meetings. Business confidence appeared to have improved in many areas, buoyed by greater success in meeting foreign competition. Overall, economic activity seemed to have picked up in early 1987, though the improvement was due importantly to a buildup of inventories. Domestic final demands were expected to grow at a relatively slow pace over the year, with business spending for equipment and nonresidential construction likely to be retarding influences. Consumer spending on automobiles was mentioned as another potentially weak area of the economy, and problems persisted in agriculture and energy. The members concluded as at previous meetings that the prospects for sustaining a moderate rate of expansion would depend to an important extent on the achievement of significant gains in net exports.

The members saw encouraging signs that the trade deficit was narrowing in real terms if not yet in current dollar terms. Business contacts in several parts of the country reported that the dollar's depreciation was fostering growing demand for their products in export markets, although that experience was not shared by businesses in all areas. On the import side, many domestic producers indicated an increased ability to compete with foreign goods. Nonetheless, the outlook for foreign trade remained subject to a great deal of uncertainty. Generally weak economic growth abroad was cited as a negative factor. Members acknowledged that the dollar's depreciation might help U.S. producers, but substantial further weakness in the dollar carried considerable risks. A large additional decline would tend to damp demands and economic growth abroad, especially in the absence of stimulative policy actions in other major industrial countries. It could lead to substantially greater inflationary pressures in the United States, with adverse impacts on

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credit markets. While a few members were of the view that the dollar sooner or later might need to decline somewhat further to correct the nation's trade imbalance—and such a decline should be accepted if it occurred—most expressed concern about the implications of continuing dollar depreciation under prevailing circumstances.

Members already were anticipating that the earlier depreciation of the dollar along with the rebound in energy prices would be reflected in a somewhat higher rate of inflation this year. Tending to support that view were indications in some parts of the country that prices of a number of products and services were rising somewhat more rapidly than earlier. Nevertheless, the still ample availability of production resources in most industries and continuing competition from abroad were viewed as likely to limit price increases, assuming the absence of a substantial further drop in the dollar. It also was noted that recent labor contract settlements were generally favorable in terms of their impact on business costs.

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 1986 to the fourth quarter of 1987 of 5½ to 8½ percent for both M2 and M3. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent. The Committee anticipated that growth in M1 would slow in 1987 from its very rapid pace in 1986 but the members decided not to establish a numerical target for the year; instead, the appropriateness of M1 changes would be evaluated during the year in the light of the behavior of M1 velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In their discussion at this meeting, Committee members agreed that domestic business and financial conditions and growth of the monetary aggregates did not call for any change in the current degree of pressure on reserve positions, at least at the start of the intermeeting period. With regard to the weeks ahead, a number of members noted that, while other developments in the economy and financial markets would need to be taken into account, continuing weakness in the dollar would suggest the possibility that some limited adjustment in policy implementation in a firming direction would be appropriate.

In the course of the Committee's discussion, a good deal of attention was devoted to the implications for policy of the currently strong downward pressure on the dollar in foreign exchange markets. Members agreed that the conduct of open market operations needed to be especially sensitive to any tendency for the dollar to weaken significantly further. Some commented that, within the framework of basically unchanged conditions of reserve availability, open market operations should be conducted with special caution to minimize unintended market impacts at times when the dollar was under particular downward pressure. Several also indicated that if pressures increased enough so that intervention in the foreign exchange markets was not effective in stabilizing the dollar, policy implementation might need to be adjusted to reduce reserve availability somewhat during the intermeeting period. In appraising the need for some firming, the Committee would be mindful of the adverse effects that a further slide in the dollar could have on domestic interest rates, on inflation expectations, and on the economy more generally over the longer run. The members also recognized that the problem was multilateral in nature and that the effectiveness of any policy steps in the United

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States would be greatly enhanced by complementary actions abroad.

There was some divergence of views regarding the circumstances under which any tendency for the dollar to fall appreciably further should be resisted through a reduced availability of reserves. Some members emphasized the desirability of relatively prompt, if limited, action to enhance the prospects for more stable exchange rates and also to reduce the need for stronger measures in the future. If successful, that approach would minimize the rise in domestic inflation and interest rates over time and perhaps facilitate a reversal of interest rates. One member noted that the success of such an approach in stabilizing the dollar might be realized more promptly and certainly if the markets were alerted to any firming action the Federal Reserve might undertake. Some other members preferred to move with relative caution, if at all, in countering any further weakening in the dollar. These members acknowledged that failure to arrest a considerable further decline in the dollar might result in substantial upward pressures on longer-term domestic interest rates, especially given current market anxieties. At the same time, they stressed the uncertainties surrounding the relationship between U.S. interest rates and the behavior of the dollar and also the negative impact that a firmer policy could have on a possibly fragile economic expansion, not only in the United States but around the world.

With regard to the monetary aggregates, the members generally viewed the recent slowdown in monetary growth as a welcome development in light of the previously rapid expansion over an extended period. In their assessment of the outlook for the months immediately ahead, the members took account of an analysis which suggested some acceleration in the growth of M2 and M3 to rates approximating the expansion in nominal income if interest rates remained around current levels. Most of the members felt that more restrained monetary growth would be acceptable, especially if it occurred against the background of further downward pressures on the dollar. While continued slow money growth that held the broad aggregates below the lower ends of their long-run ranges could be a basis for concern, some shortfall in the growth of M2 and M3 would not seem to call for a more generous provision of reserves in the period immediately ahead, given the earlier monetary expansion, continuing moderate growth of the economy, and weakness of the dollar in foreign exchange markets. On the other hand, the members would not welcome a resumption of relatively rapid growth under current conditions. Some members suggested that the Committee specify rates of acceptable growth of around 6 percent for M2 and M3 from March to June. Other members, reflecting the Committee's discussion that some shortfall in monetary growth would be of less concern than an overshoot under current circumstances, suggested various ranges of growth for the broader aggregates, with the ranges extending further below than above 6 percent. All the members were able to accept a specification of 6 percent or less on the understanding that the Committee would need to reconsider its stance should monetary growth be extremely weak, especially in the context of a more sluggish economy than was currently anticipated.

At the conclusion of the Committee's discussion, all of the members indicated that they favored or could accept a directive that called for no change in the degree of pressure on reserve positions in the immediate future. There was a consensus in favor of allowing for possible limited adjustments during the inter-

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meeting period toward some firming of reserve conditions, with excessive weakness in the dollar recognized as the potential development most likely to make such an adjustment appropriate. In particular, the members agreed that somewhat greater reserve restraint might be acceptable depending on the performance of the dollar in foreign exchange markets, but also taking into account the behavior of the monetary aggregates, the strength of the business expansion, progress against inflation, and conditions in credit markets. This approach to policy implementation was expected to be consistent with growth in M2 and M3 at annual rates of around 6 percent or less over the three-month period from March to June. Over the same period growth in M1 was expected to remain substantially below its pace in 1986. Because the behavior of M1 remained subject to unusual uncertainty, the Committee decided to continue its practice of not specifying a numerical expectation for its growth. 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 4 to 8 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 on balance that economic activity has been expanding at a faster pace than in the fourth quarter, with output apparently strengthened by a rebuilding of business inventories and some improvement in foreign trade. Total nonfarm payroll employment rose strongly again in February. The civilian unemployment rate remained at 6.7 percent for the third consecutive month. Industrial production also increased appreciably further in February. Total retail sales have continued to fluctuate substantially from month to month, largely reflecting the uneven pattern of automobile sales, but on balance overall consumer spending has been relatively flat over the past several months. Housing starts strengthened further in February after rising in December and January to their highest level since late spring. Business capital spending appears to have weakened in early 1987. Consumer and producer prices rose more rapidly in early 1987, primarily reflecting sizable increases in energy prices. Labor cost increases have remained relatively moderate in recent months.

Growth of M2 and M3 has slowed substantially from the pace in December and January, and for 1987 to date expansion of these two aggregates appears to have been around the lower ends of their respective ranges established by the Committee for the year. Growth of M1, after moderating in January from an exceptionally rapid pace in late 1986, also has slowed markedly further. Expansion in total domestic nonfinancial debt appears to have moderated appreciably since year-end. Interest rates generally have fluctuated in a relatively narrow range since the February 10–11 meeting of the Committee, although they have firmed somewhat recently. At a meeting in the latter part of February, the Finance Ministers and Central Bank Governors of major industrial countries agreed to cooperate closely to foster stability of exchange rates around then-current levels. However, after mid-March, the trade-weighted value of the dollar against the other G-10 currencies declined further on balance, including a sizable decline against the yen.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 its February meeting established growth ranges of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in

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the light of its sensitivity to a variety of influences, the Committee decided at the February meeting not to establish a precise target for its growth over the year as a whole. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circumstances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year, might target appropriate growth in M1 from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Somewhat greater reserve restraint might be acceptable depending on developments in foreign exchange markets, taking into account the behavior of the aggregates, the strength of the business expansion, progress against inflation, and conditions in credit markets. This approach is expected to be consistent with growth in M2 and M3 over the period from March through June at annual rates of around 6 percent or less. Growth in M1 is expected to remain substantially below its pace in 1986. 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 4 to 8 percent.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Ms. Seger, and Mr. Stern. Votes against this action: None.

2. Authorization for Domestic Open Market Operations

Effective April 22, 1987, the Committee approved a temporary increase of $3 billion, to $9 billion, in the limit between 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. Subsequently, effective May 6, 1987, the Committee approved a further increase of $2 billion, to $11 billion, in the intermeeting limit. These increases were effective for the remainder of the intermeeting period ending with the close of business on May 19, 1987.

Votes for the April 22 action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Ms. Seger, and Mr. Stern. Votes against this action: None.

Votes for the May 6 action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Stern.

The increases were approved on the recommendation of the Manager for Domestic Operations. The Manager had advised on April 22 that outright purchases of securities in the intermeeting interval through April 21 had reduced the leeway under the usual $6 billion limit to about $1¼ billion. On May 6, the Manager advised that the leeway had been reduced under the April 22 ceiling to a little over $100 million. Additional purchases of securities in excess of these leeways were necessary chiefly because of unusually steep increases in Treasury balances at the Federal Reserve Banks.

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Meeting Held on May 19, 1987

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity has been expanding at a moderate pace, despite some weakness in the industrial sector. However, the rate of inflation has risen in recent months, reflecting especially the impact of higher prices for energy and non-oil imports.

Labor demands grew at a brisk pace in April. The household survey indicated a sharp increase in employment and an unusually large decline in unemployment. As a result, the unemployment rate fell to 6.3 percent, 0.4 percentage point below its first-quarter average. Payroll employment rose considerably in April with gains concentrated again in trade and services. Manufacturing employment has changed little on balance so far this year, and the factory workweek dropped sharply in April, partly because of the observance of religious holidays during the survey week.

The industrial production index declined 0.4 percent in April following a smaller drop in March. Most of the decline in output in April was associated with cutbacks in motor vehicles, although small but widespread reductions were evident in other areas. Cutbacks in auto production and a pickup in sales slowed the growth in dealer stocks, but the level of stocks remained high. Outside of autos, trade inventories did not appear excessive, while inventory–sales ratios in manufacturing were near record lows.

As a result of the higher auto sales, real consumer spending appeared to be strong. Excluding autos and nonconsumer items, retail sales rose moderately in April. Housing starts were down somewhat from their first-quarter average. Total starts were at an annual rate of 1.7 million units in April. Single-family starts rose during the month, but multifamily starts fell sharply as high vacancy rates and the elimination of some tax advantages for investment in income properties continued to depress apartment construction.

Business fixed investment has shown signs of improvement from the depressed level early in the year. Shipments of nondefense capital goods rose and orders inched up in February and March. Outlays for construction of commercial and industrial structures have continued trending down in recent months. New commitments, however, have firmed recently.

Inflation rates have been higher so far this year. The CPI rose at a 6.2 percent annual rate between December and March, compared with a rate of 2.5 percent in the fourth quarter. Much of the first-quarter acceleration was caused by the rebound in energy prices, which now appear to have adjusted to the bulk of the year-end runup in the price of imported crude. Larger price increases also were posted for a number of consumer goods, probably reflecting the influence of higher import prices. At the producer level, too, large price increases were posted in a few industries that had been subject to strong import competition, such as chemicals and paper. Commodity prices began moving higher in the latter part of 1986 and have risen noticeably since the Committee's meeting on March 31. However, wage growth has continued at relatively moderate rates, with the index for average hourly earnings rising at about the same pace as in 1986.

In foreign exchange markets, the dollar was under heavy downward pressure over much of the intermeeting period, and intervention purchases were substantial. In the latter part of the period,

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the dollar was bolstered by slightly firmer monetary conditions in the United States and by easier conditions in Japan, Germany, and the United Kingdom. On balance, the dollar dropped 1 percent, with declines of about 4 percent against the yen and 3½ percent against sterling, the two strongest major currencies over this interval. Economic activity in most major foreign industrial nations continued to be relatively sluggish in the first quarter, except in the United Kingdom and Italy. In March, the merchandise trade deficit was close to the average for January and February and about the same as the fourth-quarter rate.

At its meeting in March, the Committee adopted a directive that called initially for maintaining the existing degree of pressure on reserve positions. The members decided that somewhat greater reserve restraint might be acceptable depending on developments in foreign exchange markets, taking into account the behavior of the monetary aggregates, the strength of the business expansion, progress against inflation, and conditions in domestic credit markets. M2 and M3 were expected to grow at annual rates of about 6 percent or less from March through June, while growth in M1 was expected to slow substantially from the pace in 1986. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

In light of downward pressures on the dollar, the provision of reserves was cautious at times during the intermeeting period, and open market operations were adjusted in a slightly less accommodative direction in late April. At the same time, uncertainty associated with transactions related to a huge volume of tax payments in mid-April complicated the management of reserves during the intermeeting period. Demands for reserves strengthened substantially, reflecting increases in required reserves associated with a steep rise in transactions balances near midmonth. In the second half of the month, as these payments cleared, Treasury balances at Federal Reserve Banks rose sharply and absorbed reserves, at times more rapidly than had been estimated. This decline in reserves was largely offset by a sizable volume of outright purchases of U.S. government securities, which necessitated two temporary increases in the intermeeting limit on changes in the System's portfolio, as well as by large temporary injections of reserves through repurchase agreements. Nevertheless, partly reflecting technical factors, borrowing at the discount window rose substantially, averaging around $800 million over the intermeeting period.

The federal funds rate firmed somewhat over the period. Most other interest rates also rose, with the largest increases occurring in long-term markets. The downward pressures on the dollar created uncertainty among market participants about private demands for dollar assets, the prospects for U.S. inflation, and the response of monetary policy. In addition, rising commodity and producer prices both reflected and added to concerns about the inflation outlook. Most bond yields increased slightly over a percentage point since the March meeting. Commitment rates for fixed-rate mortgages rose somewhat more, reflecting increased lender caution in a volatile rate environment. Short-term rates were up ¼ to 1 percentage point, including three ¼ percentage point increases in the prime rate.

Growth of all of the monetary aggregates picked up substantially in April. M1 was boosted by the tax-related surge in transactions balances. Partly reflecting these tax effects, growth in M2 also picked up, though remaining fairly moderate. Growth in M3 was boosted by the need to fund stronger expansion in bank

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credit. The growth of the broader aggregates was consistent with the Committee's expectations for the March to June period and left these aggregates in April just below the lower ends of their ranges established by the Committee for the year. Liquid deposits ran off at the end of April and in early May as the tax payments cleared, reversing much of the previous bulge in M1.

The staff projections continued to suggest that real GNP would grow at a moderate rate through the end of 1987. A primary contributor to the projected growth remained the foreign sector. The decline in the value of the dollar was expected to make American products more competitive, boosting exports despite the effects of relatively weak foreign economic growth and damping expansion in the volume of imports. The growth in domestic purchases was likely to be restrained by constraints on government spending, high vacancy rates in the office and rental housing markets, and increased mortgage rates. In addition, rising import prices were expected to moderate the growth of real personal incomes and thus consumer expenditures, especially in the light of an already low personal saving rate. However, business equipment spending was projected to resume a moderate uptrend partly in response to a growing export market. Inflation was expected to moderate after accelerating in the first quarter but to remain appreciably above the average pace in 1986. With output growing at a rate approximating that of potential GNP, the unemployment rate was expected to remain close to the lower level achieved recently.

In the Committee's discussion of current and prospective business conditions, the members gave attention to indications that inflationary expectations had worsened in recent weeks. Some commented that the somewhat faster rise of various price measures thus far in 1987 was not unexpected, given the depreciation of the dollar, the energy situation, and supply conditions for some agricultural products. To a considerable extent, those developments appeared to involve special factors that might normally be expected to result in one-time adjustments to the general level of prices. However, it also was noted that the rising prices, including the upturn in commodity prices in recent weeks, had become associated with an appreciable deterioration in inflationary attitudes, judging from conditions in financial markets and contacts with many business executives around the country. There were regional differences in inflationary expectations, to be sure, and some members observed that reactions in financial markets had probably been overdone. Nonetheless, most of the members believed that there was an increased risk of more inflation than they had expected earlier, particularly if inflationary attitudes became embedded in future wage settlements. On the other hand, some members pointed out that underlying pressures on resources could remain damped and inflation relatively subdued, given the outlook for less than robust economic growth in the United States and abroad and a worldwide oversupply of some commodities.

The prospective behavior of the dollar in foreign exchange markets was a key uncertainty bearing on the outlook for inflation and on that for overall business activity. Earlier declines in the exchange value of the dollar had resulted in higher import prices—an adjustment process that undoubtedly was still under way—and further dollar depreciation, if it occurred, would add to future inflation pressures. In this regard, members noted that some domestic producers were raising their prices as those of competing imports went up, thereby adding to the

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inflation impact of a lower dollar. In general, however, while the depreciation of the dollar had undoubtedly contributed to inflationary expectations, direct evidence of an inflation impact on domestic pricing was still fairly limited.

With respect to the course of domestic business activity, a number of members commented that developments in recent months were in line with earlier projections, and while there were both domestic and foreign risks to sustained expansion, further growth at a moderate pace remained a reasonable expectation. As at previous meetings, the members generally expected domestic demands to be relatively sluggish over the quarters ahead, and they felt that significant progress in reducing the nation's foreign trade deficit was needed to support the expansion. Some members expressed concern that the improvement in the trade balance would be limited over the quarters ahead. While further progress could be anticipated as exporters and importers continued to adjust to a lower value of the dollar, such progress might be restrained in particular by sluggish economic growth in foreign industrial nations. Nonetheless, the members generally expected continuing improvement in net exports and many felt that it would provide considerable impetus for domestic growth.

On the domestic side no sector of the economy was believed likely to contribute much strength to the expansion, and weaknesses persisted in a number of key sectors such as energy, agriculture, and nonresidential construction. Moreover, the recent rise in mortgage rates was likely to have some impact on housing demand. However, in their review of business developments in different parts of the country, several members reported on indications of some improvement recently in local conditions and others noted that difficulties in the agriculture and energy sectors were, at the least, no longer intensifying. Business sentiment also appeared to have improved in many parts of the country. More generally, while the members recognized the risks of a shortfall from current projections, especially given the persisting weaknesses and financial problems in some sectors of the economy, current developments on the whole appeared to be consistent with continuing moderate growth in overall business activity.

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 1986 to the fourth quarter of 1987 of 5½ to 8½ percent for both M2 and M3. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent. The Committee anticipated that growth in M1 would slow in 1987 from its very rapid pace in 1986, but the members decided not to establish a numerical target for the year; instead, the appropriateness of M1 changes would be evaluated during the year in the light of the behavior of M1 velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the Committee's discussion of policy implementation for the weeks immediately ahead, members noted that unsettled reserve conditions associated with tax payments and related flows of funds had produced a greater degree of pressure on reserve positions from time to time in recent weeks than had deliberately been sought, even after the slight firming move of late April. Market expectations about Federal Reserve policy intentions also seemed to contribute to higher short-term interest rates at times. All but one of the members indicated that they wished at least to maintain the generally firmer reserve conditions that

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had prevailed most recently, even though such conditions had not been fully anticipated in Desk operations, and a number felt that some slight further firming might be appropriate. The members generally agreed that some firming of reserve conditions had been desirable to counter the apparent intensification of inflationary expectations in recent weeks and to help stabilize the dollar in the foreign exchange markets. In another view any monetary restraint beyond what had been sought recently would not be desirable because additional tightening would incur an undue risk of stalling the economic expansion at a time when, in this view, underlying inflation pressures were likely to remain in check. Most members saw a lesser and relatively limited risk to the expansion under current economic conditions and one that needed to be accepted given the pressures on the dollar and the potential for inflation.

In the view of several Committee members, the desired reserve restraint might be more appropriately achieved by means of an immediate increase in the discount rate, providing a more overt means of reassuring financial markets with regard to the System's continuing commitment to an anti-inflationary policy; others felt a possible discount rate increase should, in effect, be held in reserve for use if a more visible signal became desirable. In any event, any decision with respect to the discount rate lay with the Board of Governors, and all but one of the Committee members agreed that, in the absence of a near-term rise in the discount rate, open market operations would be directed toward some increase in the degree of reserve pressure beyond that sought in recent weeks (but not necessarily greater than that prevailing recently). If the discount rate were increased shortly after the meeting, such firming through open market operations would not be necessary, at least in the early part of the intermeeting period.

With regard to factors that might trigger some adjustment in open market operations during the intermeeting period, the members generally agreed that both inflationary developments and the dollar should receive special emphasis. In particular, should inflation or inflationary expectations seem to be intensifying or the dollar come under renewed downward pressure, the Committee would be ready to see some prompt further firming of reserve conditions. At the same time, the members did not rule out the possibility of some easing during the period ahead, but they viewed the potential need for a correction in that direction as less likely. In keeping with the Committee's usual approach toward policy implementation, any decision to alter reserve objectives during the intermeeting period should take account of the behavior of the monetary aggregates and the overall performance of the economy.

In their consideration of the near-term outlook for growth of the monetary aggregates, the members took note of an analysis, which suggested that the broader aggregates would expand at moderate rates over the balance of the second quarter. The outsized tax payments of mid-April had continued to affect the broad aggregates as well as M1 through early May. Beyond that, M2 was likely to grow a little more slowly than income, given the slight restraining effects of the recent rise in interest rates that would be felt in coming months. M3 expansion was less likely to be affected by interest rate movements, at least in the near term, and was expected to be sustained by issuance of managed liabilities to support credit growth at depository institutions. On a cumulative basis through June, growth in M2 would remain somewhat below the lower bound

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of the growth "cone" representing the Committee's 5½ to 8½ percent range for the year, though within the parallel lines associated with the end points of that range; growth in M3 would be very near the lower bound of its growth cone and well within its parallel band. Under prevailing circumstances, Committee members indicated that they were willing to accept relatively limited growth in the broader aggregates, at least for now, but a few observed that such growth signaled the need for caution. Growth in M1 also was believed likely to moderate greatly on average in May and June, after its surge in April. However, because of the persisting uncertainties about the behavior of M1, most of the members indicated a continuing preference for not specifying a numerical growth expectation for this aggregate in the Committee's policy directive.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept a directive that called for some increase in the degree of reserve pressure beyond that sought in recent weeks, taking account of the possibility that such firming might be accomplished through an increase in the discount rate. Subsequent to some initial firming in reserve conditions through a reduced availability of reserves or through an increase in the discount rate, the members indicated that somewhat greater reserve restraint would be acceptable, and somewhat lesser reserve restraint might be acceptable, over the intermeeting period depending on developments relating to inflation and the performance of the dollar in foreign exchange markets, while also giving consideration to the behavior of the monetary aggregates and the strength of the business expansion. This approach to policy implementation was expected to be consistent with growth in M2 and M3 at annual rates of around 6 percent or less for the three-month period from March to June. Over the same period growth in M1 was expected to remain well below its pace in 1986; the members would continue to evaluate this aggregate in the light of the performance of the broader monetary aggregates and other factors. 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 4 to 8 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 on balance that economic activity is expanding at a moderate pace in the current quarter. Total nonfarm payroll employment rose considerably further in April, with most of the gains continuing to be in the service-producing sectors. The civilian unemployment rate fell to 6.3 percent from 6.6 percent in March. In April, industrial production declined after increasing at a moderate rate in the first quarter. Total retail sales changed little but were up somewhat from their average level in the first quarter. Housing starts were down somewhat in April from their first-quarter average. Recent indicators of business capital spending point to some recovery over the near term from a depressed level in the first quarter. Consumer and producer prices have risen more rapidly this year, primarily reflecting sizable increases in prices of energy and non-oil imports. Labor cost increases have remained relatively moderate in recent months.

Growth of M2 and M3 strengthened in April from a sluggish pace in February and March, but for 1987 to date expansion of these two aggregates has been slightly below the lower ends of their respective ranges established by the Committee for the year. M1 surged in April prompted by exceptionally large tax payments. Expansion in total domestic nonfinancial debt has moderated somewhat thus far this year. Most interest rates have risen considerably since the March 31 meeting of the Committee, with the

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largest increases occurring in longer-term markets.

In foreign exchange markets, the dollar was under heavy downward pressure over most of the intermeeting period and intervention purchases of dollars were substantial. Recently the dollar has tended to stabilize, but on balance its trade-weighted value against the other G-10 currencies declined over the period. In March the merchandise trade deficit was close to the average for January and February.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 its February meeting established growth ranges of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in the light of its sensitivity to a variety of influences, the Committee decided at the February meeting not to establish a precise target for its growth over the year as a whole. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circumstances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year might target appropriate growth in M1 from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

In the implementation of policy for the immediate future, the Committee seeks to increase somewhat the degree of reserve pressure sought in recent weeks, taking into account the possibility of a change in the discount rate. Somewhat greater reserve restraint would, or somewhat lesser reserve restraint might, be acceptable depending on indications of inflationary pressures and on developments in foreign exchange markets, as well as the behavior of the aggregates and the strength of the business expansion. This approach is expected to be consistent with growth in M2 and M3 over the period from March through June at annual rates of around 6 percent or less. Growth in M1 is expected to remain well below its pace during 1986. 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 4 to 8 percent.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, and Stern. Vote against this action: Ms. Seger.

Ms. Seger dissented because she did not want to lean on the side of any tightening of reserve conditions beyond the firming that had occurred since the March meeting. She was concerned that the degree of reserve pressure prevailing recently, which was somewhat greater than intended, represented a risk to an already weak economic expansion. She noted that the negative effects of recent increases in interest rates had not yet been felt in the economy. She also referred to recent indications of moderating growth in the monetary aggregates, and she did not expect inflationary pressures to persist in the context of excess production capacity and commodity surpluses worldwide.

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Meeting Held on July 7, 1987

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity expanded at a moderate pace in the second quarter, as consumer expenditures grew at a relatively modest pace, business capital spending experienced some recovery, and the trade deficit apparently continued to narrow in volume terms. Producer and consumer prices slowed in May, after sizable increases earlier in the year that reflected, to a considerable extent, higher energy prices. Rising import prices also contributed to higher consumer prices. Wage increases have remained relatively limited in recent months.

Payroll employment rose modestly further in May and June, following substantial increases in the first four months of the year, with the gains again concentrated in the service-producing sector. Employment advances in the goods-producing sector were lackluster as manufacturing employment rose minimally. In June, the household survey indicated a small drop in employment, but the labor force fell noticeably. As a result, the unemployment rate fell 0.2 percentage point to 6.1 percent; most of the drop in employment was attributed to fewer young people than normal entering the labor force as of the early June survey week.

The index of industrial production rose 0.5 percent in May; and following upward revisions to the three preceding months, the index was 2½ percent (annual rate) above the first-quarter average. The recent growth reflects in part the increased production of business equipment, especially high-technology capital goods, and of a wide variety of consumer goods. In the motor vehicles sector, however, auto assemblies have slowed in recent months due to relatively depressed sales and large dealer stocks.

Partly because of the lagging auto sales, consumer spending in real terms has been sluggish in recent months, though above its first-quarter pace. Outlays for services have continued to advance steadily, but total auto sales dropped back noticeably in May to the slow pace experienced in the first quarter. Excluding autos, outlays for durables have been flat on balance since the end of 1986, while spending on nondurable goods has edged down.

Housing activity has dropped back from its elevated pace early this year. Total starts fell to an annual rate of 1.62 million units in May. Single-family starts were down appreciably, apparently reflecting the upturn in mortgage interest rates after March. Multifamily starts increased somewhat from an extremely low level in April but remained below the first-quarter average.

Business fixed investment has rebounded after a tax-related decline at the beginning of the year. Shipments of nondefense capital goods were about flat in April and May but on average were above the first-quarter level. Outlays for nonresidential structures turned up in May, with the gains fairly widespread; and petroleum-drilling activity has continued to recover. In addition, new orders for nondefense capital goods, excluding aircraft, picked up in the spring and new commitments for nonresidential construction have moved up slightly.

Inventory investment apparently slowed in the second quarter from its rapid first-quarter pace. Production cutbacks trimmed auto inventories, but the level of dealer stocks still was relatively high. Outside of autos, inventory changes have been relatively small in recent months and inventory-sales ratios have remained low.

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The U.S. merchandise trade deficit in nominal terms was about unchanged in the first quarter from its value in the final quarter of 1986. Preliminary data suggest that the deficit declined in April as exports rose and imports fell from their first-quarter rate. Economic activity has remained sluggish in most major foreign industrial nations so far this year. Real GNP and industrial production declined sharply in Germany in the first quarter, although industrial production picked up in April and May. Japan has shown the reverse pattern with declines in industrial production registered in both April and May.

Inflation rates slowed in May. The consumer price index (CPI) rose 0.3 percent, after more rapid increases earlier this year. Increases in retail energy prices, which had boosted prices during the first quarter, were smaller in April and May and accounted for much of the slower rise in consumer prices. However, the price of crude oil has advanced further since mid-April, which suggests upward pressure on retail energy prices in the period ahead. Excluding food and energy, the CPI has risen about 1 percentage point faster so far this year than in 1986 partly because of more rapid increases in consumer goods that have high import proportions. Wage inflation, in contrast, has remained relatively low for the year to date.

At its meeting on May 19, the Committee adopted a directive that called for increasing somewhat the degree of reserve pressure from that sought in the weeks just before the meeting, taking into account the possibility of a change in the discount rate. The members agreed that somewhat greater reserve restraint would, or somewhat lesser reserve restraint might, be acceptable depending on developments relating to inflation and the dollar in foreign exchange markets, as well as the behavior of the monetary aggregates and the strength of the business expansion. M2 and M3 were expected to grow at annual rates of around 6 percent or less from March through June, while growth in M1 was expected to be well below its pace in 1986. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Adjustment plus seasonal borrowing at the discount window averaged $580 million for the three complete maintenance periods since the May meeting, close to its average level around the time of that meeting. Borrowing during the first full maintenance period after the May meeting was heavy, particularly over the long Memorial Day weekend when an imminent increase in the discount rate was expected by market participants. Total reserves decreased at an annual rate of about 2 percent between April and June, reflecting a falloff in required reserves associated with a net contraction in M1.

M2 grew only a little on balance in May and June, bringing its growth rate for the March to June period to 2¾ percent, and its M1 component declined over the two months. While some of the weakness in May reflected the unwinding of the previous tax-related buildup, more generally these aggregates appear to have been substantially affected by the increase in market interest rates among other factors this year. Expansion in M3 was better maintained as banks and thrift institutions continued to fund a moderate pace of credit extension, and for the March to June period this aggregate increased at an annual rate of 5½ percent. The growth of M2 in 1987 through June left this aggregate below the lower end of the growth "cone" representing the Committee's 5½ to 8½ percent range for the year, and growth of M3 around the lower end of its 5½ to 8½ percent growth cone.

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Early in the intermeeting period interest rates remained near the higher levels reached in the weeks before the May meeting, as markets continued to reflect concerns about the course of inflation and the dollar. However, rates subsequently declined in response to a sharp drop in some commodity prices, a firmer dollar, and an abatement of inflation fears. The federal funds rate continued to average around 6¾ percent during the intermeeting period, but other short-term interest rates were down 10 to 55 basis points on balance. Longer-term Treasury yields were about 60 basis points lower and corporate bond rates declined about half that much. The commitment rate for fixed-rate mortgages fell slightly since the May FOMC meeting, but still was well above the low established earlier in the year. Stock price indexes increased strongly over most of the period to record levels.

The dollar strengthened somewhat during the intermeeting period, boosted in part by the announcement of an economic stimulus package in Japan as well as better than expected economic and price news for the United States. On balance, the weighted-average foreign exchange value of the dollar against other G-10 currencies moved up by about 3¾ percent since the May meeting, including increases of nearly 7¾ percent against the yen and 3¾ percent against the mark. Over the same period, bond rates rose substantially in Germany and Japan, and with U.S. long-term rates declining somewhat, the rate differentials narrowed.

The staff projections suggested that real GNP would grow at a moderate rate through the end of 1987 and perhaps slow slightly from this pace in 1988. Improvement in the external sector was expected to be a major factor contributing to growth in overall output. Growth in domestic demand was anticipated to be sluggish over the forecast horizon. In particular, the rise in import prices associated with the fall in the dollar was expected to hold down real income gains and thus consumer expenditures. Construction spending was anticipated to be damped by high vacancy rates for office structures and rental housing and recent increases in mortgage rates, while the expansion of government expenditures would likely be held down by budgetary limitations. Business equipment spending, however, should rise moderately in coming quarters, reflecting continued modernization efforts and expanding domestic production. Inflation rates were forecast to edge down over the second half of this year but then to move up again in 1988, primarily due to increases in nonpetroleum import prices. Moreover, with the civilian unemployment rate projected to remain close to 6¼ percent, labor market slack would have a reduced influence in damping inflationary pressures.

In the Committee's discussion of the economic situation and outlook, the members generally agreed that business activity was likely to expand at a moderate pace over the balance of the year. Greater uncertainty surrounded the outlook for 1988, but most of the members felt that further moderate growth also was a reasonable expectation for next year. In general, the members anticipated relatively sluggish expansion in domestic demands over the projection horizon, and as at earlier meetings they believed that sustained growth in overall activity would depend to an important extent on the achievement of significant improvement in the nation's balance of trade. Most of the members anticipated a marginally higher rate of price increase in 1988.

In keeping with the usual practice at meetings when the Committee considers its long-run objectives for monetary

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growth, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members presented specific projections of economic growth, the rate of unemployment, and changes in the overall price level. With regard to the rate of expansion in real GNP, the projections had a central tendency of 2½ to 3 percent for 1987 as a whole and the same central tendency for 1988, though with a slightly wider range of individual forecasts for next year. Projections of growth in nominal GNP centered on ranges of 6¼ to 7 percent for 1987 and 5¾ to 7 percent for 1988. The rate of unemployment was not expected to deviate significantly from current levels; the central tendency of the forecasts was 6.2 to 6.4 percent for the fourth quarter of 1987 and 6.0 to 6.5 percent for the fourth quarter of 1988. With respect to the rate of inflation, as indexed by the GNP deflator, the projections centered on rates of 3¾ percent for 1987 and 4 percent for 1988. In making these forecasts, the members took account of the Committee's objectives for monetary growth established at this meeting. The members also assumed that fluctuations in the exchange value of the dollar would not be of sufficient magnitude to affect the projections significantly.

While the central tendency of the members' forecasts suggested some moderation in the rate of expansion from the pace currently indicated for the first half of this year, business activity was thought likely to be better balanced in that a number of previously depressed industries, notably in manufacturing, would benefit from further growth in net exports. Some members commented that relatively moderate expansion in line with that forecast by most of the members would represent a satisfactory economic performance under foreseeable circumstances. In this view appreciably faster growth would incur a considerable risk of increased inflationary pressures and the resulting distortions would threaten the sustainability of the expansion itself. Relatively rapid growth in domestic demands, in particular, would be inconsistent with needed external adjustment.

In the Committee's discussion of various factors bearing on the business outlook, some members commented that the growth in consumer demands seemed likely to be reasonably well maintained, especially in the services area, based on current trends and on prior cyclical experience. Others gave more weight to recent indications of softness in overall consumer spending and, in the context of increased consumer debt burdens and a relatively low saving rate, they saw relatively weak growth as a more likely prospect for the next several quarters. The members generally expected further improvement in net exports as both importers and exporters continued to adjust to a lower value of the dollar, but the extent of such improvement remained subject to considerable uncertainty. The possibility of relatively limited economic expansion in key foreign industrial countries was again cited as a negative factor. With regard to the federal budget deficit, the members emphasized that further reductions were essential to assure satisfactory economic performance over time. The outlook for continuing progress in lowering the deficit was uncertain, but any reduction in the deficit would tend to relieve pressures on financial markets, particularly in the context of diminished inflows of funds from abroad as the balance of trade improved, and would enhance the ability of the domestic economy to fund needed private capital formation.

The members differed to some extent in their assessments of the outlook for

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inflation, although most expected higher import prices to contribute to slightly greater price pressures in the period through 1988. In one view, there was a considerable risk that rising import prices would have a sizable impact on domestic pricing decisions as well. That risk might be augmented by efforts to raise wages in line with increasing inflation, particularly with reduced levels of unemployment and possible pressures on capacity in some industries experiencing strong export demand. Other members commented, however, that most industries were still operating appreciably below capacity, including in many cases industries that had been depressed earlier by the effects of the dollar's appreciation; some members also noted that most commodities remained in ample supply on world markets. A key factor tending to limit inflationary pressures was the continuing moderation in overall wage increases, but the members recognized that a substantial upturn, if it were to occur, would deal a major setback to the effort to restore price stability. The members also observed that potential developments in world oil prices were a major uncertainty in the inflation outlook.

At this meeting the Committee reviewed its ranges for growth of monetary and debt aggregates in 1987 and established tentative ranges for 1988 within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act).[1] At its meeting on February 10–11, 1987, the Committee had adopted growth ranges of 5½ to 8½ percent for both M2 and M3 for the period from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent. The Committee had anticipated that growth in M1 would slow in 1987 from its very rapid pace in 1986, but the members had decided not to establish a numerical target for the year; instead, the appropriateness of M1 changes would be evaluated during the year in the light of the behavior of M1 velocity, developments in the economy and financial markets, and potential inflationary pressures.

In the course of the Committee's review of the ranges for 1987, most of the members indicated a preference for not changing the existing ranges set in February, but some sentiment also was expressed in favor of a slightly lower range for M2. The members took account of the sharp deceleration in the growth of the broader aggregates thus far in 1987, especially in M2. However, with the advance in business activity evidencing reasonable momentum and velocity showing signs of increasing in the context of rising interest rates associated with a pickup in inflation and a weaker dollar, the members viewed such a development as acceptable.

According to a staff analysis prepared for this meeting, the relatively weak growth in the monetary aggregates in the first half of the year appeared to reflect a number of developments whose impact might be greatly diminished over coming quarters. To some extent, special factors related to the tax reform legislation may have helped to depress the growth in M2, while growth in M3 also was restrained by some unusual patterns in funding asset expansion at depository institutions. However, the available evidence suggested that a substantial portion of the slowing in monetary growth could be attributed to relatively slow adjustments in deposit interest rates to

1. The midyear Monetary Policy Report prepared pursuant to this legislation was transmitted to the Congress on July 21, 1987.

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rising market rates. Opportunity costs of holding money balances had increased over the spring after an extended period of declines. By the time of the meeting, rates on many components of the broad aggregates had adjusted to the higher market rates and the impact of wider opportunity costs on overall M2 and M3 growth appeared to be abating. The analysis concluded that growth in M2 could be expected to pick up over the balance of the year to a rate closer to the expansion in nominal GNP, assuming steady reserve conditions and market interest rates near current levels, and for the year as a whole M2 might expand at a rate around the lower end of the Committee's existing range. Growth in M3 also might strengthen somewhat over the balance of the year, leaving this aggregate well within its range.

In further discussion a number of members took the view that the existing M2 range should not be "fine tuned" at this time despite the outlook for actual growth near the bottom of the range for 1987 as a whole. The members recognized that in light of the weakness during the first half of the year and the uncertainties that were involved, growth in this aggregate might in fact be somewhat below the lower end of the range for 1987. The latter development, if it occurred, would be acceptable provided it was associated with some strengthening in M2 velocity and satisfactory economic performance; in particular, a very limited pickup in M2 growth might be appropriate should the dollar tend to weaken or inflation concerns intensify. A number of members expressed concern that a reduction in the M2 range at this point might be misread as an indication of intended firming in monetary policy. On the other hand, several members observed that they would not endorse an easier policy posture solely for the purpose of assuring M2 growth within the Committee's existing range without regard for ongoing economic and financial developments, including the behavior of the dollar in foreign exchange markets.

The members anticipated that growth in the debt of nonfinancial sectors would remain well within its monitoring range for the year, reflecting a marked reduction from the expansion in other recent years. The reduced rate of expansion was in large measure the consequence of a lower federal deficit and some slowing in state and local government borrowing. However, with growth in private debt remaining relatively strong and that in federal debt still on the high side, expansion in total nonfinancial debt appeared likely to continue to exceed that in nominal GNP and average close to its pace of recent months over the balance of the year.

Turning to M1, the members considered whether or not a specific numerical range should be reestablished for its growth over the balance of this year or tentatively for 1988. The sharp slowing of M1 growth thus far in 1987 following a long period of rapid expansion, while appropriate in the circumstances of the first half of the year, provided further evidence that this aggregate had become highly sensitive to movements in interest rates and other factors. The members concluded that the prospective behavior of M1 remained subject to exceptional uncertainties, and no member favored establishing a specific target range at this time. However, the behavior of this aggregate, evaluated in the light of other economic and financial developments, would be taken into account in implementing policy over the second half of the year. The Committee also discussed M1A—a narrower measure of aggregate transactions accounts that includes demand deposits plus currency in circulation but excludes other checkable deposits from M1. The members noted that the characteristics of this aggregate probably also had changed in recent

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years as households shifted transactions deposits from demand to NOW accounts and more businesses adopted sophisticated techniques for managing their cash balances. The velocity of this aggregate had varied less than that of M1, but given the uncertainties in its relationship to the economy and prices, the members saw no advantage at this time in introducing M1A as a formal guide to policy.

At the conclusion of the Committee's review, all of the members indicated that they favored, or could accept, a proposal not to change the ranges for growth in the broader aggregates or the monitoring range for nonfinancial debt that had been established in February for the year 1987. Growth in both M2 and M3 around the lower ends of their ranges might be acceptable depending on developments relating to their velocities and attendant economic and financial conditions, notably the strength of inflationary pressures. No numerical range would be established for M1 growth in 1987, or tentatively for 1988, but M1 developments, weighed in the context of emerging economic and financial conditions, would be taken into account in reaching operational decisions over the balance of 1987, and the desirability of a numerical range for 1988 would be reassessed early next year in the light of circumstances at that time.

Thereupon, the Committee approved the following paragraphs relating to its objectives for the broader aggregates and nonfinancial debt in 1987 and the role of M1:

The Committee agreed at this meeting to reaffirm the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range has been set for 1988. The appropriateness of changes in M1 this year will continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

With regard to the tentative ranges for 1988, all but one member of the Committee felt that some reduction in the broader aggregates from their 1987 ranges would be consistent with the Committee's longer-run objective of fostering progress toward price stability while also encouraging sustained expansion in business activity. A majority indicated a preference for reducing the M2 range by ½ percentage point. Of these, a number commented that, should economic and financial conditions warrant, they would be prepared to support a

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further reduction of ½ percentage point when the tentative ranges were reviewed in February 1988. Some sentiment was expressed for lowering the M2 range by a full percentage point at this time on the ground that such a reduction appeared fully consistent with satisfactory economic growth and with the reduced rate of inflation that was anticipated and desired over the longer run; in this view a smaller reduction might not appear sufficiently decisive with respect to restraining inflation. However, one member expressed concern that a reduction of more than ½ percentage point would establish a lower limit that might not be consistent with adequate economic growth, at least insofar as could be foreseen at this time. In light of the uncertainties that were involved some members also indicated that they could support a proposal to widen the tentative range for M2 in the expectation that it might be narrowed later. Others objected to a wider range on the ground that, because of the Committee's focus on the broader aggregates, such a range might be viewed as weakening the importance of the Committee's monetary targets.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could accept a reduction of ½ percentage point in the tentative ranges for M2 and M3 and in the monitoring range for nonfinancial debt in 1988. It was understood that all these ranges were provisional and that they, along with the possibility of establishing a numerical range for M1, would be reviewed in early 1988 in the light of intervening developments.

The following paragraph relating to the ranges for 1988 was approved for inclusion in the domestic policy directive:

> For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7½ to 10½ percent.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, and Stern. Vote against this action: Ms. Seger.

Ms. Seger dissented because she did not want to reduce at this time the tentative M2 and M3 ranges for 1988 below those established for this year. In her view the performance of key sectors of the domestic economy implied a relatively weak business expansion, and she did not anticipate enough offsetting support from gains in foreign trade. In the circumstances, inflationary pressures seemed likely to remain subdued, and she concluded that a policy consistent with monetary growth within this year's ranges would probably be needed to sustain the expansion in 1988. She recognized that the economic outlook was surrounded by a great deal of uncertainty, and she would be prepared to lower the M2 and M3 ranges early next year if intervening developments seemed to warrant such a reduction.

In the Committee's discussion of policy implementation for the weeks immediately ahead, all of the members indicated that they were in favor of continuing to direct open market operations toward maintaining the existing degree of reserve availability. Recent financial developments, including indications of some easing in inflationary sentiment and the emergence of a more stable dollar in foreign exchange markets, along with evidence of continued moderate expansion in business activity did not point to the need for any change in reserve conditions at this time. The outlook for monetary expansion also seemed consistent with such a stance since unchanged reserve conditions and relatively stable market rates were

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thought likely to be associated with some strengthening in money growth over the third quarter. Even so, the cumulative expansion of M2 through September might still be somewhat below the Committee's target range for the year; growth in M3 might move this aggregate closer to the middle of the Committee's 1987 range by September. The outlook for growth in M1 remained uncertain, but a relatively moderate rate of expansion in this aggregate over the third quarter appeared consistent with stable reserve conditions and the Committee's expectations for the broader aggregates.

Most members felt that there should be no presumption about the likely direction of any intermeeting adjustment in policy implementation. The market concerns about inflation and downward pressures on the dollar that had argued for a relatively prompt firming of reserve conditions at the time of the May meeting had eased somewhat, and growth in the monetary aggregates had been quite restrained in recent months. One member felt that policy implementation should be especially alert to developments that might call for some easing, given the risks in this view that indicators of business activity might prove to be weaker than expected and a related belief that the risks of greater inflation were limited. The members generally indicated that attention should continue to be given to developments bearing on the outlook for inflation and the performance of the dollar in foreign exchange markets, but in keeping with the Committee's usual approach to policy implementation, any decision to alter reserve objectives during the intermeeting period would take account of the behavior of the monetary aggregates and the overall performance of the economy.

At the conclusion of the Committee's discussion, all of the members agreed on the desirability of a directive that called for no change in the degree of pressure on reserve positions. Some firming or some easing of reserve conditions would be acceptable depending especially on developments relating to inflation and the performance of the dollar in foreign exchange markets, while also taking account of the behavior of the monetary aggregates and the strength of the business expansion. This approach to policy implementation was expected to be consistent with growth of M2 and M3 at annual rates of around 5 percent and 7½ percent respectively, over the three-month period from June to September. Over the same period, growth in M1 was expected to resume after declining on balance in May and June but to remain well below its pace in 1986. Because the behavior of M1 was still subject to unusual uncertainty and in keeping with its decision regarding the longer-run target, the Committee decided to continue its practice of not specifying a numerical expectation for its short-run growth. 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 4 to 8 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 on balance that economic activity expanded at a moderate pace in the second quarter. In May and June, total nonfarm payroll employment rose modestly further, with most of the gains continuing to be in the service-producing sectors. The civilian unemployment rate fell to 6.1 percent in June and was down appreciably from its average level in the first quarter. Industrial production increased substantially in May after rising moderately on balance in earlier months of the year. Consumer spending appears to have increased in the second quarter, but housing starts were down somewhat further

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in May to a level considerably below their first-quarter average. Recent indicators of business capital spending point to some recovery, particularly in equipment outlays, from a depressed level in the first quarter. In April the merchandise trade deficit was smaller than in March and below the monthly average for the first quarter. The rise in consumer and producer prices moderated in May but for the year to date prices have risen more rapidly than in 1986, primarily reflecting sizable increases in prices of energy and non-oil imports. Wage increases have remained relatively moderate in recent months.

M2 increased slightly in May and June while growth of M3 remained moderate. For 1987 through June, expansion of M2 has been below the lower end of the range established by the Committee for the year, and growth of M3 around the lower end of its range. Following a surge in April, M1 contracted on balance in May and June. Expansion in total domestic nonfinancial debt has moderated this year.

Most interest rates have declined somewhat on balance since the May 19 meeting of the Committee. In foreign exchange markets, the trade-weighted value of the dollar against the other G-10 currencies has risen on balance since the May meeting.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 reaffirm the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7½ to 10½ percent.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range has been set for 1988. The appropriateness of changes in M1 this year will continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on indications of inflationary pressures and on developments in the aggregates and the strength of the business expansion. This approach is expected to be consistent with growth in M2 and M3 over the period from June through September at annual rates of around 5 and 7½ percent, respectively. Growth in M1, while picking up from recent levels, is expected to remain well below its pace during 1986. 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 4 to 8 percent.

Votes for the short-run operational paragraph: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

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Meeting Held on August 18, 1987

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity has continued to expand at a moderate pace in the current quarter. Labor demand has been strong and the unemployment rate has declined further. The industrial sector apparently has benefited from increased international competitiveness. In addition, spending by domestic sectors has continued to advance with spending on business equipment remaining strong and retail sales picking up in recent months. Price increases, although still appreciable, have been somewhat smaller than in the early part of the year, and wage inflation has held at about the same slow pace as in 1986.

Household employment surged in July, and the civilian unemployment rate edged down 0.1 percentage point to 6.0 percent, bringing the cumulative decline so far this year to 0.7 percentage point. Payroll employment registered a sizable increase in July, after two months of slower growth. Hiring remained strong in services, but manufacturing employment recorded its largest monthly gain in three years, and construction employment was essentially unchanged in July following earlier declines.

Gains in employment were associated with a strong increase in industrial production in July. The industrial production index rose 0.8 percent and was revised upward for the previous two months. Advances in July were widespread among products and materials. Output of consumer goods rose noticeably with large increases in production of light trucks and consumer nondurables. Output of business equipment also registered a strong increase as a result of continued sharp advances for construction and mining, manufacturing, and commercial equipment.

Retail sales posted large increases in June and July, after a period of relatively sluggish growth earlier in the year. Automotive dealers and gasoline stations recorded sizable sales gains in July, although spending also increased at most other types of stores. Upward revisions to data for earlier months suggested that nominal spending had been well maintained recently at stores specializing in general merchandise, apparel, and certain durable goods.

Housing activity has leveled off in recent months after declining earlier. Total starts were at an annual rate of 1.61 million units in July, essentially unchanged from the pace in May and June. During the month an increase in single-family starts offset a decline in multifamily units. Despite the rise in July, single-family homebuilding remained significantly below the robust pace recorded during the early months of the year when mortgage rates were at a nine-year low. The decline in multifamily starts reflected the continuing influence of high vacancy rates and tax law changes.

Capital spending appeared to be strengthening, especially for equipment. Real outlays for producers' durable goods rebounded in the second quarter, after a steep tax-related decline in the first quarter. In addition, recent data on new orders suggested further gains in spending on equipment in the period ahead. Outlays for nonresidential construction were little changed in the second quarter after sharp declines over most of the preceding two years; office building continued to decline in the second quarter, but spending was firm in most other sectors, especially in petroleum drilling, which rose for a third consecutive quarter.

Nonfarm inventory investment apparently slowed in the second quarter as

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auto dealers' inventories leveled off after a rapid first-quarter accumulation. Stockbuilding at nonauto trade establishments picked up fairly sharply in April and May, although serious inventory imbalances were not evident. In manufacturing, inventories increased slightly in the second quarter, but the inventory-sales ratio at the end of June fell to the lowest level of the current expansion.

The U.S. merchandise trade deficit in current dollars was higher in June than in any previous month of 1987, but it appeared to have changed little on average between the first and second quarters in nominal terms on a balance of payments basis. In real terms, the deficit recorded a further improvement in the second quarter despite an increase in the quantity of imports of petroleum and petroleum products. Available data indicated some improvement in economic activity in foreign industrial countries in the second quarter, compared with the generally weak first-quarter results. Indicators of economic activity in the United Kingdom suggested broad-based strength. German construction activity rebounded from its first-quarter drop, although other indicators of German economic activity showed less strength. In Japan, signs were mixed, but growth in the consumer and housing sectors seemed more robust in the latter part of the quarter.

Inflation rates have slowed in recent months but have continued to run above the pace in 1986. The recent slowdown has been concentrated among items other than food and energy; after increasing rapidly in the first four months of the year, the CPI excluding food and energy rose 0.3 percent in May and 0.2 percent in June. Consumer food prices rose sharply in May and June; however, farm commodity prices have fallen recently. Upward pressures on energy prices have persisted, partly reflecting heightened tensions in the Persian Gulf, which pushed crude oil prices up further in July. Prices of imports other than oil rose sharply in the second quarter for a fairly wide range of intermediate materials and products. In addition, domestic producers have raised prices for materials. Wage inflation remained comparatively moderate in the first half of 1987.

At its meeting on July 7, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. The members decided that somewhat greater or lesser reserve restraint would be acceptable depending on indications of inflationary pressures and on developments in foreign exchange markets, as well as on the behavior of the monetary aggregates and the strength of the business expansion. M2 and M3 were expected to grow at annual rates of 5 and 7½ percent respectively, from June through September, while growth in M1 was expected to remain below its pace in 1986 but to pick up from recent levels. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Growth in M2 picked up a little in July but remained sluggish; for the year through July cumulative M2 growth fell further below the 5½ percent lower bound of the range established by the Committee for 1987. The slightly faster growth of M2 reflected a turnaround in M1, which edged up in July; demand deposits contracted, albeit less than in June, while other checkable deposits rose moderately. M3 expanded at only a 2 percent rate in July as banks, experiencing low loan demand, ran off large CDs; in July this aggregate was somewhat below the growth cone associated with the Committee's 5½ to 8½ percent range for this year. Total reserves continued to decline in July, but at a reduced rate; the decline largely reflected

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weakness in transactions deposits and decreases in excess reserves. Adjustment plus seasonal borrowing at the discount window averaged $466 million for the three reserve maintenance periods that ended since the meeting of the Committee on July 7.

Federal funds traded generally at 6½ to 6¾ percent during the intermeeting period. Most other private short-term rates were essentially unchanged, but rates on Treasury bills backed up considerably, particularly after legislative action to raise the debt ceiling permitted a resumption of auctions. At the same time, paydowns of bills in weekly auctions slowed from the pace earlier in the year. In the longer-term markets, yields on Treasury and corporate bonds rose 25 to 35 basis points since the July meeting. The pressures on prices of petroleum coupled with relatively strong economic data appeared to increase concerns about inflation and credit demands in the future. Even so, stock prices increased appreciably over the intermeeting period.

The dollar was about unchanged on balance since the July meeting of the Committee in terms of a weighted average of other G-10 currencies. It rose substantially through much of the period, primarily in response to the tensions in the Middle East and the relative strength of the U.S. economy, but it subsequently fell back after the publication of the June trade figures in mid-August. The dollar was stronger against the mark than against the yen, perhaps reflecting a relatively sluggish outlook for the German economy. Money market conditions tightened somewhat in Germany and more in the United Kingdom and remained unchanged in Japan. Long- term rates rose significantly in all these countries, with the largest rise occurring in Japan. The increase in Japanese rates was attributed to signs of stronger economic activity and concerns about the inflation implications of Mideast tensions.

The staff projections suggested that real GNP would grow at a moderate rate through the end of 1988. Improvement in the external sector was expected to provide substantial impetus for real growth, as changes in the foreign exchange value of the dollar helped to boost U.S. exports and damp import growth. In contrast, growth in domestic spending was anticipated to be relatively subdued. Rising import prices associated with the fall in the value of the dollar were likely to limit increases in real income and consumer spending; budgetary pressures would constrain government purchases; and the rise in mortgage interest rates and high vacancy rates were expected to curtail construction activity. Business equipment spending, however, should rise at a moderate pace in coming quarters. After slowing in the second half of the year, inflation was expected to move back up in 1988 reflecting pressures from non-oil import prices. Moreover, with the civilian unemployment rate projected to remain around 6 percent, slack in the labor market would not have much of a damping influence on wages. As a result, compensation increases were expected to rise noticeably next year.

In the Committee's discussion of the economic situation and outlook, members commented that recent indicators of business activity had a relatively strong tone and tended to reinforce earlier expectations that a moderate rate of economic expansion would be sustained. Indeed, in the view of several members, the chances of any deviation from such expectations were on the side of faster economic growth with attendant risks of intensifying inflationary pressures. Others, stressing the uncertainties that continued to cloud the outlook for economic activity, viewed the

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likelihood of a deviation from a moderate growth scenario as more evenly balanced and the risks of inflation as less worrisome.

During the Committee's discussion several members reported that local business conditions appeared to have strengthened, including evidence that some previously depressed manufacturing industries and also oil drilling and agriculture had tended to stabilize or were showing increased signs of recovery. Business optimism also was reported to have improved recently in many areas. With regard to the outlook for investment, it was noted that a number of recent statistical indicators pointed on balance to stronger business capital spending. Other favorable developments cited in this connection included the surge in stock prices, indications of potentially sizable profit gains in some sectors of the economy, and the prospect that with the depreciation of the dollar a larger share of the demand for business equipment was likely to be met by domestic producers. Some members commented that consumer spending probably would be reasonably well maintained, if not robust, in light of the impact of income tax changes on disposable incomes, the strength of the stock market, and other factors. On the negative side, it was suggested that the growth in consumer expenditures might be relatively restrained, in part because sales of automobiles were likely in this view to remain weak on balance despite the temporary fillip from sales incentive programs. Some members also referred to the emergence of unusually conservative attitudes among business borrowers and farmers, at least in some parts of the country.

The members continued to view an improvement in the trade balance as a key factor but also as a major uncertainty in the outlook for economic expansion; in particular, a number of members again questioned whether such improvement would be substantial enough to provide more than very modest support to the expansion. In this view relatively sluggish growth in the economies of major trading partners and the persistence of numerous trade barriers pointed to relatively limited gains in net exports, at least over the quarters immediately ahead. Other members were somewhat more optimistic about the outlook for trade despite recently disappointing trade data. They felt that the depreciation of the dollar and ongoing increases in the prices of many imports had strengthened the competitive position of U.S. firms in both domestic and foreign markets. Such competitive gains were already reflected in the stronger performance of many domestic manufacturing industries and reports of increasing export opportunities were multiplying.

The members expressed some divergence of views with regard to the outlook for inflation, but they generally agreed that domestic pressures on prices did not appear to be intensifying currently and that wage increases had remained moderate despite the faster rise in prices experienced earlier in the year. Nonetheless, several members stressed the risks of greater inflation over the next several quarters, particularly if the expansion in economic activity proved to be on the high side of their current expectations. These members were concerned that the economy might be at or near the point where relatively rapid growth would result in more inflation, given the substantial drop in unemployment to a relatively low level this year; long-term debt markets already reflected heightened inflationary expectations. Another substantial increase in energy

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prices clearly would exacerbate the inflationary pressures, but the outlook for energy was highly uncertain.

Other members agreed that inflation was a potentially serious problem, but they saw a lesser risk of intensifying inflationary pressures. These members tended to emphasize the possibility that economic growth would remain relatively moderate or that gains would tend to be concentrated in previously depressed industries that had greater margins of available labor and production capacity. Moreover, business managers were likely to persist in their efforts to cut costs and improve operating efficiencies, as evidenced by recent labor negotiations. Reference also was made to broadly deflationary factors including the moderate growth in the monetary aggregates this year and an ample availability of labor and productive capacity, especially for basic commodities, in world markets. All of the members agreed that a critical element in the inflation outlook was the potential for rising prices to be reflected at some point in rising wages. Such a development would represent a dangerous setback in the fight against inflation and would greatly increase the costs of bringing inflation under control.

At its meeting in July the Committee had reviewed the basic policy objectives established in February for growth of the monetary and debt aggregates in 1987 and had set tentative objectives for growth in 1988. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the Committee had reaffirmed the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3. The Committee agreed that growth in these aggregates around the lower ends of their ranges might be appropriate, depending on the circumstances. The monitoring range for expansion in total domestic nonfinancial debt also was left unchanged at 8 to 11 percent for 1987. For 1988 the Committee had agreed on tentative objectives for monetary growth that included reductions of ½ percentage point to ranges of 5 to 8 percent for both M2 and M3. The Committee had also reduced the associated range for growth in total domestic nonfinancial debt by ½ percentage point to 7½ to 10½ percent for 1988. With respect to M1, the Committee had decided at the July meeting not to set a specific target for growth over the remainder of 1987 or to establish a tentative range for 1988. It was understood that all the ranges for 1988 were provisional and that they would be reviewed early next year in the light of intervening developments. The issues involved with establishing a target for M1 would be carefully reappraised at the beginning of 1988.

In the Committee's discussion of policy implementation for the weeks immediately ahead, a majority of the members favored unchanged conditions of reserve availability, at least initially during the intermeeting period, but some indicated a preference for a modest firming. The members recognized that monetary policy exerted its effects with a lag and that inflationary forces should not be allowed to gather momentum. However, several stressed the uncertainties that surrounded the outlook for prices and wages, and in the view of a majority, more evidence of sustained strength in the economy or of intensifying inflation was needed before action toward firmer reserve conditions should be taken, particularly in the context of relatively slow monetary expansion. Some of these members also commented that the Committee would have an opportunity to review its decision within a few weeks, given the relatively short interval until

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the next scheduled meeting. Other members gave somewhat greater emphasis to the potential for more inflation. In this view some slight firming at this point would have a favorable effect on inflationary expectations and would incur very little recessionary risk. Moreover, such a move could be readily reversed if changing conditions seemed to warrant such a step later.

In their review of the outlook for monetary growth, the members took account of a staff analysis that suggested that monetary expansion was likely to accelerate from its sluggish pace in recent months, assuming that interest rates remained around their current levels. The analysis contemplated that growth in the broader aggregates would return to a pace closer to that in nominal GNP as the interactive effects of earlier increases in interest rates and the lagged adjustments in offering rates on various types of interest-bearing deposits abated. Recent monetary data tended to support that expectation. It was noted, however, that such faster monetary growth was still likely to leave cumulative expansion in the broad aggregates through September below the Committee's ranges for the year, especially in the case of M2. Some members commented that relatively slow monetary growth appeared appropriate in light of the higher inflation and the increase in inflationary expectations experienced this year. The latter had contributed to higher market interest rates which had curbed demand for assets in the monetary aggregates and had raised velocity. The possibility of some further rise in velocity implied that limited monetary expansion might remain consistent with satisfactory economic performance. However, given the shortfall in the growth of the broader aggregates from their 1987 ranges, a number of members indicated that they would find acceptable somewhat faster growth in these aggregates than was currently projected, provided that price pressures did not appear to be worsening and the dollar was not subject to substantial weakness.

The members differed to some extent in their views regarding the emphasis that should be given to various factors that might trigger intermeeting adjustments, if any, in the degree of pressure on reserve positions. Most felt that policy implementation should be especially alert to developments that might call for somewhat firmer reserve conditions, particularly if the Committee decided against any initial firming in those conditions. Other members believed that there should be no presumptions about the likely direction of any intermeeting adjustments, but they could accept a directive that looked to firming action as the more likely direction of any adjustment. The members generally agreed that developments relating to the outlook for inflation should continue to receive important weight in judging the need for any policy changes during the intermeeting period. There was also considerable sentiment in favor of giving increased attention to the overall performance of the economy in this period, given the recent signs of strength. In addition, several members commented that a possible weakening of the dollar in the foreign exchange markets might call for a policy response in the period ahead, but some other members cautioned that dollar developments would need to be interpreted with particular care. It was noted in this regard that the dollar was still appreciably above the lows it had reached in the spring, and in this view a judgment would need to be made as to whether any weakness in the dollar related more to uncertainties about oil market developments than to

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fundamental concerns about underlying inflationary pressures in the economy. Nevertheless, Committee members generally remained sensitive to developments relating to the dollar.

At the conclusion of the Committee's discussion, all of the members indicated that they favored or could accept a directive that called for no change, at least initially, in the degree of pressure on reserve positions. With regard to possible adjustments during the intermeeting period, the members indicated that somewhat greater reserve restraint would be acceptable, while slightly lesser reserve restraint might be acceptable, depending on developments relating to inflation, the strength of the business expansion, the performance of the dollar in foreign exchange markets, while also taking account of the behavior of the monetary aggregates. Unchanged conditions of reserve availability were expected to be consistent with growth in M2 and M3 at annual rates of around 5 percent for the three-month period from June to September; given its performance in July, expansion in M3 was expected to be somewhat less than had been anticipated at the time of the July meeting. Over the same period, growth in M1 was expected to pick up from its average pace over the past several months but to remain well below its rate of expansion in 1986. Because the behavior of M1 was still subject to unusual uncertainty and in keeping with the decision not to set a longer-run target for M1, the Committee decided to continue the practice of not specifying a numerical expectation for its short-run growth. 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 4 to 8 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 on balance that economic activity is expanding at a moderate pace in the current quarter. In July, total nonfarm payroll employment rose considerably further; the increase included continuing large gains in the service-producing sector and a sizable advance in manufacturing. The civilian unemployment rate fell slightly further to 6.0 percent. Industrial production increased strongly in July after rising moderately on balance in the first half of the year. Consumer spending grew at a reduced pace earlier in the year but retail sales posted large increases in June and July. Housing starts were unchanged in July and remained at their reduced second-quarter level. Recent indicators of business capital spending point to some strength, particularly in equipment outlays. The rise in consumer and producer prices has been moderate in recent months, but for the year to date prices generally have risen more rapidly than in 1986, primarily reflecting sizable increases in prices of energy and non-oil imports. Wage increases have remained relatively moderate in recent months.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was unchanged on balance since the meeting of the Committee on July 7. In the second quarter the merchandise trade deficit in current dollars was about the same as in the first quarter.

The monetary aggregates grew slowly in July. For 1987 through July, expansion of both M2 and M3 has been below the lower ends of the ranges established by the Committee for the year, while growth in M1 has been well below its pace in 1986. Expansion in total domestic nonfinancial debt has moderated this year. Most long-term interest rates have risen somewhat since the July meeting; in short-term markets, Treasury bill rates also have increased somewhat while private rates are little changed. Stock prices have risen substantially since the latest meeting.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over

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time, 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 July to reaffirm the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7½ to 10½ percent.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided at the July meeting not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range was set for 1988. The appropriateness of changes in M1 this year will continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the aggregates. This approach is expected to be consistent with growth in M2 and M3 over the period from June through September at annual rates of around 5 percent. Growth in M1, while picking up from recent levels, is expected to remain well below its pace during 1986. 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 4 to 8 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

2. Authorization for Domestic Open Market Operations

Effective August 19, 1987, the Committee approved a temporary increase of $6 billion, to $12 billion, in the limit between 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 Operations. The increase was effective for the intermeeting period ending with the close of business on September 22, 1987.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the normal leeway of $6 billion for changes in the System's account would

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not be sufficient over the intermeeting period because a large buildup in the Treasury cash balance at Federal Reserve Banks was expected after the September tax date.

Meeting Held on September 22, 1987

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity was expanding in the current quarter at a pace similar to that in the first half of the year. Output and employment appeared to have registered solid gains in the third quarter, with particular strength in the industrial sector of the economy. On the spending side, outlays for consumption and business equipment have risen noticeably this quarter, but construction has been weak. Price advances have eased in recent months after a sharp rise earlier in the year, and wage increases have remained subdued.

Industrial production rose further in August after large gains in other recent months; the August level was more than 7 percent (annual rate) above the second-quarter average. Business equipment and materials have been the strongest components of industrial output in recent months, but advances have been widespread among major market groupings.

Nonfarm payroll employment increased again in August; although the gain was half the size of the July increase, the average change in the two months was close to the pace of the first half of the year. The average workweek also rose in August and, coupled with the employment gains, pushed up aggregate hours of production and nonsupervisory workers significantly. Hiring remained strong in services, but employment leveled off in manufacturing after a large gain in July. The unemployment rate was unchanged at 6.0 percent in August, about three-quarters of a percentage point lower than at the beginning of the year.

Retail sales have increased considerably in recent months. Auto sales have been boosted by end-of-model-year discounts and financing incentives. However, a considerable decrease in domestic car sales in the first ten days of September suggested that the effectiveness of the incentive programs might be waning. Retail spending on consumer goods excluding autos and gasoline continued to advance at a moderate pace in July and August to a level slightly above the second-quarter average. Housing starts edged down to an annual rate of 1.58 million units, as a decline in single-family starts more than offset some increase in multifamily construction. The run-up in mortgage interest rates during April and May has damped housing demand, as reflected in the reduced pace of housing starts and sales in recent months. Multifamily starts have remained close to the average rate in the second quarter but substantially below that recorded during the first three months of the year. Business fixed investment appeared to be strengthening, particularly for equipment. In July, shipments of nondefense capital goods were 2½ percent above the second-quarter average, and orders for these goods rose substantially in recent months. Spending for nonresidential structures has continued to trend lower, albeit at a slower rate than over the past couple of years, partly because of renewed strength in petroleum drilling. Inventories in midsummer appeared to be moderate in most segments of the nonfarm business sector. At auto dealers, the quickened selling pace in August, combined with scaled-back production, reduced inventories to more comfortable levels. For retailers other than auto dealers, stocks increased at a relatively

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slow rate, and the inventory-sales ratio edged down in August. As a result of the apparently conservative inventory stance in manufacturing, factory stocks have remained generally lean, with the July inventory-shipments ratio near its lowest point in the current cycle.

Preliminary data suggested that the nominal U.S. merchandise trade deficit was essentially unchanged in July from its June level despite substantial increases in the quantity and prices of oil imports. However, the July deficit was larger than the second-quarter average. In real terms, the second-quarter deficit on goods in the GNP accounts narrowed only slightly further because a rebound in the quantity of oil and non-oil imports largely offset a substantial rise in the quantity of exports. The surplus on services in the GNP accounts narrowed in real terms. The average pace of economic growth in the major foreign industrial economies increased in the second quarter after a very weak first quarter. A rebound in German GNP in the second quarter reversed a first-quarter decline but left GNP no higher than its third-quarter 1986 level. Real GNP also resumed growing in the second quarter in France and Italy, while real GNP in Canada and the United Kingdom showed continued strength. In Japan, real GNP did not grow in the second quarter on average as a more rapid rise in domestic demand was offset by the negative contribution of the external sector; however, industrial production picked up in June and July. While cumulative surpluses in the trade and current accounts of Japan and Germany for the year to date remained at or near a record rate, data for recent months indicate some adjustment, especially for Japan.

Price increases have eased in recent months; the CPI and PPI for finished goods both rose 0.2 percent in July, and the August PPI was unchanged. The deceleration in these price measures from the pace in the first half of the year largely reflected a downturn in food prices and smaller energy price increases. Producer prices for finished foods fell sharply in August, and although the effect of rising oil prices continued to be evident, declines in both spot and contract prices were likely to damp retail energy prices by early autumn. Excluding food and energy, the CPI rose in July at around the reduced pace of the second quarter and the comparable PPI increased moderately over the first two months of the current quarter.

At its meeting on August 18, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. The members decided that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. M2 and M3 were expected to grow at annual rates of around 5 percent from June through September, while growth in M1 was expected to pick up from the much reduced pace of recent months. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Total and nonborrowed reserves resumed expansion in August, primarily because of higher levels of excess reserves. In the maintenance period after the August meeting, federal funds generally traded in a 6½ to 6¾ percent range, though the rate moved a bit higher around the end of August when markets began to expect that the System would tighten policy. In light of the potential for greater inflation, associated in part with weakness in the dollar, a deci-

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sion was made in early September to reduce marginally the availability of reserves through open market operations. On September 4 the discount rate was raised from 5½ percent to 6 percent. After the discount rate increase, federal funds traded mainly in the 7 to 7¼ percent area. In the two maintenance periods completed since the August meeting, adjustment plus seasonal borrowings averaged about $530 million.

Other interest rates rose substantially over the intermeeting period. Market interest rates moved up early in the period amid pressures on the dollar, concerns about inflation, and expectations of policy-firming actions by the Federal Reserve. Rates rose further after the increase in the discount rate, particularly short-term rates; also, commercial banks raised the prime rate by ½ percentage point. On balance, market rates were up ½ to ¾ percentage point over the intermeeting period. Most stock price indexes reached new highs in late August but subsequently retreated to levels 2½ to 6 percent below those at the time of the August meeting.

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies declined about 2½ percent in the weeks immediately following the August meeting. The main factor in the dollar's depreciation appeared to be greater pessimism about the pace of adjustment of external imbalances, following the release of U.S. merchandise trade data that were worse than market participants had expected. Moreover, prospects for growth abroad relative to that in the United States suggested only a limited contribution from this source to external adjustment. The dollar rose somewhat later in the period after the increase in the discount rate, reducing its net decline over the intermeeting period to about 1½ percent.

Growth in the monetary aggregates increased in August from the sluggish pace of previous months. The acceleration of M2 in August partly reflected faster growth in its M1 component as the runoff in demand deposits ended and the growth of other checkable deposits accelerated slightly. The strongest growth among nontransactions components of M2 occurred in RP liabilities at banks, which rose sharply in association with a surge in acquisitions of Treasury securities for trading accounts, and in money market mutual funds. Bolstered by the expansion in M2 and by faster growth in managed liabilities, M3 expanded at a 7½ percent annual rate in August. Over July and August the broader monetary aggregates increased at annual rates of 4 to 5 percent, and for the year through August their cumulative growth remained below the low ends of their target ranges for 1987, with M2 substantially below its range.

The staff economic projections had changed only marginally since the August FOMC meeting. Somewhat stronger growth was anticipated over the near term, but real GNP still was expected to expand at a moderate rate through the end of 1988. Improvement in the external sector was projected to provide substantial impetus for real growth as changes in the foreign exchange value of the dollar boosted U.S. exports and damped import growth. In contrast, growth in domestic spending would probably be relatively subdued. Rising import prices associated with the fall in the value of the dollar were likely to limit increases in real income and consumer spending; budgetary pressures probably would constrain government purchases; and rising mortgage rates and high vacancy rates were expected to damp construction activity. As in previous forecasts, inflation was projected to moderate in the second half of 1987, but to move back up in 1988, reflecting

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pressures from rising import prices. Moreover, with the civilian unemployment rate projected to edge lower, the pickup in prices was expected to push up labor costs and compensation gains next year.

In the Committee's discussion of the economic situation and outlook, members commented that current indicators of business activity were generally favorable and pointed on balance to continuing expansion at a moderate pace. A number of members believed that any deviation from current expectations was likely to be in the direction of faster growth. However, some saw factors in the outlook that would be likely to restrain any potential for a substantially stronger expansion, and one view stressed the vulnerability of the expansion to a slowdown. With regard to the outlook for inflation, members noted that developments in financial markets suggested some buildup in inflationary expectations, but they also stressed that there was no current evidence of an upturn in broad measures of inflation. Nonetheless, several expressed concern about the risks of some intensification in price and wage pressures. Others saw greater prospects that the rate of inflation might hold around current levels or possibly decline.

In their discussion of specific developments bearing on the outlook for domestic business activity, members observed that key economic indicators provided evidence of appreciable momentum in the business expansion. Individual members also reported that local business conditions appeared to be strengthening in many parts of the country, although recovery in some previously depressed areas or sectors of the economy was still quite modest or tentative, with current activity still well below earlier peaks. It was suggested that the expansion could be characterized currently as better balanced than earlier, with favorable implications for its sustainability. At the same time, some members believed that the risks of appreciably more rapid expansion were relatively limited in the context of considerable progress in reducing the federal budget deficit, restrained monetary expansion, and an increased level of interest rates. Some members also noted that increasing domestic demands and the prospects for improvement in the foreign trade balance had greatly reduced the odds of a shortfall in the expansion from current expectations.

The members continued to view the very large deficits in the federal budget and in the foreign trade balance as issues of fundamental concern. Although a great deal of progress had been made in reducing the federal deficit in the current fiscal year, the outlook for needed further progress was uncertain. The trade deficit also had improved in real terms, though not in nominal terms, over the course of recent quarters. The members generally expected at least some progress to be made on the latter basis as foreign trade patterns and prices were adjusted over time to the reduced value of the dollar in foreign exchange markets. However, the timing and extent of such improvement remained subject to considerable uncertainty, and differing views were expressed regarding the most likely prospects for net exports and the underlying pressures on the dollar. The members agreed that the vigor of the domestic expansion would depend to a substantial extent on foreign trade developments. Some members noted that with shrinking margins of excess capacity in labor markets, overall domestic demands would need to remain relatively moderate to provide room for growth in export production; in that regard continuing progress in reducing the federal budget deficit was essential.

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Turning to the outlook for inflation, members commented that the sharp decline in unemployment this year together with anecdotal evidence of labor shortages in many areas of the country had not triggered any general increases in wage rates thus far. Additionally, the members did not see in recent indicators any evidence of an upturn in the general level of prices. However, several expressed concern that the economy might have reached the point where employment and production levels would tend to be associated with stronger pressures on wages and prices, particularly if the business expansion proved to be more vigorous than was generally anticipated. Of particular concern was the prospect that rising prices of internationally traded goods could foster a more general increase in domestic prices and lead to higher wages. Because such developments would reflect broader and more permanent cost factors, the inflation problem would become much more difficult for policymakers. A number of other members saw a lesser risk that inflation would intensify over the period ahead. Highly competitive conditions continued to characterize many markets, both domestic and international, and businessmen were persisting in their efforts to curb their costs of production. It also was noted that a portion of the gains in output and employment was occurring in previously depressed industries where the availability of labor and other production resources was concentrated. In this view monetary policy had been sufficiently tight, with relatively low monetary growth, and in the context of a less expansionary fiscal policy, the economy was not seen as likely to generate excessive demand pressures over the next several quarters.

At its meeting in July the Committee reviewed the basic policy objectives that it had set in February for growth of the monetary and debt aggregates in 1987 and established tentative objectives for expansion of those aggregates in 1988. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the Committee reaffirmed the ranges established in February involving growth of 5½ to 8½ percent for both M2 and M3. Given developments through midyear, the Committee agreed that growth in these aggregates around the lower ends of their ranges might be appropriate, depending on the circumstances. The monitoring range for expansion in total domestic nonfinancial debt also was left unchanged at 8 to 11 percent for 1987. For 1988 the Committee agreed on tentative reductions of ½ percentage point to growth ranges of 5 to 8 percent for both M2 and M3. The Committee also reduced the associated range for growth in total domestic nonfinancial debt by ½ percentage point to 7½ to 10½ percent for 1988. With respect to M1, the Committee decided at the July meeting not to set a specific target for the remainder of 1987 or to establish a tentative range for 1988. It was understood that all the ranges for 1988 were provisional and that they would be reviewed early next year in the light of intervening developments. The issues involved with establishing a target for M1 would be carefully reappraised at the beginning of 1988.

In the Committee's discussion of policy implementation for the weeks immediately ahead, most of the members indicated that they were in favor of directing open market operations, at least initially, toward achieving the increased degree of reserve pressure that had been sought in recent weeks. No change in policy would be involved, given the decision in early September to reduce the availability of reserves; however, because implementation of that decision had not yet been reflected in

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actual pressures on reserves or in money markets, an unchanged policy at this meeting would imply some slight firming from the actual reserve conditions that had prevailed recently. A few members expressed a preference for maintaining the existing degree of reserve pressure. The members agreed that the differences in question were slight and that, against the background of earlier policy-firming actions, significant further changes in policy were not desirable at this time. In the latter connection, some members urged that particular caution be exercised in implementing policy following today's meeting in order not to convey a misleading impression of the System's policy intentions.

In reaching their decisions the members took account of a staff analysis that suggested that even without any increase in reserve pressures money growth was likely to remain fairly subdued over the months ahead. This outlook reflected in large measure the expected effects on money demand of the increase in market interest rates associated in part with the decisions in early September to achieve slightly firmer reserve conditions and to raise the discount rate. In the circumstances, growth of M2 might continue at about its average pace of recent months and on a cumulative basis remain appreciably below the Committee's range for the year. Growth in M3 might pick up marginally from its recent pace, ending the year around the lower limit of its range for 1987. Given its particular sensitivity to interest rates, growth in M1 for the balance of the year was expected to slow further from its considerably reduced pace thus far in 1987. The members recognized that projections of monetary growth necessarily involved a wide range of uncertainty. In particular, developments in the months ahead would depend importantly on the unknown extent to which holders of money assets would respond to the higher market interest rates that had emerged and also on the extent to which depository institutions would adjust their offering rates on interest-bearing deposits. In light of the uncertainties that were involved, judgments about appropriate rates of monetary growth would need to rely on accompanying economic and financial developments.

With regard to possible adjustments in policy implementation during the intermeeting period, the members generally felt that there should be no presumptions about the likely direction of such adjustments, if any. A number of members commented that, taking account of earlier policy firming decisions, monetary policy was now appropriately positioned under the circumstances that were most likely to prevail. While a few members felt that the Committee should remain especially alert to developments that might call for somewhat firmer reserve conditions, others did not want the directive to lean in the direction of still further firming, given the slight initial firming that was already contemplated. The members generally agreed that in addition to developments relating to the outlook for inflation, any reserve adjustments during the intermeeting period should give weight to ongoing business developments and the performance of the dollar in foreign exchange markets. In keeping with the Committee's usual approach, it also was understood that any decision to alter reserve objectives during the intermeeting period would take account of the behavior of monetary aggregates.

The members generally supported a proposal to raise the existing intermeeting range for the federal funds rate by 1 percentage point to 5 to 9 percent. One member expressed concern that the higher range might be misinterpreted as signaling future firming action. Others

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pointed out, however, that the increase was a technical adjustment intended to take account of the rise in the federal funds rate over the course of recent weeks and to provide a more symmetrical range around the current rate. By itself the increase would have no significance for policy. The federal funds range provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all of the members indicated that they preferred or could accept a directive that called for maintaining the slightly firmer degree of reserve pressure that had been sought in recent weeks. With regard to possible adjustments during the intermeeting period, the members indicated that somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on developments relating to inflation, the strength of the business expansion, the performance of the dollar in foreign exchange markets, while also taking account of the behavior of the monetary aggregates. The contemplated provision of reserves was expected to be consistent with growth in M2 and M3 at annual rates of around 4 percent and around 6 percent respectively, for the four-month period from August to December. Growth in M1 was expected to remain relatively slow over the same period. Because of the unusual uncertainty relating to the behavior of M1 and in keeping with the decision not to set a longer-run target for this aggregate, the Committee decided to continue the practice of not specifying a numerical expectation for its short-run growth. The members agreed that the intermeeting range for the federal funds rate should be raised from 4 to 8 percent to 5 to 9 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 on balance that economic activity is expanding in the current quarter at a pace similar to that in the first half of the year. Total nonfarm payroll employment rose further in August after a large increase in July. The civilian unemployment rate remained at 6.0 percent, well below its level at the start of the year. Industrial production increased further in August following large gains in other recent months. Consumer spending, bolstered by a rise in auto sales, posted a large increase in August. Recent indicators of business capital spending point to some strength, particularly in equipment outlays. Housing starts fell in August to a level a little below their average in other recent months. Preliminary data suggest that the nominal U.S. merchandise trade deficit was unchanged in July from its June level but larger than the second-quarter average. The rise in consumer and producer prices has slowed in recent months, reflecting favorable price developments in food and energy.

Growth of the monetary aggregates strengthened in August, but for 1987 through August, expansion of both M2 and M3 remained below the lower ends of the ranges established by the Committee for the year; growth in M1 has been at a much reduced pace in 1987. Expansion in total domestic nonfinancial debt has moderated this year. Interest rates have risen considerably since the meeting on August 18. On September 4, the Federal Reserve Board approved an increase in the discount rate from 5½ to 6 percent. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated on balance since the latest meeting; some of the decline in the dollar early in the intermeeting period was later reversed.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 July to reaffirm the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3 measured from the fourth quarter of 1986 to the fourth quarter of 1987. The Committee agreed that growth in these aggregates

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around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7½ to 10½ percent.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided at the July meeting not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range was set for 1988. The appropriateness of changes in M1 this year will continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully appraised at the beginning of 1988.

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. Somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the aggregates. This approach is expected to be consistent with growth in M2 and M3 over the period from August through December at annual rates of around 4 percent and around 6 percent, respectively. M1 is expected to continue to grow relatively slowly. 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 5 to 9 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Kelley, Keehn, Johnson, Ms. Seger, and Mr. Stern. Votes against this action: None.

On every business day from October 19 to 30, 1987, the Committee conferred by telephone and reviewed the extremely volatile conditions that had developed in financial markets. The members agreed on the need for special flexibility in open market operations during this period for meeting the liquidity requirements of the economic and financial system. Such an approach to policy implementation was deemed to be consistent with the directive adopted at the meeting on September 22, but it was understood that policy would have to be kept under particularly close review.

Meeting Held on November 3, 1987

1. Domestic Policy Directive

The economic information available at this meeting was reviewed in the context of the extraordinary developments in financial markets since the Committee meeting on September 22. Over the period, equity prices had fallen sharply and a record drop in mid-October was accompanied by falling interest rates and heightened preferences for safety and liquidity. The economic effects of such developments were not yet clear. At the

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time of the meeting, data relating to nationwide business activity were available only for the period prior to the mid-October collapse in stock prices. Such data showed that the economy had expanded at a fairly brisk pace in the third quarter; growth in the industrial sector was especially robust, spurred by sharp pickup in business investment and a further expansion in exports. Prices continued to rise at a relatively moderate rate in recent months, and even with fairly strong labor demands and a considerably reduced unemployment rate, wages accelerated only slightly.

Industrial production rose somewhat further in September after a large increase earlier in the summer. In the third quarter as a whole, output was up nearly 9 percent at an annual rate, with large gains in most major groupings. Production of business equipment was especially strong, apparently reflecting improved foreign as well as domestic demand for U.S. products. Materials output also continued to strengthen, but auto assemblies were reduced sharply in August and September.

Labor demand, on balance, remained strong. Nonfarm payroll employment rose again in September. Manufacturing employment posted a sizable rise in the third quarter, with widespread gains across both durable and nondurable goods industries. Job growth elsewhere, however, has slowed; construction employment dropped in September, and hiring in the finance, insurance, and real estate grouping was damped in part by slower mortgage originations. The civilian unemployment rate continued to edge down in September, touching 5.9 percent.

Retail sales declined somewhat in September, but consumer spending rose substantially in the third quarter, reflecting primarily an incentive-induced increase in outlays on motor vehicles. With the expiration of the incentives at the end of September, sales of domestic autos dropped sharply. Purchases of other goods were about unchanged last quarter because of continued softness in the demand for big-ticket items as well as for most types of nondurables. However, outlays for services rose appreciably.

Housing activity through September continued to be limited by the effects of higher mortgage interest costs and elevated rental vacancy rates. Building permits were flat in September and, although starts picked up to an annual rate of 1.67 million units, they remained well below the pace of early this year.

Business fixed investment was strong in the third quarter, paced by a surge in purchases of computers, a bulge in purchases of motor vehicles, and a substantial increase in spending on other types of equipment. Outlays on structures also recorded a large rise, as petroleum drilling activity expanded sharply, spending by public utilities increased appreciably, and office construction firmed. The advance spending indicators available through September also pointed to continued strength. Recent events in financial markets were expected to lead to some reassessment of spending plans, but investment outlays would be supported in the near term by projects that were already under way.

Inventory investment was held down in the third quarter by a sharp liquidation of stocks at automobile dealers. Based on data available through August, the level of stocks in other trade categories rose somewhat further but generally did not appear to be excessive in relation to sales. In the manufacturing sector, the stronger orders received since last spring contributed to an increase in the pace of inventory accumulation that was fairly widespread by industry and by stage of fabrication; nonetheless, inventory–

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sales ratios in most industries remained low at the end of August.

The U.S. merchandise trade deficit in July–August was estimated to have been marginally larger than in the second quarter on a seasonally adjusted basis; both imports and exports rose substantially over the two months. A surge in oil imports, most of which went into domestic inventories, accounted for about half of the July–August rise in total imports. Nonagricultural exports continued to grow at a rapid pace, with shipments of commercial aircraft showing particular strength in July. Agricultural exports also picked up markedly.

Indicators of business conditions in major foreign industrial countries generally suggested somewhat faster economic expansion in the third quarter than the weak average pace of the first half of the year, while inflation abroad remained low. In Japan, industrial production in the third quarter was noticeably above the average level for the first half of the year. The trade surplus was down slightly in nominal terms in the third quarter, and more substantially in real terms. At the same time, consumer prices in Japan were slightly above their year-earlier level, while wholesale prices showed a smaller four-quarter decline than in previous quarters. German industrial production rebounded significantly in August, after declines in the previous two months, but the average level for July–August was still below its year-earlier level. Consumer prices in Germany in the third quarter were slightly above their level of a year earlier. Output in the United Kingdom continued to grow at a healthy pace, while that in France and Italy slowed somewhat.

Increases in U.S. consumer prices have been relatively moderate in recent months. The CPI rose 0.2 percent in September, as retail energy prices fell but food prices rose. Excluding food and energy items, consumer prices have slowed a bit recently from the average pace over the first seven months of the year. Price increases for finished goods at the producer level also have remained moderate. However, prices for intermediate and crude materials (apart from food and energy) have continued to rise substantially, reflecting the higher levels of industrial activity, the lower exchange value of the dollar, and the effects on petroleum-based products of earlier increases in crude oil prices. Wage trends have remained moderate, although increases in the past few months have been slightly larger than earlier in the year.

At its meeting on September 22, the Committee adopted a directive that called for maintaining the degree of pressure on reserve positions that had been sought since early September. The members decided that somewhat greater or somewhat lesser reserve restraint would be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. Adjustment plus seasonal borrowing in the first complete reserve maintenance period following the September meeting increased to a daily average of about $725 million, boosted in part by unusual borrowing related to Reserve Bank computer problems. Apart from higher levels around the quarter-end, federal funds traded in a 7¼ to 7½ percent range during that maintenance period. Federal funds and other interest rates subsequently rose through mid-October as market participants appeared to anticipate monetary tightening in an environment of firmer policy abroad, concerns about the dollar, and pessimism about the prospects for domestic inflation.

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After declining appreciably in the first half of the month, stock prices plunged on October 19 in chaotic trading. Most interest rates fell sharply. The Committee held daily telephone conferences in the last two weeks of October to assess the extraordinary developments in financial markets. The members agreed on the need to assure adequate liquidity in a period of continuing volatility in domestic and international financial markets, and in particular on the need to meet promptly any unusual liquidity requirements of the economic and financial system in this period. They recognized that special flexibility in the conduct of open market operations was called for after the stock market collapse. Accordingly, reserves were provided generously on a daily basis, often at an atypically early hour. In the process, operations were directed toward some easing in reserve market conditions. The degree of pressure that was sought on reserve positions was reduced shortly after October 19 and again late in the month, but actual operations continued to be guided by day-to-day developments. Growth in nonborrowed reserves surged in late October as open market operations accommodated substantially enlarged desires for excess reserves and a large increase in required reserves associated with a sharp rise in transactions deposits.

In addition to providing liquidity to the financial markets through open market operations, the Federal Reserve assisted the Treasury market by relaxing some of the constraints on its collateralized lending of Treasury securities to primary dealers. Committee members agreed on a temporary suspension of the size limits[1] imposed on loans of securities to individual dealers and the requirement that such loans not be related to short sales. The federal funds rate dropped from above 7½ percent just before October 19 to 7 percent and below immediately following the stock market collapse; borrowing at the discount window averaged $525 million in the reserve maintenance period ending October 21 and excess reserves rose substantially, reflecting cautious reserve management by depository institutions. During the early part of the current reserve maintenance period, federal funds traded mostly in a 7 to 7¼ percent range, but more recently the funds rate moved below 7 percent after large injections of reserves by the Desk. Borrowing in the current reserve maintenance period was running well below that in the previous period.

Equity prices fluctuated sharply after their collapse on October 19, but most major stock indexes have recovered to levels somewhat above their October lows. Markets for fixed-income securities also were quite volatile after mid-October, but yields fell substantially on balance, with rates on long-term Treasury and high-grade corporate bonds reversing much of their runup since August. In recent days, bond markets generally have retained their earlier gains, as market participants have appeared to reassess the outlook for the economy, inflation, and monetary policy. In short-term markets, Treasury bill rates have shown net declines of around 1¼ percentage points since mid-October, in association with the easing of reserve conditions as well as increased demands for safe and liquid instruments, while rates on some private money market instruments have fallen somewhat less. In general, pressures in financial markets appeared to have moderated to some extent, although the markets continued to be characterized by an unusual degree of anxiety and uncertainty.

The dollar moved lower during the

1. Secretary's note: The temporary liberalization of securities lending terms was terminated effective November 19, 1987.

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first half of October, especially after the release of U.S. trade data on October 14 intensified market concern over the failure of the U.S. current account balance to improve. Though the dollar firmed temporarily immediately following the worldwide stock market collapse and reports of Secretary Baker's meeting with German officials, by the latter part of October the dollar again came under downward pressure amid widespread speculation that dollar exchange rates under the Louvre accord would be allowed to adjust downward. In addition, interest rates in the United States had dropped substantially relative to those in other major industrial countries. Over the entire intermeeting period, the dollar declined by about 4½ percent in terms of a weighted average of other G-10 currencies.

The plunge in equity prices prompted moves to short-term liquid assets, and growth of money, especially M1, appears to have accelerated in October. Demand deposits rose sharply around the time of the stock market collapse, perhaps reflecting the huge increase in financial transactions associated with the market turmoil. M2 growth was bolstered as well by an increase in assets of money market funds, which may have been associated in part with shifts from equity market funds. Even so, growth in M2 through October was estimated to have remained well below its long-run range. Expansion in M3 was boosted by increases in the managed liabilities of banks, partly to finance a sharp rise in security loans. This aggregate has continued to increase at about the lower bound of its range for the year. Growth of nonfinancial debt has remained around the middle of its long-run monitoring range.

The staff projection suggested that the decline in equity prices would lead to weaker economic growth through the end of 1988 than was expected at the time of the September meeting. The economy would be supported to an extent by the decline in interest rates and the lower dollar. However, the effects of these developments on domestic demand and net exports were thought likely to offset only part of the adverse impact of sharply lower equity prices on consumers and businesses. Consumption was expected to be relatively subdued in the quarters immediately ahead, reflecting the termination of automobile sales incentive programs as well as stock market developments, but to pick up later next year. Real business fixed investment was projected to grow at a slow pace given the outlook for sales. Housing construction was likely to drop somewhat in the near term, but that decline was forecast to be stemmed by lower mortgage rates. The outlook for real net exports of goods and services remained favorable, but with domestic demands weaker, the unemployment rate probably would move up somewhat. Against this background, the projected increases in prices and wages over the coming year were expected to be somewhat less than previously expected. Nonetheless, some pickup in price pressures still might be observed in association with sizable increases in nonpetroleum import prices.

In the Committee's discussion of current and prospective economic developments, the members focused on the potential effects of the recent turbulence in financial markets. They generally agreed that the sharp decline in stock prices and the still unsettled conditions in financial markets portended weaker growth in economic activity, at least for the nearer term, but also a lower risk of any substantial pickup in inflation. Members stressed that, while the direction of the adjustment was clear, it still was too early to quantify the impact of the recent

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disturbances in financial markets. No data were available on the overall performance of the economy since mid-October. Most business contacts around the country reported little or no immediate changes in retail sales activity or in business investment plans, but uncertainties about prospective business conditions clearly had increased. A more cautious attitude had emerged in the business community and possibly also among consumers.

Members commented that the staff forecast of somewhat reduced economic growth over the next several quarters was a reasonable expectation, but one that presumed the return of confidence and more normal conditions in financial markets. Accordingly, the risks of a different outcome, notably in the direction of more weakness, were viewed as much greater than usual. The prospects for satisfactory economic performance clearly depended on the restoration of generally stable financial conditions that would in turn foster the basic confidence that was needed to sustain long-term investments in business capital and in the debt and equity markets. The timing of such a development could not be predicted, but the members agreed that progress in reducing the federal budget deficit could play a key role by relieving market concerns and uncertainties. Indeed, recently renewed efforts to cut the budget deficit had contributed to a marginal reduction of tensions in key financial markets.

Despite the uncertainties that were involved, a few members stressed that the outlook for sustained economic growth still could be viewed as basically promising. Available data indicated an appreciable momentum in the current expansion, at least through the third quarter, and recent declines in interest rates along with an increasing ability of domestic firms to compete with foreign producers constituted elements of strength in the business picture. The view also was expressed that both the financial and the nonfinancial sectors of the economy were better balanced than earlier in the current business expansion. A less optimistic view pointed to the possibility that consumer and business spending might continue to be inhibited by the negative impact of stock price declines on wealth positions, the cost of equity capital, and more generally on consumer and business confidence. One member observed that a recession could not be ruled out and incoming data on the economy would need to be scrutinized with special care for signs of greater weakness than now were expected.

The members continued to view further improvement in real net exports as a key to sustaining moderate expansion in business activity, especially in the context of potentially weaker domestic demands than had been anticipated earlier. The prospects for continuing gains seemed favorable, given the depreciation of the dollar and indications of considerable improvements in the productivity of U.S. manufacturers. Tending to support such an outlook were reports from various parts of the country indicating that many domestic firms were competing more effectively in export markets and with importers. At the same time, some members commented that improvement in the nation's nominal net export position continued to be held back by the vigorous efforts of foreign firms to maintain market shares at the expense of profit margins as their own currencies appreciated in relation to the dollar. As they had at earlier meetings, members observed that trade developments would depend to an important extent on the economic performance of key foreign industrial nations.

Turning to the prospects for wages and prices, a number of members indi-

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cated that they saw in recent developments a potential for somewhat less inflation than they had anticipated earlier. The large decline in stock prices had reduced inflation expectations, and the weakening in the outlook for economic growth implied less pressures on wages and prices. Other developments that would tend to curb inflation included indications of ongoing improvement of labor productivity in manufacturing and the substantial slowdown in monetary growth this year. On the other hand, reference also was made to pressures on capacity in a number of industries, including some that competed actively with foreign producers. A sizable further decline in the dollar, should it occur, would exacerbate price and wage pressures in those industries and in the economy more generally.

At its meeting in July the Committee reviewed the basic policy objectives that it had set in February for growth of the monetary and debt aggregates in 1987 and established tentative objectives for expansion of those aggregates in 1988. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the Committee reaffirmed the ranges established in February that included growth of 5½ to 8½ percent for both M2 and M3. Given developments through midyear, the Committee agreed that growth in these aggregates around the lower ends of their ranges might be appropriate, depending on the circumstances. The monitoring range for expansion in total domestic nonfinancial debt also was left unchanged at 8 to 11 percent for 1987. For 1988 the Committee agreed on tentative reductions of ½ percentage point to growth ranges of 5 to 8 percent for both M2 and M3. The Committee also reduced the associated range for growth in total domestic nonfinancial debt by ½ percentage point to 7½ to 10½ percent for 1988. With respect to M1, the Committee decided at the July meeting not to set a specific target for the remainder of 1987 or to establish a tentative range for 1988. It was understood that all the ranges for 1988 were provisional and that they would be reviewed early next year in the light of intervening developments. The issues involved with establishing a target for M1 would be carefully reappraised at the beginning of 1988.

In the Committee's discussion of policy implementation for the weeks immediately ahead, the members generally agreed on the basic desirability of directing open market operations toward maintaining the easier conditions that had developed in money markets. This would involve about the degree of pressure on reserve positions that had been sought most recently. The members recognized that the still unsettled conditions in financial markets and related uncertainties in the economic outlook might continue to call for the more flexible and accommodative approach to policy that had characterized operations since October 19. This approach implied giving more weight than usual to money market conditions in order to facilitate the return to a more normal functioning of financial markets and to minimize the chances that the Committee's intentions would be misinterpreted. Such an approach also could help to assure that shifting demands for liquidity and reserves would be accommodated without undesirable fluctuations in money market conditions. As financial markets continued to stabilize, open market operations would be phased into a more normal approach to policy that was oriented more fully to a provision of reserves keyed to pressures on reserve positions. The transition would need to be executed with a great deal of caution under the still sensitive market circumstances that were foreseen.

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Committee members agreed that the lower interest rates that had emerged since mid-October were needed to help offset the effects of the sharp decline in stock prices. It was acknowledged that the interest rate reductions increased the risks for the dollar in the foreign exchange markets, particularly in the absence of similar reductions abroad, but in the opinion of a number of members those risks were manageable. Some members expressed concern, however, that a further substantial depreciation in the dollar, if it were to materialize, would have seriously adverse consequences for domestic prices and interest rates and might indeed trigger another crisis in domestic and international financial markets.

To the extent that market developments permitted a more normal focus on the implementation of a desirable degree of pressure on reserve positions, attention might need to be given during the intermeeting period to a possible adjustment in such reserve conditions depending on economic and financial developments and the behavior of the monetary aggregates. All of the members could foresee possible adjustments in either direction under alternative potential circumstances. However, in light of the uncertainties that continued to dominate financial markets and the risks that the recent developments could depress business activity, nearly all believed that policy implementation should remain especially alert to developments that might call for somewhat easier reserve conditions.

In keeping with the Committee's usual approach, it was understood that any decision to alter reserve objectives during the intermeeting period should take account of the behavior of the monetary aggregates. The members took note of a staff analysis, which indicated that the uncertainty surrounding projections of monetary growth was considerably greater than usual. In particular, the extent to which heightened preferences for liquidity and substantial variations in the volume of financial transactions might affect future demand for money balances was difficult to gauge. Moreover, it was hard to assess how quickly the money markets and depository institutions would move to reestablish a more normal structure of short-term market and deposit interest rates and in particular how fully the opportunity costs of holding money balances would be adjusted in the period ahead. On the assumption that conditions in financial markets would gradually return to more normal patterns but that some residual of the heightened demands for liquidity would remain, the reserve conditions that were contemplated might be accompanied by somewhat faster growth in M2 and M3 in the current quarter than had occurred in the third quarter. The members understood that such growth implied expansion in M2 for the year that would be well below the Committee's range and growth in M3 that was close to the lower end of its range. Growth in M1 continued to be particularly difficult to project in present circumstances, but a considerable slowing after the October bulge was seen as likely over the balance of the quarter.

Given the Committee's current approach to open market operations, the members anticipated that the federal funds rate would continue to fluctuate generally in a fairly narrow band close to recent levels. Nonetheless, most of the members agreed that the usual, relatively wide range to trigger a consultation should continue to be set for the federal funds rate. A majority favored a reduction in the range from the current 5 to 9 percent to 4 to 8 percent. While the midpoint of the current range would be centered approximately on the expected

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average trading level, some members commented that a rise toward 9 percent would have destabilizing effects in the period ahead. Moreover, a 4 to 8 percent range might be viewed as more in keeping with the recent thrust in monetary policy and the expectation that intermeeting adjustments, if any, were likely to be in the direction of easier reserve conditions.

At the conclusion of the Committee's discussion, all of the members indicated their support of a directive that called for maintaining the degree of reserve pressure that had been sought in recent days. The members recognized that the volatile conditions in financial markets and related uncertainties in the business outlook might continue to indicate the need for special flexibility in the conduct of open market operations. Such an approach to policy implementation would depend in particular on the strength of demands for liquidity stemming from recent and prospective developments in financial markets. To the extent that the functioning of those markets permitted a return to more normal open market operations, the members indicated that somewhat lesser reserve restraint would be acceptable, while slightly greater reserve restraint might be acceptable, depending on the strength of the business expansion, indications of inflation, the performance of the dollar in foreign exchange markets, with account also taken of the behavior of the monetary aggregates. The members believed that the outlook for monetary growth over the months ahead was subject to unusual uncertainty, but the contemplated reserve conditions were thought likely to be consistent with somewhat faster growth in M2 and M3 than had been expected earlier; such growth might center on annual rates of around 6 to 7 percent for the period from September through December. Largely reflecting the bulge in October, growth in M1 in the fourth quarter as a whole was expected to be well above its average pace in the previous several months. However, because of the very substantial uncertainty that still surrounded the outlook for M1, the Committee decided to continue its practice of not specifying a numerical expectation for its growth. 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 reduced from 5 to 9 percent to 4 to 8 percent.

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

The economic information available at this meeting was reviewed against the backdrop of extraordinary developments in financial markets in the period since the previous Committee meeting on September 22. Share prices in the stock market were down sharply. Following a particularly large decline of stock prices in mid-October, interest rates fell steeply and increases that had occurred during the first part of the intermeeting period subsequently were more than reversed on most types of debt obligations. Foreign exchange markets were relatively calm over most of the intermeeting period, but the dollar came under significant downward pressure late in the period.

In the third quarter economic activity had expanded at a fairly brisk pace. Total nonfarm payroll employment rose further in September, with the manufacturing sector continuing to record relatively sizable gains. The civilian unemployment rate edged down to 5.9 percent. Industrial production increased somewhat further in September following large gains in other recent months. Retail sales declined somewhat in September, but consumer spending, bolstered by a rise in auto sales, posted a large increase over the third quarter. Business capital spending was strong in the third quarter and forward indicators pointed to continuing gains. Housing starts were up in September

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but were little changed in the third quarter from their second-quarter average. The nominal U.S. merchandise trade deficit narrowed in August, but the July–August average remained above the second-quarter rate. The rise in consumer and producer prices was relatively moderate in recent months following more rapid increases earlier in the year.

Growth of the monetary aggregates appeared to have strengthened in October, with some of the strength reflecting heightened demands for transaction balances and other liquid assets in the latter part of the month. Even so, for 1987 through October, expansion of M2 evidently moved closer to, but remained below, the lower end of the range established by the Committee for the year, while growth of M3 was around the lower end of its range. Expansion in total domestic nonfinancial debt has remained on a more moderate trend in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 July to reaffirm the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3 measured from the fourth quarter of 1986 to the fourth quarter of 1987. The Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7½ to 10½ percent.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided at the July meeting not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range was set for 1988. The appropriateness of changes in M1 this year will continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

In the implementation of policy for the immediate future, the Committee seeks to maintain the degree of pressure on reserve positions sought in recent days. The Committee recognizes that the volatile conditions in financial markets and uncertainties in the economic outlook may continue to call for a special degree of flexibility in open market operations, depending, in particular, on demands for liquidity growing out of recent or prospective developments in financial markets. Apart from such considerations, somewhat lesser reserve restraint would, or slightly greater reserve restraint might, be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. While the outlook for monetary growth over the months ahead is subject to unusual uncertainty, the contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from September through December at annual rates of about 6 to 7 percent, but more rapid growth is possible should preferences for liquidity be particularly strong. Over the same period, growth in M1 is expected to be well above its average pace in the previous several months. 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

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be associated with a federal funds rate persistently outside a range of 4 to 8 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

2. Authorization for Domestic Open Market Operations

Effective November 4, 1987, the Committee approved a temporary increase of $3 billion, to $9 billion, in the limit between 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 Operations. The increase was effective for the intermeeting period ending with the close of business on December 16, 1987.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the normal leeway of $6 billion for changes in the System's Account probably would not be sufficient over the intermeeting period because of seasonal increases in currency in circulation and required reserves; such increases could be enlarged even further if current financial market tensions persisted.

Meeting Held on December 15–16, 1987

1. Domestic Policy Directive

The data on the economy reviewed at this meeting largely reflected the impact of developments that were under way before the stock market collapse in mid-October. The ultimate effects of the decline in stock prices and associated developments in financial markets remained uncertain. Available data suggested that growth in output was moderating from a brisk pace in the third quarter. Spending indicators pointed to a considerable slowing in the expansion of domestic private final demands in the current quarter. Prices and wages continued to increase at about the same pace as in earlier months of the year.

Industrial production rose 0.4 percent in November, following a strong rise in the previous month. In November, gains were widespread with the exception of the motor vehicles industry. Capacity utilization in mining, manufacturing, and utilities rose slightly further in November, and the overall rate in manufacturing was at its highest level since August 1984.

Total nonfarm payroll employment continued to rise strongly over October and November. The manufacturing sector again recorded relatively large gains, with hiring increases widespread across durable and nondurable goods industries. At the same time, job growth in service industries continued at a brisk pace. Aggregate hours worked by production and nonsupervisory workers remained on a strong uptrend. The civilian unemployment rate fell back to 5.9 percent in November.

Growth in consumer spending appeared to have weakened thus far in the fourth quarter, mainly because of a drop in purchases of new cars after incentive programs ended in September, although sales of other items also were weak. Retail sales edged up in November after two months of substantial declines. Spending on furniture and appliances fell sharply in September and October and moved lower again in November. Outlays for apparel recovered a bit in November, but spending on general

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merchandise registered another decline.

Housing starts rebounded in November but their average level in October and November remained somewhat below the averages in the second and third quarters. The improvement in November reflected a sharp rise in the multi-family category, which had dropped noticeably in October. Single-family starts edged up, supported by lower interest rates, but remained below their third-quarter average. The number of permits issued was about unchanged in November.

The expansion in business fixed investment appeared to have decelerated markedly from the exceptional pace of the third quarter. Outlays for capital equipment were damped by the drop in auto sales and a sharp decline in purchases of heavy trucks. Outside of motor vehicles, equipment demand remained strong early in the current quarter. Nominal shipments of nondefense capital goods, although down somewhat in October, remained above the third-quarter average. In addition, new orders moved up further, suggesting that shipments were likely to retain some momentum in the near term. Spending for nonresidential structures softened in recent months; petroleum drilling appeared to have leveled off, and nonresidential construction put-in-place declined somewhat in September and October.

Inventory investment was strong in October. Nonetheless, factory stocks remained low relative to sales by historical standards. In the auto sector, production exceeded sales in both October and November, and dealer stocks again rose to relatively high levels. At other retail trade establishments, inventory accumulation slowed in October.

The nominal U.S. merchandise trade deficit appeared to have deteriorated substantially in October from the average rate in the third quarter, reflecting in part large seasonal swings in both exports and imports. Exports were up slightly in October; about half of the increase was accounted for by a strong seasonal rise in agricultural products. The rise in nonagricultural exports was concentrated in shipments of a variety of products to Canada while exports of commercial aircraft dropped. Imports rose considerably in October. Most of the increase was in non-oil products, particularly machinery imports and imports of passenger cars from Japan, Canada, and Korea.

Economic growth in the major foreign industrial countries increased markedly in the third quarter. Real GNP rose substantially in Japan mainly because of a large increase in domestic demand, although net exports made a small positive contribution to growth; expansion in residential investment was particularly strong. German GNP, which had declined over the first half of the year, also increased sharply largely in response to domestic demand. Industrial production data for October showed some further expansion of activity in Japan and Germany. Available data suggested that GDP growth in the third quarter was strong in France, the United Kingdom, and Canada, as well.

The rise in most broad measures of prices and wages in recent months generally was close to that experienced earlier in the year. Retail energy prices dropped in October, and crude oil prices edged down in recent weeks. However, apart from energy, increases in consumer prices picked up recently, including higher prices for food, new cars, apparel, and rents. At the producer level, prices of finished goods turned down in October, but prices for intermediate and crude materials remained on a strong uptrend.

At its meeting on November 3, the Committee adopted a directive that

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called for maintaining the degree of pressure on reserve positions that had been sought around the time of that meeting. The Committee recognized that the volatile conditions in financial markets, including potential shifts in demands for liquidity, and uncertainties in the economic outlook might continue to call for a special degree of flexibility in open market operations. Taking account of conditions in financial markets, the members decided that somewhat lesser reserve restraint would, or slightly greater reserve restraint might, be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. The intermeeting range for the federal funds rate was reduced by 1 percentage point to 4 to 8 percent.

During the interval since the November meeting, reserves continued to be supplied on a more flexible basis than usual to help maintain relatively steady conditions in the money market at a time of unusual sensitivity and uncertainty in financial markets generally. Adjustment plus seasonal borrowing tended to be relatively low and averaged about $225 million during the two maintenance periods ending December 2. As evidence of a reduced willingness to borrow accumulated, such borrowing behavior was accommodated through provision of nonborrowed reserves in order to keep money market conditions from firming. Borrowing declined somewhat further so far in the latest maintenance period. After expanding at a double-digit pace in October, total and nonborrowed reserves contracted in November, reflecting a drop in required reserves associated in large measure with the reversal of the postcrash bulge in transactions accounts and a lower average level of demands for excess reserves.

Federal funds traded mainly in the 6¾ to 6⅞ percent range over the intermeeting period, close to the average level around the time of the November meeting. Most other short-term rates rose somewhat on balance. The increases apparently reflected some ebbing of preferences for liquidity as financial markets calmed further. In addition, expectations of further ease in monetary policy tended to diminish as incoming data suggested continued, albeit moderate, expansion in the economy and as the dollar fell in foreign exchange markets. To some extent rates on very short-term instruments increased because of positioning in advance of anticipated pressures in money markets around the year-end. Yields on long-term Treasury securities were up about 20 basis points after early November, while corporate bond yields rose half that much. In contrast, municipal bond yields and mortgage rates fell over the intermeeting period. Stock prices declined slightly further on balance. In general, while financial markets appeared to be functioning more normally, they remained unsettled with occasional episodes of unusually wide price swings and of flights to liquidity and quality echoing the experience after mid-October.

Since the November meeting, the foreign exchange value of the dollar declined about 5 percent on a weighted-average basis in terms of the other G-10 currencies. The dollar came under pressure early in the period, partly because of market disappointment over U.S. efforts to reduce the budget deficit. In early December concerted reductions in official interest rates by Germany and several other European countries temporarily boosted the dollar; over the entire intermeeting period short-term interest rates declined about ½ percentage point, on average, in major foreign industrial countries, while long-term rates were

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down slightly on balance. However, the dollar's decline resumed, especially after the very disappointing U.S. trade figures for October were released on December 10.

The monetary aggregates weakened substantially in November. While some of the weakness reflected a runoff of the bulge in demand deposits that followed the stock market plunge in October, demand deposits dropped below early October levels. Other checkable deposits also decreased. With the nontransactions portion of M2 expanding only sluggishly, the level of M2 was about unchanged in November. Only small time deposits and money fund shares showed any strength, as their yields remained attractive relative to rates on market instruments and liquid deposits. To supplement weak growth in core deposits, banks and thrift institutions issued managed liabilities at a robust pace in November, and flows into institution-only money funds moved up sharply, as returns on these funds lagged the downward movement of market rates in late October. Even so, M3 expanded at an annual rate of only 4¾ percent. For the year through November, M2 and M3 grew respectively at rates well below and at the lower ends of the 5½ to 8½ percent annual ranges established by the Committee. M1 growth also slowed sharply this year. The reduced growth of these aggregates and a turnaround of their velocities appeared to be attributable primarily to the rebound in interest rates and opportunity costs in 1987 after steep declines in 1985 and 1986.

The staff projection continued to point to relatively sluggish growth in economic activity during the first part of 1988 and to some pickup later in the year. The contour of the projection was dominated by the anticipated effects of the decline in stock prices and the accompanying developments in financial markets, although these effects now were projected to be more muted than was expected in early November. In the context of recent decisions to reduce the federal budget deficit, fiscal policy would exert a moderately restraining impact on aggregate demand. As in the previous projection, consumer spending was projected to slow in coming quarters, but to strengthen later in 1988 as most of the adjustment to the lower level of stock market wealth was completed. Growth in spending for plant and equipment was likely to slow in response to the sluggish pace of domestic sales—offset only in part by further growth in export sales—and the resulting diminished requirements for additional capacity. The decline in mortgage interest rates was expected to stimulate a modest improvement in residential construction. The external sector would provide a substantial positive contribution to activity over the entire projection horizon. Prices were likely to rise at a moderate rate in 1988. Energy prices were expected to be flat, but nonpetroleum import prices were projected to continue to place upward pressure on inflation and nominal gains in compensation were anticipated to increase. However, continuing efforts to improve competitiveness were expected to damp real wages and labor costs over the projection horizon.

In the Committee's discussion of the economic situation and outlook, members referred to conflicting signs with regard to the prospective strength of the business expansion. On the one hand, employment and production had been well maintained in recent months and financial markets had calmed since late October. To date, the sharp decline in stock prices appeared to have had little impact on domestic business activity, perhaps because it had merely reversed a runup in earlier months of the

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year and because it was associated with a reduction in market interest rates. Moreover, recent declines in the foreign exchange value of the dollar would help to sustain the improvement in net exports. In these circumstances, business investment also might remain fairly strong. Members cited favorable reports from businesses in many parts of the country that tended to support an optimistic outlook for overall business activity, although some areas or industries had recovered only slightly thus far from relatively depressed conditions. On the negative side, a number of members observed that the risks to the economy were in the direction of slower growth than foreseen in the staff forecast. Consumer spending in particular had been relatively weak, as evidenced by recent trends and the apparent need for widespread discounting to buttress sales. Moreover, growth in disposable incomes was believed likely to remain relatively sluggish, and together with an already low saving rate and rising consumer debt burdens would tend to retard expansion in retail sales. It also was noted that the full effects of the decline in stock prices might not yet have been felt. In addition, money growth had been quite weak, and at some point the slow growth might be reflected in incomes and spending. Several members commented that current projections were subject to a great deal of uncertainty, especially in light of still unusually sensitive conditions in domestic financial markets and the uncertain prospects for the dollar and the nation's foreign trade balance.

The members gave considerable attention during the discussion to the outlook for foreign trade and its implications for domestic economic activity. Recent data on nominal net exports were disappointing, but real net exports had shown considerable improvement so far this year. Gains in exports were especially encouraging. The data indicating an improved real trade balance were supported by members' observations from around the country. Many business contacts were reporting greatly enhanced export opportunities as a result of the dollar's depreciation, although there were exceptions, and they also indicated that their ability to compete in domestic markets against imported goods had improved. The members generally agreed that the foreign trade sector was positioned to make an appreciable contribution to sustained expansion in domestic economic activity at a time when growth in overall domestic demands might be weakening. However, the likely extent of actual gains from trade would depend to some degree on the strength of the economies of foreign industrial nations.

In further discussion members observed that, given the higher rate of utilization of domestic capital and labor resources, substantial improvement in the nation's trade balance implied the need for relatively restrained growth in domestic demands over time as more production was diverted to export markets. The adjustment in trade, which appeared inevitable in light of the unsustainable size of the current trade deficit and the rapid growth in the nation's external indebtedness, appeared feasible over time without causing major disruptions in domestic business activity. However, such an adjustment would require the implementation of appropriate fiscal, monetary, and trade policies by the United States and its major trading partners.

Turning to the outlook for inflation, some members commented that inflationary expectations seemed to have abated to some extent since the collapse in stock prices during October. The depreciation of the dollar would continue

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to exert upward pressures on domestic prices, but increases in wages and other costs did not appear to be worsening, and in the view of some members inflation might be in the process of easing. Concern was expressed by a number of members, however, that wage and price pressures might well intensify if the economy were to expand at an appreciably faster pace than many members currently expected or if the dollar were to decline substantially in the foreign exchange markets.

At its meeting in July the Committee reviewed the basic policy objectives that it had set in February for growth of the monetary and debt aggregates in 1987 and established tentative objectives for expansion of those aggregates in 1988. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the Committee reaffirmed the ranges established in February involving growth of 5½ to 8½ percent for both M2 and M3. Given developments through mid-year, the Committee agreed in July that growth in these aggregates around the lower ends of their ranges might be appropriate, depending on the circumstances. The monitoring range for expansion in total domestic nonfinancial debt also was left unchanged at 8 to 11 percent for 1987. For 1988 the Committee agreed on tentative reductions of ½ percentage point to growth ranges of 5 to 8 percent for both M2 and M3. The Committee also reduced the associated range for growth in total domestic nonfinancial debt by ½ percentage point to 7½ to 10½ percent for 1988. With respect to M1, the Committee decided at the July meeting not to set a specific target for the remainder of 1987 or to establish a tentative range for 1988. It was understood that all the ranges for 1988 were provisional and that they would be reviewed in early 1988 in the light of intervening developments. The issues involved with establishing a target for M1 would be carefully reappraised at the same time.

At this meeting the Committee held a preliminary discussion of issues relating to its target ranges for monetary growth in 1988. The behavioral characteristics of the aggregates in recent years were reviewed. Considerable attention was devoted to the question of whether or not to establish a target for M1 or some possible alternative such as M1A or the monetary base. While no decisions were made at this meeting, the members were not currently inclined to reestablish a range for M1, given the continued large interest rate sensitivity of the demand for this aggregate and the associated wide swings in its velocity. The Committee will complete its review of these issues and decide on its target ranges for 1988 at the February meeting.

In the Committee's discussion of policy for the next intermeeting period, most of the members agreed that on balance economic and financial developments called for unchanged conditions of reserve availability. Such a policy was viewed as consistent with continuing growth in the economy at a moderate pace. The members recognized that financial markets remained unsettled despite the emergence of a much calmer atmosphere since the latter part of October, and they believed that money market conditions might be subject to considerable volatility around the year-end. In this situation most of the members felt that open market operations should continue to be conducted with a special degree of flexibility and should give considerable weight to conditions in the money market, at least over the nearer term, to accommodate shifting demands for liquidity and reserves and to temper potentially excessive fluctuations in short-term markets. However, most of the members also fa-

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vored looking for opportunities to move toward more normal procedures for implementing policy if financial markets continued to stabilize.

In the majority view the risks associated with either firming or easing under current circumstances outweighed the potential benefits. It was noted, for example, that any significant firming would have unsettling effects on domestic financial markets and the associated rise in interest rates would pose considerable risks to the economic expansion. At the same time, many members felt that any appreciable easing would not be desirable currently, especially in light of the dollar's weakness and the risks to domestic financial markets and the economy that a sharp further decline in the dollar would incur. Other members weighed such risks differently, including one member who concluded that monetary policy should move toward somewhat easier reserve conditions in light of the potential for appreciably slower growth in the economy, given in this view the prospects for substantially reduced growth in domestic demands and the possibility that improvement in the nation's foreign trade balance would not provide a sufficient offset. In light of the differences among the members with regard to policy for the short run, including the Committee's operating procedures in the near term, and the uncertainties surrounding financial markets and the economy, it was understood that the members might need to consult on policy implementation before the next scheduled meeting on February 9–10, 1988.

Several members expressed some concern about the generally sluggish growth in the monetary aggregates since the early months of the year, including indications of little or no growth in M2 in recent weeks and much slower expansion in M3 than had been expected earlier. The members recognized that the relationship between monetary growth and economic performance had been very imprecise in recent years. Nonetheless, money growth and the economy were not unrelated and the reemergence of a stronger linkage could not be ruled out. In these circumstances, a continuation of sluggish growth of the monetary aggregates needed to be monitored closely as a potential danger signal with regard to the sustainability of the economic expansion.

The members also focused on the question of possible adjustments in policy implementation during the intermeeting period. A majority felt that there should be no presumptions about the likely direction of such adjustments, if any. In their view the risks that economic and financial developments might differ significantly from current expectations were fairly evenly balanced in both directions. A number of other members believed that the Committee should remain especially alert to developments that might call for somewhat easier reserve conditions. In particular, these members felt that incoming information regarding the performance of the economy should be evaluated with particular care for evidence of a possible slowing in the expansion. The members recognized that the performance of the dollar in foreign exchange markets might have a key bearing on policy implementation in this period. No member wanted to tie monetary policy exclusively to the dollar, but some strongly emphasized that further substantial depreciation in the dollar could have highly adverse repercussions on domestic financial markets and the economy.

During this meeting the members reviewed the Committee's operating procedures. These had been directed toward greater emphasis on stabilizing money market conditions since the stock market

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collapse in October and had given relatively less attention to the implementation of a specified degree of pressure on reserve positions. The members generally agreed that the Committee should return to its earlier operating procedures. The latter were seen to possess a number of advantages, including greater scope for market forces to be reflected in money market conditions. Given the still sensitive conditions in financial markets, however, the members expressed a range of views with regard to the appropriate timing of a return to the Committee's former operating procedures. Some endorsed the prompt implementation of those procedures. However, a majority felt that a gradual shift toward greater emphasis on reserve objectives should be implemented during the intermeeting period. Such an approach would continue to give some attention to moderating fluctuations in money market conditions but would tolerate somewhat greater fluctuations than had occurred in recent weeks. A few members disagreed and indicated a preference for retaining the recent operating procedures at least for now. These members emphasized that a normal or predictable relationship between the provision of reserves and money market conditions had not been reestablished and was not likely to reemerge in the near term, at least in the period through the year-end when interest rates and reserves were expected to be subject to considerable variations associated with the bank statement date. The procedures could be reviewed in early January and a decision delayed until then.

At the conclusion of the Committee's discussion, all but two of the members indicated their support of a directive that called for maintaining the existing degree of pressure on reserve positions and that would phase open market operations into a more normal approach to policy implementation keyed increasingly to a desired degree of reserve pressure while giving less emphasis than recently to money market conditions. The members recognized that the conduct of open market operations might continue to require a special degree of flexibility, given still quite sensitive conditions in financial markets and the uncertainties in the business outlook. Taking account of conditions in financial markets, the members indicated that somewhat less or somewhat more reserve restraint would be acceptable, depending on the strength of the business expansion, indications of inflation, the performance of the dollar in foreign exchange markets, with consideration also taken of the behavior of the monetary aggregates. If current reserve conditions were maintained, the members expected growth in M2 and M3 to pick up from the pace in recent months to annual rates of about 5 percent and 6 percent respectively over the four-month period from November to March. Growth of M1 was expected to remain relatively limited over the same period; because of the substantial uncertainty that continued to surround the outlook for M1, the Committee continued its practice of not specifying a numerical expectation for its growth. 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 4 to 8 percent.

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

> The economic information reviewed at this meeting largely reflected the influence of developments that were under way before the financial disturbances of mid-October. The extent to which those disturbances would

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affect the economy remained uncertain. Information available for the current quarter suggested that the expansion in economic activity was moderating from a brisk pace in the third quarter. Total nonfarm payroll employment rose strongly further over October and November, with the manufacturing sector recording relatively large gains. The civilian unemployment rate, at 5.9 percent in November, remained close to its level since mid-year. Industrial production also increased considerably further over October and November, following sizable advances since late spring. Retail sales edged up in November after two months of substantial declines. Recent indicators of business capital spending suggested modest further growth after a surge in the third quarter. Housing starts rose somewhat in November, after slowing in October, but were little changed from the average pace in the second and third quarters. The nominal U.S. merchandise trade deficit in October appeared to have deteriorated substantially from the average rate in the third quarter. The rise in broad measures of prices and wages in recent months generally has been close to that experienced earlier in the year.

Financial markets remained somewhat unsettled. Stock and bond prices continued to fluctuate over a relatively wide range during the period since the previous Committee meeting on November 3. On balance, share prices fell somewhat further in this period. Changes in long-term yields were mixed while short-term interest rates rose, especially on short-maturity private market instruments. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined considerably further.

The monetary aggregates weakened in November after strengthening in October in conjunction with a temporary surge in demands for transaction balances and other liquid assets in the latter part of that month. For 1987 through November, expansion of M2 fell somewhat further below the lower end of the range established by the Committee for the year, while growth of M3 remained around the lower end of its range. Growth of M1 was close to that of nominal GNP for the year to date and expansion in total domestic nonfinancial debt remained well within the Committee's monitoring range for the year.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, 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 July to reaffirm the ranges established in February for growth of 5½ to 8½ percent for both M2 and M3 measured from the fourth quarter of 1986 to the fourth quarter of 1987. The Committee agreed that growth in these aggregates around the lower ends of their ranges might be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity was expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed in July on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7½ to 10½ percent.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. Because of this sensitivity, which had been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided at the July meeting not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range was set for 1988. The appropriateness of changes in M1 this year would continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures. The Committee welcomed substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee indicated in July that in reaching operational decisions over the balance of the year it would take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

In the implementation of policy for the immediate future, the Committee seeks to

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maintain the existing degree of pressure on reserve positions. The Committee recognizes that still sensitive conditions in financial markets and uncertainties in the economic outlook may continue to call for a special degree of flexibility in open market operations. Taking account of conditions in financial markets, somewhat lesser reserve restraint or somewhat greater reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from November through March at annual rates of about 5 percent and 6 percent, respectively. Over the same period, growth in M1 is expected to remain relatively limited. 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 4 to 8 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Keehn, Kelley, and Stern. Votes against this action: Mr. Johnson and Ms. Seger.

Mr. Johnson dissented because he believed that policy implementation should continue to focus on maintaining generally stable conditions in the money market, at least through the year-end, pending the emergence of more settled conditions in financial markets and a more predictable relationship between reserve objectives and money market conditions. He also preferred a directive that gave greater weight to the possibility for some easing, given potential developments during the intermeeting period.

Ms. Seger dissented because she favored some slight easing of reserve conditions in light of her concern about the downside risks in the economy, especially in the context of sluggish growth in reserves and the monetary aggregates over an extended period. She also wanted to continue to focus on money market conditions in System open market operations and in particular to counter upward pressures on short-term interest rates.

2. Authorization for Domestic Open Market Operations

Effective December 17, 1987, the Committee approved a temporary increase of $3 billion, to $9 billion, in the limit between 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 Operations. The increase was effective for the intermeeting period ending with the close of business on February 10, 1988.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager advised that the normal leeway of $6 billion for changes in System Account holdings of securities probably would not be sufficient to accommodate desirable reductions in the intermeeting period because of seasonal declines in currency in circulation and required reserves.

On January 5, 1988, the Committee held a meeting by telephone conference to review monetary and financial developments since mid-December and to assess the Committee's decisions at the December meeting to begin to redirect its operating procedures towards more emphasis on achieving a desirable degree of pressure on reserve positions. In the period after the stock market collapse in October, open market operations had been guided to an important

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extent by the objective of restoring and sustaining stability in the money market, and less attention was given than previously to the implementation of objectives relating to reserve conditions.

In the Committee's discussion most of the members agreed that with the further passage of time since the October disturbances in financial markets and with year-end pressures in the money market now unwinding, further progress could be made toward restoring the Committee's earlier approach to open market operations. The members recognized that conditions in financial markets were still somewhat unsettled and that the relationship between reserves and money market conditions had not been reestablished on a fully normal or predictable basis. In the circumstances and in light of the uncertainties in the economic outlook, it was agreed that some amount of flexibility might continue to be needed in the conduct of open market operations.

To reflect and endorse the further progress toward the operating procedures in use before mid-October, the Committee decided to amend the relevant reference in the operational paragraph of its directive issued at its December meeting. The amendment encompassed solely a change in emphasis relating to operating procedures and did not include any change in the Committee's short-run policy objectives.

At the conclusion of this telephone meeting, the Committee voted to change the operational paragraph of its directive to read as follows:

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. The Committee agrees that the passing of time and the year-end should permit further progress toward restoring a normal approach to open market operations, although still sensitive conditions in financial markets and uncertainties in the economic outlook may continue to call for some flexibility in operations. Taking account of conditions in financial markets, somewhat lesser reserve restraint or somewhat greater reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from November through March at annual rates of about 5 percent and 6 percent, respectively. Over the same period, growth in M1 is expected to remain relatively limited. 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 4 to 8 percent.

Vote for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, and Stern. Vote against this action: Ms. Seger.

Ms. Seger dissented because she continued to believe that open market operations should be directed toward some slight easing. She also felt that financial markets remained too unsettled to warrant any shift at this time in operational procedures toward more emphasis on reserve objectives.

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Consumer and Community Affairs

In 1987 the Federal Reserve Board used its rulewriting and enforcement authority to maintain statutory protections for consumers while easing regulatory burdens. This report examines in detail the activities of the Federal Reserve System in support of those goals.

Regulatory Matters

The Board amended Regulations E and Z and proposed further amendments to Regulation Z. The Board also proposed Regulation CC, to carry out the provisions of the Expedited Funds Availability Act. In other regulatory matters, the Board cooperated in the production of brochures to clarify for consumers the process of applying for a mortgage and cosponsored a conference to aid bankers in setting up programs for basic banking and home equity lines of credit that are responsive to concerns of consumers.

Regulation E (Electronic Fund Transfers)

In August the Board amended Regulation E (Electronic Fund Transfers) to eliminate the requirement to issue periodic statements for institutions that provide EFT services but do not themselves hold consumer accounts. The amendments, which were effective November 15, 1987, apply to retailers (such as gasoline stations or supermarkets) that offer point-of-sale EFT services to consumers and use automated clearinghouses to access consumer accounts held at financial institutions. The Board believes that the amendments should facilitate the development of point-of-sale EFT services without imposing substantial compliance costs on financial institutions or significantly reducing consumer protections.

To take advantage of the exemption from the periodic statement requirement, providers of point-of-sale EFT services must take these steps:

- Issue consumers a debit card that includes the name and address or telephone number they can use to contact the service provider about errors or other problems.
- Include on each transaction receipt the address and telephone number for reporting errors.
- Transmit, in accordance with Regulation E, the information needed to identify the transaction, including the terminal location, to the account-holding financial institution.
- Inform the consumer in the initial disclosure statement that the provider should be notified in the event of an error.
- Extend the periods available to the consumer for notice of errors (from 60 to 90 days) and for notice of lost or stolen debit cards (from 2 to 4 business days).

The amendments also require account-holding financial institutions to include a description of these EFT transactions on the periodic statements they provide to their customers. To reduce costs and help institutions comply with the new requirements, disclosure of the terminal location will not be required until July 1, 1990. In addition, financial institutions with assets of $25 million or less will not be required to comply with any aspect of these amendments to the regulation (except to cooperate with the service provider in the investigation of errors) until July 1, 1990.

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Regulation Z (Truth in Lending): Adjustable Interest Rate Limits

In November the Board amended Regulation Z (Truth in Lending) to require creditors that offer adjustable-rate loans secured by a dwelling to set a limit on the maximum interest rate that may be charged. The amendment, which implements a provision of the Competitive Equality Banking Act of 1987, applies to closed-end transactions (such as traditional second mortgages) and open-end plans (such as home equity lines of credit) made on or after December 9, 1987, the effective date of the law. Determination of the maximum rate is left to the creditor's discretion.

Regulation Z: Adjustable-Rate Mortgages

In December the Board amended Regulation Z to require creditors to give consumers more information about the variable-rate feature of closed-end, adjustable-rate mortgages with maturities longer than one year. The amendment, effective October 1, 1988, applies to mortgages secured by the consumer's principal dwelling and requires creditors to give consumers an educational booklet about adjustable-rate mortgages; to give a detailed description of the variable-rate feature; and to give an example based on historical data that shows the effect of actual changes in index values on a $10,000 loan. This information must be provided at the time the consumer gets an application form or before the consumer pays a nonrefundable fee, whichever is earlier.

These revisions address concerns about the adequacy of information given to consumers who apply for adjustable-rate mortgages; they are expected to be adopted shortly by the other federal agencies that regulate financial institutions. Moreover, the new rules will provide a common approach to ARM disclosures. Until now, the Board, the Federal Home Loan Bank Board, the Comptroller of the Currency, and the Department of Housing and Urban Development all have had different disclosure requirements for these loans. The differences may have hampered consumers in comparing ARMs before entering into these transactions. The differences have also proved burdensome to mortgage lenders seeking to take full advantage of the secondary market because of the need to satisfy more than one regulation. For example, lenders who originate mortgages for possible sale either to a federal savings and loan association or a national bank typically have had to make disclosures under the rules of two agencies.

Regulation Z: Home Equity Lines of Credit

In December the Board proposed to amend Regulation Z to require that creditors give consumers more detailed disclosures about home equity lines of credit early in the credit process. The disclosures would apply to home equity lines of credit secured by a consumer's principal dwelling; they would have to be given to the consumer at the time of application or before the consumer pays a nonrefundable fee, whichever is earlier. These disclosures would have to be segregated from other information given to the consumer. They would include notice of whether the creditor could terminate or change the terms of the plan. For plans with a variable-rate feature, creditors would have to specify the index used to calculate rate adjustments, the frequency of rate adjustments, and a history of changes in the index. Creditors also would be required to give consumers a brochure describing home equity plans.

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Regulation CC (Expedited Funds Availability)

In December the Board proposed a new regulation, Regulation CC, to carry out the Expedited Funds Availability Act, which is title VI of the Competitive Equality Banking Act of 1987. The act and proposed regulation address the practice of some depository institutions of delaying access to deposits, a practice that may cause problems for customers. They require, among other things, that depository institutions make funds deposited into accounts available within specified time schedules and disclose their policies on funds availability.

The time schedules differ based on several factors, including the type of deposit and relative locations of the depository and paying banks. The act allows financial institutions to delay access for certain types of deposits for longer periods. These deposits include deposits to a new account; checks for large dollar amounts; deposits that the institution has reasonable cause to believe are uncollectible; deposits of checks that have been returned unpaid and redeposited; and deposits to accounts that have been overdrawn repeatedly. Depository institutions are required to make disclosures before opening accounts, to existing customers, on deposit slips and automated teller machines, and in branch lobbies. In the proposed regulation, the Board included model disclosure forms to make it less burdensome and less costly for financial institutions to comply with the new requirements. The act and regulation will be effective September 1, 1988.

Regulation B (Equal Credit Opportunity)

In September the Board determined that the Equal Credit Opportunity Act (ECOA) and Regulation B do not preempt certain provisions of Wisconsin law. The ECOA authorizes the Board to consider inconsistencies between the act and state laws relating to credit discrimination.

The Board determined that because Wisconsin is a community property state, the state and federal laws do not conflict in regard to inquiries about marital status.

The Board also considered a state provision that allows a nonapplicant spouse unilaterally to terminate an account. Because Regulation B prohibits an institution from refusing to grant an individual account to a creditworthy applicant on the basis of marital status, the federal and state laws appear to be inconsistent. The Board determined not to preempt, however, basing its decision on a provision of the ECOA that allows creditors to take into account state property laws directly or indirectly affecting creditworthiness.

Regulation AA (Credit Practices Rule)

In January the Board granted a request from New York State for an exemption from Regulation AA (Credit Practices Rule). That rule prohibits banks and their subsidiaries from using certain creditor remedies to enforce consumer credit obligations and from "pyramiding" late charges; it also affords special protections for cosigners. To qualify for an exemption, the state must have a law that protects consumers at least as well as the corresponding federal provision.

Because the New York law covers only transactions involving $25,000 or less, transactions above that amount remain subject to the federal rule. However, the Board determined that compliance with New York law will constitute compliance with the federal requirements.

The Board also received an applica-

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tion from the State of California for an exemption from the cosigner provisions of the Credit Practices Rule. The Board published notice of the application in July; final action is expected in early 1988.

Interpretations

In 1987 the Board continued to offer legal interpretations and guidance in updates to the official staff commentaries on Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), and Regulation Z (Truth in Lending). These commentaries, which are published by April 1 each year, help financial institutions and others apply the regulations to specific situations.

Mortgage Brochures

In response to a congressional request, the Federal Reserve Board and the Federal Home Loan Bank Board prepared three brochures to improve consumer understanding of the mortgage application process. These brochures—on refinancings, lock-ins, and closing costs—are scheduled for publication early in 1988. They were prepared in consultation with numerous trade and consumer groups and government agencies.

Conference on Basic Banking and Home Equity Lines of Credit

In October the Board cosponsored a conference on basic banking and home equity lines of credit with the American Bankers Association and the Consumer Bankers Association. More than 100 bankers from 26 states attended. The conference was intended to help bankers design basic banking and home equity programs that are responsive to consumer concerns. The speakers at the conference, mainly bankers, presented case studies of successful programs at their respective institutions.

Community Affairs

The Federal Reserve System continued to gather and disseminate information about community development strategies and techniques to help banks, holding companies, and others address the economic needs of their local communities, including areas with low- and moderate-income neighborhoods. These strategies and techniques have emphasized the value of partnerships among cities, communities, and banks. In many instances they have offered reliable ways of achieving the aims of the Community Reinvestment Act to meet community credit needs and to address the problem of disinvestment.

To support the Community Affairs program, the Board offered training for the Reserve Banks' Community Affairs Officers (CAOs) and their staffs. A two-week course presented by the Development Training Institute in Baltimore sought to ensure that the CAOs are well versed in community development lending. The CAOs used the knowledge of development issues gained during this training program to educate banks and other organizations about becoming involved in community development.

During the year, the Reserve Banks sponsored 63 seminars and workshops, ranging from half-day forums that centered on specific issues to three-day conferences that explored a variety of topics related to community investment, community revitalization, and rehabilitation financing. With the Office of the Comptroller of the Currency, the Board also cosponsored a conference on community development corporations (CDCs) that are subsidiaries of national banks or bank holding companies. The aim was to inform bankers who seek to promote housing and economic development in low-income neighborhoods about the

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flexible financial strategies available through CDCs.

In meetings with community development practitioners in the private and public sectors, members of the community affairs staffs at the Reserve Banks detailed successful programs and strategies that might be duplicated. These outreach efforts by all the Reserve Banks helped bankers to address the needs of communities. For example, they helped bankers to develop housing programs in New Jersey and Rhode Island; prompted banks to work together to address community development in Camden, New Jersey, and Columbus and Cincinnati, Ohio; and attracted the involvement of banks in local government programs in Nashville, Tennessee, and New York City. A seminar on revolving loans for commercial revitalization, sponsored by the Richmond Federal Reserve Bank, helped banks in Galax and Winchester, Virginia, to establish revolving loan pools at favorable rates in their towns.

In other meetings, the staffs of the Reserve Banks discussed community development issues with representatives of bank holding companies, community groups, city government officials, banks, and trade associations. Through these discussions the participants learned more about the credit needs of their respective communities. In addition, examiners made hundreds of contacts with individuals and organizations in the communities of the banks they were examining.

In 1987 the staffs of the Reserve Banks were invited to speak before 101 groups concerning the Community Reinvestment Act and community development, a significant increase from previous years. Although many of the presentations were primarily for bankers, many also were made to regional workshops sponsored by the Department of Housing and Urban Development, the American Planners Association, the National Association of Counties, and the Council for Urban Economic Development and to community groups such as National Peoples Action and the Association of Community Organizations for Reform Now (ACORN). In all, the CAOs and their staffs reached over 650 audiences in 1987 through speeches, conferences, meetings, and neighborhood tours.

Compliance with Consumer Regulations

Data from the five federal agencies that supervise financial institutions and from other federal supervisory agencies indicate that compliance with the Truth in Lending Act and the Equal Credit Opportunity Act declined slightly from 1986 levels, while compliance with the Electronic Fund Transfer Act remained substantially the same. This section summarizes data on compliance gathered from the regulatory agencies covering the reporting period July 1, 1986, to June 30, 1987.[1]

Truth in Lending Act (Regulation Z)

According to aggregate data from the Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Federal Home Loan Bank Board (FHLBB), and the National Credit Union Administration (NCUA), 54 percent of examined institutions had no violations under Regulation Z; the proportion for 1986 was 62 percent. The OCC, the FDIC, and the NCUA noted

1. Not all the federal agencies that regulate financial institutions use the same method to compile data on compliance. However, the data support the general conclusions presented here.

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declines in compliance, while the Board and the FHLBB reported little change from 1986. Among institutions supervised by the Board, the OCC, and the NCUA that were not in full compliance, half had fewer than five violations. This record indicates substantial compliance even among institutions with violations. (The other agencies do not collect data on the frequency of violations.) Financial institutions were most frequently cited for failing to give accurate disclosures of the following items:

- The annual percentage rate.
- The number, amount, and timing of payments scheduled to repay the obligation.
- The finance charge.
- The amount financed.

The violation next in frequency was the failure to make disclosures clearly and conspicuously, in writing. The FDIC issued one cease-and-desist order, and the OCC issued three formal enforcement actions involving violations of Regulation Z. Under the Regulation Z Interagency Enforcement Policy Guide, 164 institutions supervised by the Board, the FHLBB, the FDIC, and the OCC reimbursed $1.2 million to 10,507 accounts. In 1986, $1.3 million was reimbursed to 12,252 accounts.

The Federal Trade Commission (FTC) continued its compliance program to enforce the requirements of Regulation Z regarding credit advertising, with an emphasis on advertisers of real estate and automobile credit. Most companies contacted by the commission promptly brought their programs into compliance, and three companies signed consent decrees.

In the past year the FTC, in conjunction with the National Association of Attorneys General, began a major new enforcement program against fraud in telemarketing and other fraud involving charges to credit cards. The program uses data gathered from consumer complaints to trace companies suspected of violating the Federal Trade Commission Act and the Truth in Lending Act. A number of actions have been brought in federal district courts alleging violations of the act's requirements for prompt notification of returns and crediting of refunds.

To heighten the awareness of consumers and creditors concerning their rights and responsibilities, the FTC issued several new publications: "Lost or Stolen: Credit and ATM Cards," "Telemarketing Travel Fraud," "Telephone Investment Fraud," and "How to Write Readable Credit Forms."

The Department of Transportation (DOT) reported a satisfactory level of compliance with the Truth in Lending Act by foreign and domestic air carriers subject to its jurisdiction. As the result of consumer inquiries investigated by the agency, DOT entered into a consent order with an air carrier that included provisions relating to the act. The other agencies that enforce the act—the Packers and Stockyards Administration of the Department of Agriculture and the Farm Credit Administration—also reported satisfactory levels of compliance.

Equal Credit Opportunity Act (Regulation B)

The five financial regulatory agencies reported a slight decline in the overall level of compliance with the Equal Credit Opportunity Act. In the aggregate, the number of institutions that had no violations declined from 79 percent in 1986 to 74 percent for the 1987 reporting period. However, the three agencies that collect data on violation frequency (the Board, the OCC, and the NCUA) reported that among the institutions not in full compliance, 75 percent had fewer than five violations, a number that suggests substantial compliance.

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The most frequent violations of Regulation B were the following items:

• Failing to provide a written notice of adverse action that contains the information required by the regulation.

• Failing to give notice of the action taken within 30 days of receiving a completed application.

• Failing to request information for monitoring purposes on applications involving the purchase or refinancing of a primary residence.

• Failing to provide the specific reasons for adverse action.

• Illegally requiring the signature of an applicant's spouse or other cosigner.

The OCC and the FHLBB each issued a formal enforcement action that included provisions addressing ECOA violations.

The FTC continued an investigative program in which testers pose as credit applicants to monitor compliance with the ECOA. During this reporting period, the FTC settled an ECOA case in litigation, entered into a consent decree with a creditor, and amended a consent decree with another creditor. As part of its ongoing consumer education effort, the FTC issued a new brochure, "Credit and Older Americans." Other agencies—the Department of Transportation, the Interstate Commerce Commission, the Small Business Administration, the Securities and Exchange Commission, and the Packers and Stockyards Administration—reported satisfactory compliance with the ECOA among the entities they supervise.

Electronic Fund Transfer Act (Regulation E)

The five financial regulators reported that 90 percent of the institutions they examined were in full compliance with Regulation E. This level of compliance is substantially the same as last year's. Among the institutions examined by the Board, the OCC, and the NCUA that were not in full compliance, 87 percent had fewer than five violations.

The five most frequent violations of Regulation E involved the failure to give the following disclosures:

• A written statement outlining the terms and conditions of the EFT service.

• A statement of the consumer's liability for unauthorized transfers.

• A notice explaining procedures for resolving errors and the consumer's rights.

• The types of electronic fund transfers that the consumer may make and any dollar and frequency limitations.

• A periodic notice of the procedures for resolving disputes.

The other agencies responsible for enforcing the Electronic Fund Transfer Act, the Department of Transportation and the Securities and Exchange Commission, reported a satisfactory level of compliance.

Economic Effect of Regulation E

In accordance with statutory requirements, the Board monitors the effects of the Electronic Fund Transfer Act on the costs and benefits of EFT service to financial institutions and consumers. During 1987, the economic effect of the act broadened as more financial institutions offered EFTs and more consumers used them. Approximately two-thirds of the depository institutions in the United States now provide EFT services that are covered by the requirements of the act and by Regulation E.

Demand for EFT services has continued to grow. Consumers gained greater access to EFT services through the expansion of shared ATM networks. Depository institutions processed approximately 350 million debit-card transactions per month for consumer accounts. While most of those transactions were initiated at the country's 70,000 ATMs, about 7 million transactions per

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month were carried out at electronic point-of-sale terminals. The number of merchant terminals capable of supporting direct-debit POS transactions is expected to grow rapidly from its current level of approximately 75,000.

In 1987 the Board adopted amendments to Regulation E that are expected to make POS electronic transactions easier and less costly for merchants to offer, although they impose new responsibilities and costs on depository institutions. The amendments are expected to facilitate the growth of electronic POS systems controlled by merchants, thereby offering consumers a less expensive method of payment.

More and more consumers are electing to receive payroll or government transfer payments by electronic direct deposit; and more corporations offer direct deposit of payroll. In the public sector, about 46 percent of social security recipients now receive monthly benefits electronically. The number of military personnel who receive payroll and other benefits by automated direct deposit is growing, and the Internal Revenue Service offers electronic deposit of individuals' income tax refunds.

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 in any case. Statistics from examination reports do not suggest widespread violation of the consumer rights established by the act. Moreover, in 1987, according to reports by the federal agencies that regulate financial institutions, the proportion of institutions that were not in full compliance was, as in 1986, only one in ten. The violations involved primarily the failure to provide one or more disclosures to consumers. Eighty-seven percent of the institutions cited for noncompliance had fewer that five violations, a small number in light of the volume of consumer EFT transactions in individual institutions.

Data from the Board's Consumer Complaint Control System confirm that consumers have no serious problems with EFT. Only 74 of the 2,621 complaints processed in 1987 involved EFTs. The Federal Reserve System forwarded 29, which did not pertain to state member banks, to other agencies for resolution. Of the remaining 45, none involved a violation of the regulation.

Because the costs of industry practices that would have evolved in the absence of statutory requirements are unknown, the incremental costs associated with the act, like the benefits, are difficult to quantify. But the compliance cost of an EFT transaction is probably not high enough to compromise the cost advantage such transactions have over check-based transactions.

As EFT systems mature, as transaction volume builds, and as start-up costs for compliance are amortized, compliance costs imposed by the act per EFT transaction and per dollar of transferred funds are likely to decline.

Complaints against State Member Banks

In 1987 the Federal Reserve System received a total of 2,621 complaints (see accompanying table). Within this total, 907 were against state member banks, which the Federal Reserve investigates and resolves. The System referred the remaining 1,714 complaints, involving other creditors and businesses, to the appropriate enforcement agencies. Most of the complaints (2,163) were made in letters; 450 were made by telephone, and 8 were made in person. The Board also received 217 written inquiries concerning consumer credit laws and banking practices. In responding, the Board's staff gave consumers brochures on the general issues plus explanations of laws,

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Consumer Complaints Received
by the Federal Reserve System,
by Subject, 1987[1]

Subject	Number
Regulation B (Equal Credit Opportunity)	162
Regulation E (Electronic Fund Transfers)	74
Regulation M (Consumer Leasing)	4
Regulation Q (Interest on Deposits)	98
Regulation Z (Truth in Lending)	748
Regulation BB (Community Reinvestment)	1
Fair Credit Reporting Act	122
Fair Debt Collection Practices Act	50
Fair Housing Act	2
Holder in due course	2
Transfer agents	7
Unregulated bank practices	1,254
Other[2]	97
Total	**2,621**

1. Comprises 907 complaints about state member banks, over which the Federal Reserve has jurisdiction, and 1,714 complaints about other lenders, which the Federal Reserve referred to the appropriate agencies.

2. Primarily miscellaneous complaints against business entities.

regulations, and banking practices specific to their complaints or inquiries.

The Board's staff continues regularly to review and assess the System's handling of complaints. The staff samples the handling of complaints about state member banks for adherence to System policies; and, through follow-up questionnaires, it attempts to gauge complainants' perceptions of how well the process works. Approximately 86 percent of the respondents found the explanations clear and understandable; 92 percent were satisfied with the speed in handling their complaints; and 83 percent found the resolution of their complaints acceptable. All of the respondents indicated that they were treated courteously by the Federal Reserve staff and that they would contact the Federal Reserve again if they had other problems with banks.

The accompanying table summarizes the nature and resolution of complaints filed against state member banks in 1987, classified according to bank functions: loans, deposits, electronic fund transfers, trust services, and others. Of the 907 complaints received, approximately 58 percent concerned loan functions, including alleged discrimination on a prohibited basis, credit denial on a nonprohibited basis, and disclosure of credit costs. About 22 percent involved practices concerning deposit accounts, including disputes about interest.

Unregulated Practices

Under section 18(f) of the Federal Trade Commission Act, the Federal Reserve Board is authorized to identify unfair or deceptive banking practices and adopt regulations that prohibit them. The Board has a system to monitor complaints about banking practices that are not addressed by an existing regulation but that may be unfair or deceptive. The Board identifies unregulated practices that are the subject of 15 or more complaints per quarter, or 50 or more for the year. About one-fourth, or 332, of the 1,254 complaints received in 1987 about unregulated practices met that criterion. These concerned denial of credit based on credit history (99); denial based on other nonprohibited factors, such as the lack of sufficient assets (66); discrepancies in accounts (56); excessive time to clear checks, including delayed availability of funds (54); and other unregulated lending practices (57). Each of these categories accounts for a small fraction (4 percent or less) of all consumer complaints received by the System. Many of the complaints about denials based on credit history indicated that the applicant did not realize the implications of a poor credit history or a lack of borrowing experience on the decision about creditworthiness.

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Consumer Complaints Received by the Federal Reserve System, by Function and Resolution, 1987

Type of resolution	Total	Type of complaint					
		Loan function		Deposit function	Electronic fund transfers	Trust services	Other
		Discrimination	Other				
Complaints about state member banks							
Number	907	104	418	198	45	7	135
Percent	100	11	46	22	5	1	15
Complaints about state member banks, by type							
Insufficient information[1]	41	4	13	13	0	0	11
Information furnished to complainant[2]	163	27	86	25	1	1	23
Bank legally correct							
No accommodation	311	33	137	69	29	1	42
Accommodation made[3]	99	11	52	14	10	2	10
Clerical error, corrected	137	14	70	29	0	1	23
Factual dispute[4]	36	2	17	9	1	2	5
Bank violation, resolved[5]	7	2	1	3	0	0	1
Possible bank violation, unresolved[6]	7	0	2	5	0	0	0
Customer error	12	2	2	3	1	0	4
Pending, December 31	94	9	38	28	3	0	16
Complaints referred to other agencies[7]	1,714	59	980	337	29	15	294
Total, all complaints	**2,621**	**163**	**1,398**	**535**	**74**	**22**	**429**

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. In these cases the bank appears to be legally correct but has chosen to make an accommodation.
4. These cases involve 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. In these cases a bank appears to have violated a law or regulation and has taken corrective measures voluntarily or as indicated by the Federal Reserve System.
6. When a bank appears to have violated a law or regulation, 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.
7. Complaints about nonmember institutions.

Community Reinvestment Act

The Board is required by the Community Reinvestment Act to encourage institutions under its jurisdiction to help meet the credit needs of their communities, including the needs of low- and moderate-income neighborhoods, in keeping with the safe and sound operation of the institutions. The Board assesses the CRA record of state member banks during regular examinations; and it takes an institution's CRA performance into account when acting on applications filed by state member banks and bank holding companies. The Board may withhold approval of certain applications if the CRA record of the institution is not satisfactory.

During the 1987 reporting period (July 1, 1986, through June 30, 1987), Federal Reserve personnel examined 576 state member banks for compliance with the CRA. The record of almost all of these banks was satisfactory or better.

During calendar year 1987, the number of protests against applications filed by state member banks or bank holding companies, based on CRA performance, increased significantly. Thirty-six applications were protested in 1987, compared with 20 in 1986. Ten

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protests were withdrawn following negotiated agreements between applicants and protestants. In 10 other instances, the applications were approved after the applicant made commitments to improve its CRA performance. By year-end 31 of the applications had been approved by the Board, and 5 were still pending.

Consumer Advisory Council

The Consumer Advisory Council (CAC) met in March, June, and October to advise the Board on its responsibilities under financial protection laws and to discuss other issues relating to consumer financial services. The CAC has 30 members, representing the interests of consumers and the financial services industry. Its meetings are open to the public.

At each of its 1987 meetings, the CAC considered the advantages and disadvantages of home equity lines of credit and the adequacy of current disclosure requirements. The CAC's interest was sparked by the growing popularity of these programs and concerns about the potential risk to consumers. The CAC focused on those characteristics that increase the risk to consumers: balloon payments, interest-only payments, and credit standards that base approval solely on equity in the home without considering the homeowner's income and ability to repay. The Council also reviewed industry actions that promote the responsible use and marketing of home equity lines.

The CAC was briefed on current Truth in Lending disclosures for home equity lines and the possible need for additional or different disclosures. Members supported the disclosure of all account terms and conditions, especially features that give a creditor the right to terminate a plan and demand immediate repayment in full. The CAC favored giving disclosures for home equity lending earlier than is required for other forms of open-end credit, and it supported their segregation from other contract terms. Members also urged that model forms be adopted to ease creditor compliance and facilitate comparison shopping.

At its June meeting, the CAC supported the early disclosure of essential terms in credit card applications mailed to consumers. These disclosures would include annual percentage rates, variable-rate information, and any fees and grace periods. The CAC also recommended that "take one" applications for credit cards available at retail outlets such as shops and restaurants include a telephone number or address where consumers can obtain cost information.

In October the CAC discussed holds on deposited checks and the disclosures mandated by the Expedited Funds Availability Act, which goes into effect September 1, 1988. The legislation calls for institutions to give specific, detailed descriptions of their check-hold policies to consumers. The CAC was asked about giving institutions the option of a more general notice if they place holds only in certain cases. Many institutions, for example, offer next-day availability with only a few exceptions, such as when a check is deposited to a new account. Without this option, these institutions may be inclined to hold all check deposits for the longer periods allowed by the statute. Many members of the CAC supported such an alternative.

Also in October the CAC suggested two revisions to the Board's Regulation Q (Interest on Deposits), which governs the advertising of interest on deposits by state member banks. One suggestion addressed the practice by some banks of not paying interest on that portion of a consumer's deposit that must be held in reserve. The CAC recommended that the Board require banks to calculate the

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percentage yield on the full amount of the consumer's deposit. The second suggestion dealt with the calculation of compound interest. Currently, some institutions use 360 days in calculating the yearly interest. The CAC recommended requiring the percentage yield to be based on 365 days.

In 1987, the CAC commended the Reserve Banks for their programs encouraging economic development activities by state member banks. It suggested that the Reserve Banks also sponsor conferences to help state member banks develop internal management programs for compliance with the CRA; a committee devised materials that could be used at such conferences.

In 1987 the CAC also considered the following issues:

- The possible effects of a legislative proposal requiring banks to cash government checks for nondepositors, free of charge.
- The Federal Reserve's educational outreach efforts.
- Efforts by industry trade groups to encourage the offering of basic financial services to low- and moderate-income consumers.
- The enforcement of private agreements negotiated by community groups under the CRA with bank holding companies and state member banks.
- Expanded powers for banks, starting with insurance brokerage services.

Legislative Recommendations

In 1987 the Board testified before subcommittees of the House and Senate on legislation dealing with credit cards and home equity lines of credit.

Credit Card Disclosures and Interest Rates

In March the Board submitted a statement to the Subcommittee on Consumer Affairs and Coinage of the House Committee on Banking, Finance and Urban Affairs on proposed legislation related to disclosures of prices and terms in credit card applications and to a nationwide ceiling on credit card interest rates. In April the Board testified about these same issues before the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing, and Urban Affairs.

Credit Card Disclosure

Under the proposed legislation, card issuers would have to give full disclosures on prices and terms in all credit card applications and solicitations. Currently, disclosures are required in solicitations only when the creditor advertises certain price information.

The Board reiterated its support for additional disclosures that will give consumers information that is both adequate and early enough to enable comparison shopping. The Board believes that any disclosure rules should be structured so as not to overload consumers with less important information and should apply evenhandedly to all competitors. The Board believes it is unlikely that the proposals under consideration would lessen advertising of credit cards, given the limited increase in disclosures. The Board also believes that any increase in costs to the industry could be minimized by allowing creditors sufficient time to implement the changes.

Credit Card Rate Ceilings

The Board opposes a federal ceiling on credit card interest rates. It believes that credit is most efficiently distributed when interest rates are set in a market free of artificial restraints. In support of its views, the Board cited a staff analysis, prepared in response to a congressional request, on the economic effects of a rate cap. Efforts to constrain credit rates could have undesirable side effects in the form of a reduction in credit avail-

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ability, especially for the consumers that these bills seek to aid. Moreover, a ceiling on credit rates might encourage less efficient means for offsetting the costs of credit card operations.

Home Equity Lines of Credit

In October the Board testified before the Subcommittee on Consumer Affairs and Coinage of the House Committee on Banking, Finance and Urban Affairs. It addressed proposed legislation that would amend the Truth in Lending Act to establish requirements on disclosures and advertising for home equity lines of credit. The Board supports additional disclosures for home equity plans. Disclosures about these plans, it believes, should alert consumers to the most important information about the cost of the credit transaction. It suggested that the timing, format, and content of the disclosures currently required for home equity lines of credit may not be adequate. In November the Board reiterated these views in testimony before the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing, and Urban Affairs. As already discussed, the Board in December proposed amendments to Regulation Z to address the concern that consumers may not be receiving adequate information about home equity lines of credit. The Board's proposal would require creditors to give consumers more detailed disclosures about these lines of credit.

In the November testimony, the Board also addressed proposals for imposing substantive restrictions on home equity lines. The Board opposed any restrictions on these products except those necessary to prevent misleading or abusive practices; however, the Board is unaware of any evidence that such problems currently exist. The Board also believes that, because restrictions could affect a creditor's ability to offer this type of product, consumers who might otherwise enjoy the advantages of a home equity line could be adversely affected. The Board urged Congress not to restrict the terms and conditions of home equity programs unless there is evidence of a clear and unequivocal need for such action.

Recommendations of Other Agencies

Each year the Board asks the agencies with enforcement responsibilities under Regulations B, E, and Z for recommendations of changes to the regulations or the underlying acts. In 1987 the agencies submitted no recommendations.

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Litigation

During 1987 the Board of Governors was named in 47 pending lawsuits, the same number as in 1986. Of the 21 new lawsuits filed in 1987, 12 raised questions under the Bank Holding Company Act, compared with 9 in 1986. As of December 31, 1987, 25 cases were pending, 15 of which involve questions under the Bank Holding Company Act.

Bank Holding Companies—Antitrust Action

In 1987 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 *Florida Bankers Association et al.* v. *Board of Governors*, Nos. 84-3269 and 84-3270 (11th Circuit, filed April 20, 1984), petitioners sought 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 trust company subsidiary in Florida (*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). By order dated January 27, 1986, the Supreme Court granted the petition of intervenor U.S. Trust Company for certiorari (No. 85-193), vacated the court of appeals judgment, and remanded the case back to the court of appeals (474 U.S. 1098). In an opinion dated October 6, 1986, that court upheld the Board's order (800 F.2d 1534). A petition for certiorari to the U.S. Supreme Court (No. 86-1023) was denied on April 20, 1987 (107 S. Ct. 1887).

In *Florida Bankers Association* v. *Board of Governors*, Nos. 84-3883 and 84-3884 (11th Circuit, filed December 21, 1984) and *Florida Department of Banking* v. *Board of Governors*, Nos. 84-3831 and 84-3832 (11th Circuit, filed November 11, 1984), consolidated, petitioners sought review of Board orders dated November 1, 1984, approving the applications of Bankers Trust New York Corporation and Bank of Boston Corporation to expand activities of trust company subsidiaries (*Federal Reserve Bulletin*, vol. 71, January 1985, pp. 51 and 55). The cases were voluntarily dismissed on June 3, 1987.

In *CBC, Inc.* v. *Board of Governors*, No. 86-1001 (10th Circuit, filed January 2, 1986), petitioner seeks review of the Board's amendment to Regulation Y requiring certified financial statements in annual reports for bank holding companies with assets of $150 million or more (50 Fed. Reg. 50950, December 13, 1985). The case is pending.

In *Independent Community Bankers Association of South Dakota* v. *Board of Governors*, No. 86-5373 (8th Circuit, filed October 3, 1986), petitioners seek review of a Board order dated September 15, 1986, approving the application of Michigan National Corporation to acquire a nationally chartered credit card bank in South Dakota (*Federal Reserve Bulletin*, vol. 72, November 1986, p. 792). The case is pending.

In *Independent Insurance Agents of America, Inc.* v. *Board of Governors*,

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Nos. 86-1572, 86-1573, 86-1576 (D.C. Circuit, filed October 24, 1986), petitioners sought review of a Board order amending provisions of Regulation Y concerning permissible insurance activities for bank holding companies. On December 29, 1987, the court affirmed the Board regulations but denied the petition for review on grounds of ripeness.

In *Grimm et al.* v. *Board of Governors*, No. 87-4006 (2nd Circuit, filed January 16, 1987), petitioners sought review of a Board order approving the acquisition by BankEast Corporation of Royal/Grimm & Davis, Inc., a discount brokerage firm (*Federal Reserve Bulletin*, vol. 73, February 1987, p. 137). The case was dismissed on June 24, 1987.

In *Bankers Trust New York Corp.* v. *Board of Governors*, No. 87-1035 (D.C. Circuit, filed January 23, 1987), petitioner sought review of a Board order conditionally approving Bankers Trust's application to engage in placement of commercial paper to a limited extent (*Federal Reserve Bulletin*, vol. 73, February 1987, p. 138). A stipulation of dismissal in the case was filed on October 30, 1987.

In *Lewis* v. *Board of Governors*, Nos. 87-3455 and 87-3545 (11th Circuit, filed June 25, 1987), petitioners seek review of Board orders dated May 29, 1987, and July 1, 1987, approving applications of Chemical New York Corporation and of Manufacturers National Corporation to expand activities of trust company subsidiaries in Florida (*Federal Reserve Bulletin*, vol. 73, July 1987, p. 609, and September, p. 735). This case has been stayed pending the resolution of proceedings in a related case in the same judicial circuit.

In *Chase Manhattan Corporation* v. *Board of Governors*, No. 87-1333 (D.C. Circuit, filed July 20, 1987), petitioner seeks review of a Board order dated July 17, 1987, conditionally approving the application of Chase Manhattan Corporation to underwrite and deal in mortgage-related securities to a limited extent (*Federal Reserve Bulletin*, vol. 73, September 1987, p. 729). The case is pending.

In *National Association of Casualty and Surety Agents et al.* v. *Board of Governors*, Nos. 87-1354 and 87-1355 (D.C. Circuit, filed July 29, 1987), petitioners seek review of Board orders dated June 29, 1987, and July 2, 1987, permitting Sovran Financial Corporation and MNC Financial, Inc., to retain insurance agency activities (*Federal Reserve Bulletin*, vol. 73, August 1987, p. 672, and September, p. 740). The case is pending.

In *Board of Trade of Chicago et al.* v. *Board of Governors*, No. 87-2389 (7th Circuit, filed September 1, 1987), petitioners seek review of a Board order dated August 5, 1987, approving the application of Security Pacific Corporation to engage in brokerage clearing and other services through wholly owned subsidiaries (*Federal Reserve Bulletin*, vol. 73, October 1987, p. 815). The case is pending.

In *Independent Community Bankers Association of South Dakota* v. *Board of Governors*, No. 87-397 (petition for certiorari to the U.S. Supreme Court, filed September 3, 1987), petitioners sought review of the judgment of the Court of Appeals (820 F.2d 428) upholding a Board order dated July 12, 1985, which approved the application of First City Bancorporation of Texas to acquire a nationally chartered credit card bank in South Dakota (*Federal Reserve Bulletin*, vol. 71, September 1985, p. 716). On January 11, 1988, the Supreme Court denied the petition for certiorari (56 U.S.L.W. 3459, January 12, 1988).

In *Citicorp* v. *Board of Governors*, No. 87-1475 (D.C. Circuit, filed Sep-

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tember 9, 1987), petitioner seeks review of a Board order dated August 10, 1987, denying petitioner relief from certain conditions on prior approvals of acquisitions of thrift institutions. The case is pending.

In *Independent Insurance Agents of America, Inc.* v. *Board of Governors*, No. 87-4118 (2nd Circuit, filed September 17, 1987), petitioner seeks review of a Board order dated September 10, 1987, granted at the request of Merchants National Corporation, determining that nonbanking prohibitions of the Bank Holding Company Act do not apply to activities of banks (*Federal Reserve Bulletin*, vol. 73, November 1987, p. 876). The case is pending.

In *Independent Insurance Agents of America, Inc., et al.* v. *Board of Governors*, No. 87-1686 (D.C. Circuit, filed November 19, 1987), petitioner seeks review of a Board order dated October 20, 1987, approving the application of U.S. Bancorp to acquire Peoples BanCorporation (*Federal Reserve Bulletin*, vol. 73, December 1987, p. 941). The case is pending.

In *National Association of Casualty and Surety Agents et al.* v. *Board of Governors*, No. 87-1801 (D.C. Circuit, filed December 21, 1987), petitioners seek review of a Board order dated November 9, 1987, approving the application of Security Pacific Corporation to retain certain insurance agency activities (*Federal Reserve Bulletin*, vol. 74, January 1988, p. 75). The case is pending.

Other Litigation Involving Challenges to Board Procedures and Regulations

In 1987, actions were taken, were pending, or were dismissed under the Financial Institutions Supervisory Act, the Glass–Steagall Act, and the Farm Credit Act.

Financial Institutions Supervisory Act

In *Adkins* v. *Board of Governors*, No. 86-3853 (4th Circuit, filed May 8, 1986), petitioner sought review of the Board's assessment of civil money penalties against him. By order dated April 28, 1987, the court dismissed the appeal for want of jurisdiction (818 F.2d 28).

In *Adams et al.* v. *Board of Governors*, No. 87-5311MN (8th Circuit, filed July 13, 1987), the plaintiffs appeal the decision of a district court (659 F.Supp. 948) holding that the Board did not violate the Right to Financial Privacy Act when it reviewed and copied plaintiffs' records at a national bank. The case is pending.

In *Northeast Bancorp, Inc., et al.* v. *Board of Governors*, No. 87-1365 (D.C. Circuit, filed July 31, 1987), petitioners seek review of the Board determination that an officer and director who consents to be removed from a national bank is also barred from serving in a holding company. The case is pending.

In *Anonymous Bank* v. *Board of Governors*, No. 87-1661 (S.D. Fla., filed September 4, 1987), a case placed under seal by court order, plaintiffs sought to set aside a Board order suspending a bank director and officer from a state member bank. A motion to dismiss the case as moot is pending.

Glass–Steagall Act

In *Securities Industry Association* v. *Board of Governors*, No. 86-5667 (D.C. Circuit, filed October 30, 1986), plaintiff appealed the district court's order of October 27, 1986, dismissing plaintiff's complaint, which sought a declaration that a discount broker subsidiary of a bank holding company participated in a public offering of securities in violation of the Bank Holding Company Act. By

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order dated June 25, 1987, the court dismissed the action as moot.

In *Securities Industry Association* v. *Board of Governors*, No. 87-1030 (D.C. Circuit, filed January 20, 1987), petitioner sought review of a Board order dated December 24, 1986, approving the application of Banker's Trust to engage in placement of commercial paper to a limited extent (*Federal Reserve Bulletin*, vol. 73, February 1987, p. 138). The case was dismissed on December 2, 1987.

In *Securities Industry Association* v. *Board of Governors*, No. 86-1429 (petition for certiorari to the U.S. Supreme Court, filed March 3, 1987), petitioners challenge a Board decision of June 4, 1985, approving the placement methods of Bankers Trust Company in selling third-party commercial paper. By memorandum orders dated February 4 and 18, 1986, the district court invalidated the Board's decision and permanently enjoined Bankers Trust from employing their placement methods (627 F.Supp. 695, 628 F.Supp. 1438). By order dated December 23, 1986, the court of appeals reversed the district court and reinstated the Board's decision (807 F.2d 1052). A petition for certiorari to the Supreme Court was denied on June 22, 1987 (107 S. Ct. 3228).

In *Securities Industry Association* v. *Board of Governors*, No. 87-1169 (D.C. Circuit, filed April 17, 1987), petitioner seeks review of a Board order dated March 18, 1987, approving the application by Chase Manhattan Corporation to underwrite and deal in commercial paper to a limited extent (*Federal Reserve Bulletin*, vol. 73, May 1987, p. 367). The case is pending.

In *Securities Industry Association* v. *Board of Governors*, No. 87-4041 (2nd Circuit, filed May 1, 1987), petitioner seeks review of Board orders dated April 30 and May 18, 1987, authorizing various bank holding companies to underwrite and deal in certain securities to a limited extent through a securities subsidiary (*Federal Reserve Bulletin*, vol. 73, June 1987, p. 473, and July, p. 607). The case is pending. Several other cases involve similar petitions for review, which have been withdrawn pending a decision in this case. These cases are as follows: *Securities Industry Association* v. *Board of Governors*, Nos. 87-4091 and 87-4093 (2nd Circuit, filed July 1, 1987), No. 87-4095 (2nd Circuit, filed July 15, 1987), No. 87-4115 (2nd Circuit, filed September 9, 1987), and No. 87-4135 (2nd Circuit, filed October 8, 1987).

In *Securities Industry Association* v. *Board of Governors*, No. 87-562 (petition for certiorari to the U.S. Supreme Court, filed October 2, 1987), petitioner sought review of the July 7, 1987, order of the Court of Appeals upholding a Board order dated June 13, 1986, approving National Westminster Bank's acquisition of a company offering investment advice and securities brokerage (*Federal Reserve Bulletin*, vol. 72, August 1986, p. 584). On January 11, 1988, the Supreme Court denied the petition for certiorari (56 U.S.L.W. 3459, January 12, 1988).

In *Securities Industry Association* v. *Board of Governors*, No. 87-4161 (2nd Circuit, filed December 24, 1987), petitioner seeks review of a Board order dated December 14, 1987, approving the application by Bank of New England Corporation to underwrite and deal in certain securities (*Federal Reserve Bulletin*, vol. 74, February 1988, p. 133). The case is pending.

Farm Credit Act

Several cases have been filed in various federal courts seeking injunctive relief and damages relating to loans made to

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plaintiff farmers by commercial banks and the Farm Credit System. These cases have been dismissed in favor of the federal defendants. In *Kurkowski et al.* v. *Wilkinson et al.*, No. 85-0-916 (8th Circuit, filed October 16, 1985), *Farmer et al.* v. *Wilkinson et al.*, No. 4-85-1448 (D. Minn., filed October 21, 1985), and *Kolb et al.* v. *Wilkinson et al.*, No. C85-4184 (N.D. Iowa, filed October 22, 1985), plaintiffs sought damages and injunctive relief relating to loans to plaintiff by the Farm Credit System. *Farmer* was dismissed on January 21, 1987; *Kolb* was dismissed on March 27, 1987; and on August 26, 1987, the court in *Kurkowski* affirmed the district court's dismissal of the action. In *Myers et al.* v. *Federal Reserve Board*, No. 85-1427 (D. Idaho, filed November 18, 1985), plaintiffs sought damages and injunctive relief related to loans made to plaintiffs by commercial banks. The case was dismissed on September 22, 1987.

Other Actions

In *Urwyler et al.* v. *Internal Revenue Service et al.*, No. 85-2877 (9th Circuit, filed December 9, 1985) and *Wight et al.* v. *Internal Revenue Service et al.*, No. 85-2826 (9th Circuit, filed November 26, 1985), plaintiffs appealed from orders dismissing their complaint that the Sixteenth Amendment to the U.S. Constitution was not properly ratified and that the use of Federal Reserve notes constitutes illegal gambling. On February 11, 1987, the court in *Urwyler* affirmed the district court's order of dismissal (811 F.2d 1509). On March 5, 1987, the court in *Wight* affirmed the district court's order of dismissal (812 F.2d 1412).

In *Lewis* v. *Volcker et al.*, No. 86-3210 (6th Circuit, filed March 5, 1986), the court affirmed the district court's dismissal of plaintiff's action seeking damages resulting from an alleged violation by the Board and BancOhio National Bank of federal statutes governing monetary credit and bankruptcy (815 F.2d 78).

In *Optical Coating Laboratory, Inc.* v. *United States*, No. 288-86C (U.S. Claims Court, filed May 6, 1986), plaintiff sought damages in an action based on the expiration of a contract. The case was settled on October 23, 1987.

In *Jenkins et al.* v. *Board of Governors*, No. 87-1336 (D.C. Circuit, filed July 18, 1986), petitioner seeks review of a Board order dated May 21, 1986, granting an application for membership in the Federal Reserve System (*Federal Reserve Bulletin*, vol. 72, July 1986, p. 477). The case is pending.

In *Howe* v. *United States et al.*, No. 86-889 (petition for certiorari to the U.S. Supreme Court, filed November 26, 1986), petitioner sought review of the July 30, 1986, order of the Court of Appeals affirming the district court's dismissal of the action on April 18, 1986, that challenged the constitutionality of the current monetary system. A petition for certiorari was denied by the Court on January 27, 1987 (107 S. Ct. 952).

In *Melcher* v. *Federal Open Market Committee*, No. 86-5692 (D.C. Circuit, filed December 16, 1986), appellant sought review of a district court decision (644 F. Supp. 510) upholding the constitutionality of the methods used to select certain members of the Federal Open Market Committee. On December 18, 1987, the court affirmed the ruling of the district court on the constitutionality of the selection methods but held that the district court should have dismissed the suit on grounds of equitable discretion.

In *Jones* v. *Volcker*, No. 87-0427 (D. D.C., filed February 19, 1987), plaintiff brought an action to enjoin alleged dis-

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criminatory practices. The case was dismissed on June 18, 1987.

In *Brown* v. *United States Congress et al.*, No. 87-5586 (9th Circuit, filed March 2, 1987), plaintiff appeals the dismissal of his complaint seeking damages for alleged discrimination in home financing and a mandatory injunction regarding the Board's monetary policy. The case is pending.

In *Air Continental, Inc.* v. *Federal Reserve Bank of Boston et al.*, No. 87-1877-N (D. Mass., filed July 23, 1987), plaintiff sought review of the award of a contract by the Reserve Bank for air transportation of checks. A stipulation of dismissal was entered in the case on September 18, 1987.

In *Barrett* v. *Greenspan*, No. 87-2280 (D. D.C., filed August 17, 1987), plaintiff seeks to enjoin an alleged discriminatory practice. The case is pending.

In *Teichgraeber* v. *Board of Governors*, 87-2505-0 (D. Kans., filed October 16, 1987), plaintiff seeks to require disclosure of certain documents under the Freedom of Information Act. The case is pending.

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Legislation Enacted

Competitive Equality Banking Act of 1987

Public Law 100–86, the Competitive Equality Banking Act of 1987 (CEBA), was approved on August 10, 1987, and consists of 12 titles. Title I (Competitive Equality Amendments of 1987) extends the Bank Holding Company Act (BHCA) to encompass certain financial institutions (commonly referred to as "nonbank banks") that had previously avoided regulation under the act.

Title II imposes a moratorium on certain nonbanking activities from March 6, 1987, to March 1, 1988.

Titles III and IV provide for the recapitalization of the Federal Savings and Loan Insurance Corporation (FSLIC) and contain other provisions designed to aid the thrift industry.

Title V (Financial Institutions Emergency Acquisitions Amendments of 1987) enhances and expands the provisions for emergency interstate acquisitions of failing institutions under the Garn–St Germain Depository Institutions Act of 1982 and exempts the agencies regulating depository institutions from the sequestration requirements of the Balanced Budget and Emergency Deficit Control Act of 1985.

Title VI (Expedited Funds Availability Act) provides for the improved availability of deposited funds.

Title VII (Credit Union Amendments of 1987) primarily amends the Federal Credit Union Act to improve the operation and regulation of credit unions.

Title VIII allows agricultural banks (generally those with 25 percent or more of their loans used to finance the production of agricultural products) to amortize any loss on agricultural loans over seven years. This title also allows such banks to reappraise the value of real property acquired in connection with agricultural loans and to amortize any consequent loss over seven years.

Title IX reaffirms the intent of Congress to back federally insured deposits by the full faith and credit of the United States.

Title X provides that Treasury checks outstanding for more than one year will not be paid, but that nonetheless, the underlying obligation of the government is not extinguished by such nonpayment.

Title XI requires the FDIC to pay interest on certain nonnegotiable ("yellow") certificates found to be insured deposits.

Title XII requires a study, among other things, of competitive issues in the payments system and requires the Board of Governors of the Federal Reserve System to limit the interest that may be required on adjustable rate mortgages.

The following summary describes titles I, II, V, and VI in more detail.

Title I

1. The definition of "bank" under the BHCA is expanded to include any institution insured by the Federal Deposit Insurance Corporation (FDIC) as well as any institution that both accepts transaction accounts and makes commercial loans. The amended definition excludes the following types of institutions:

- Federally insured thrift institutions.
- Credit unions.
- Trust companies serving solely in a trust or fiduciary capacity that have no FDIC insured deposits that are marketed through an affiliate; do not accept demand accounts or other deposits subject

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to withdrawal by check or similar means for payment to third parties or others; receive deposits almost exclusively in a bona fide fiduciary capacity; and do not have borrowing privileges at a Federal Reserve Bank or access to other services of the Federal Reserve System.

- Credit card banks that engage only in credit card operations; do not accept demand deposits or deposits that may be withdrawn by check or similar means for payment to third parties or others; do not have savings or time deposits of less than $100,000; do not accept deposits at not more than one office; and do not make commercial loans.
- Industrial banks that are required by state law in effect or under consideration on March 5, 1987, to obtain FDIC insurance and that meet at least one of the following three conditions: (1) do not accept transaction accounts, (2) have total assets of less than $100 million, or (3) has not come under the control of any company since August 10, 1987. The definition of "bank" also excludes industrial banks that do not meet the above test but that do not directly, indirectly, or through an affiliate engage in any activity in which they were not lawfully engaged as of March 5, 1987. An exempted industrial bank loses its exemption if it incurs an overdraft at a Federal Reserve Bank on behalf of an affiliate and the overdraft was not inadvertent.
- Edge or Agreement corporations.
- Certain foreign organizations.

2. Any company that on March 5, 1987, controlled a nonbank bank covered by the CEBA and was not a bank holding company on August 9, 1987, shall not be treated as a bank holding company by virtue of the company's control of that bank. A company loses this exemption if any of the following events occur:

- The company acquires control of an additional bank, FSLIC-insured institution, or federal savings bank other than through an emergency acquisition.
- The company acquires control of more than 5 percent of the shares or assets of an additional bank, FSLIC-insured institution, or federal savings bank. Acquisition of more than 5 percent is permissible in certain cases, including a temporary or emergency acquisition.
- Any bank subsidiary of the company violates the limitations placed on grandfathered nonbank banks, described in the following paragraph.

3. Nonbank banks held by companies not treated as BHCs because of the grandfathered provisions of the CEBA may not take any of the following actions:

- Engage in any activity in which they were not lawfully engaged as of March 5, 1987.
- Offer or market products or services of an affiliate that are not permissible for bank holding companies under section 4(c)(8) of the BHCA nor permit their products or services to be offered or marketed by an affiliate that engages in activities that are not permissible for bank holding companies under section 4(c)(8) unless the products or services were being so offered and marketed in the same manner as of March 5, 1987.
- Permit or incur any overdraft at a Federal Reserve Bank on behalf of an affiliate other than a fully secured overdraft on behalf of a primary dealer or an inadvertent overdraft.
- Increase their assets at an annual rate greater than 7 percent.

4. Any nonbank bank and any of its affiliates are subjected to the anti-tying restrictions of the BHCA, that is, neither one may give a discount on its products and services on condition that the customer purchase services from the other. These restrictions also apply to exempt

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trust companies, credit card banks, and industrial banks.

5. A bank holding company that acquired a nonbank bank before the date of enactment of the CEBA may retain it on the following conditions: (1) the nonbank bank does not engage both in the taking of demand deposits and in commercial lending and (2) it does not increase the number of locations from which it conducts its business after March 5, 1987. These restrictions cease to apply on the date the acquisition would become permissible under section 3(d) of the BHCA (the Douglas Amendment).

6. Any company, other than a bank as defined by the BHCA as amended by the CEBA, that acquires an Edge or Agreement corporation after March 5, 1987, will be treated as a bank holding company for purposes of the BHCA. However, section 3 of the BHCA, which concerns the acquisition of banks, generally will not apply to such a company.

7. Section 23B is added to the Federal Reserve Act, under which certain transactions between a member bank and an affiliate must be made under the same circumstances and on the same terms and conditions as would be extended to a nonaffiliated company. This requirement includes transactions between the bank and third parties in which the affiliate has an interest or is a participant or the proceeds from which are used for the benefit of the affiliate. The restriction also applies to transactions in which the affiliate acts as a broker or receives a fee for services.

Section 23B also prohibits banks in their fiduciary capacity from purchasing securities from an affiliate unless authorized by the trust agreement or by state law, or from purchasing, as principal or fiduciary, securities underwritten by an affiliate.

8. The prohibition under the Glass–Steagall Act preventing affiliations and management interlocks between member banks and companies that are primarily engaged in underwriting is extended to insured nonmember banks beginning on March 6, 1987; the extension expires on March 1, 1988. Affiliations and interlocks existing on March 5, 1987, are not covered by the extension.

9. Last, title I amends portions of the Federal Home Loan Bank Act and the provisions of the National Housing Act covering mutual holding companies and savings and loan holding companies and expands the leasing authority of national banks.

Title II

1. All federal banking agencies are prohibited from taking the following actions:

- Approve an application or issue a regulation that would increase the real estate powers in the United States of banks, foreign banks, or holding companies.
- Authorize or allow any bank holding company, insured bank, foreign bank, or any of their subsidiaries or affiliates, to engage in the United States to any extent (1) in the flotation, underwriting, public sale, dealing, or distribution of securities if that approval would require the agency to determine that the entity would not be engaged principally in such activities, (2) in securities activities not legally authorized in writing prior to March 5, 1987, or (3) in the operation of a nondealer marketplace in options.
- Approve an application or issue a regulation that would increase the insurance powers of banks, foreign banks, or holding companies beyond those authorized for bank holding companies under section 4(c)(8) of the BHCA.
- Approve an acquisition by a bank holding company or foreign bank of any

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company, including a state bank, unless the bank holding company or foreign bank has agreed to limit the insurance activities in the United States of that company or state bank to those permitted under section 4(c)(8) of the BHCA.

• Permit a national bank to expand its insurance activities into places where it was not conducting these activities on March 5, 1987.

2. The foregoing restrictions on federal banking agencies do not prohibit an agency from acting if the order or regulation involved is not effective until after March 1, 1988.

3. Grandfather rights conferred upon foreign banks or other companies by section 8(c) of the International Banking Act of 1978 terminate two years after the foreign bank or other company becomes a bank holding company. The Board of Governors is authorized to extend the grandfather provision on a case-by-case basis for up to three years.

Title V

1. Emergency interstate acquisitions of banks in danger of closing are permitted under the following conditions: in the case of an individual bank, if the failing bank has assets of more than $500 million; in the case of affiliated banks, if the aggregate assets of the failing banks are more than $500 million and equal more than 33 percent of the total assets of all the affiliated insured banks.

2. If an out-of-state bank or bank holding company has acquired one or more failing affiliated banks that have assets of at least 33 percent of the aggregate assets for all the affiliated insured banks, then the interstate acquisition of the failing bank's holding company or its nonfailing affiliated banks may be permitted.

3. Two years after its interstate acquisition of a failing institution, an out-of-state bank holding company may acquire additional banks in the state on the same terms as if it were an in-state bank holding company.

4. No bank in danger of closing may be sold without the express concurrence of the state supervisory agency.

Title VI

1. Depository institutions must make deposited funds available to depositors within specified time schedules that are based on several factors, including the type of deposit and the relative locations of the depository and paying banks.

2. Exempted from the schedules for funds availability are new accounts, large deposits, checks that have been returned and redeposited, accounts that have been overdrawn repeatedly, and checks that the depository institution has reasonable cause to believe are uncollectible.

3. Depository institutions must disclose to their customers their policies on the availability of funds.

4. The Board of Governors has broad authority to adopt regulations to improve the system for clearing of checks so that checks may be cleared and returned within the times established by the mandated availability schedules.

5. Depository institutions that fail to comply with any provision of this title are subject to civil liability.

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Banking Supervision and Regulation

One of the Federal Reserve's principal responsibilities is the supervision and regulation of commercial banking organizations. In carrying out its duties, the Federal Reserve supervises and regulates state member banks, bank holding companies and their nonbank subsidiaries; the international activities of banks and bank holding companies; and the U.S. banking and nonbanking operations of foreign banks. Many of these supervisory activities are coordinated with those of other federal and state regulatory agencies.

Supervisory coordination is also important at the international level. In 1987 the Federal Reserve, together with the other U.S. federal banking agencies and supervisory authorities from the leading industrial countries, took an important step toward achieving more consistent standards for assessing the financial soundness of international banking organizations. This step was the development of a risk-based capital proposal in conjunction with the Basle Committee on Banking Regulations and Supervisory Practices. The effort to better coordinate supervisory policies among countries with important financial centers recognizes the growing internationalization of banking and financial markets. When implemented, the proposal will contribute to a more stable international banking system and reduce a source of competitive inequality arising from differences in national supervisory requirements.

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, and enforcement and other supervisory actions.

Examinations and Inspections

The on-site review of operations is an integral part of ensuring the safety and soundness of financial institutions. Examinations of state member banks and Edge corporations and inspections of bank holding companies and their subsidiaries entail (1) an appraisal of the quality of the institution's assets; (2) an evaluation of management, including 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 Federal Reserve System. At the end of 1987 there were 1,105 state member banks, accounting for about 8 percent of all insured commercial banks and about 18 percent of the assets of all such 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 section of this REPORT covering consumer and community affairs. Compliance with other statutes and regulations, which is treated in this section, is the responsibility of the Board's Division of Banking Supervision and Regulation and the Reserve Banks, whose examiners check for safety and soundness.

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The Federal Reserve in 1986 increased the frequency of scheduled examinations and inspections of state member banks and bank holding companies. In general, the guidelines call for state member banks to be examined at least annually. Except for large or troubled banks, examination by either a Reserve Bank or state banking agency will meet that requirement. In 1987, 1,068 state member banks were examined at least once by either the Federal Reserve or a state banking agency. Altogether, the state agencies conducted 319 examinations of state member banks, and the Federal Reserve conducted 835 examinations, some of them jointly with the state agencies.

Bank Holding Companies

In 1987 the number of bank holding companies decreased by 22 to a total of 6,443. These organizations control 9,340 commercial banks, which hold 92 percent of the assets of all insured commercial banks in the United States.

Most large bank holding companies, as well as small companies with significant nonbank assets, are inspected annually under the new 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 nonbank subsidiaries. The subsidiary banks are examined by the appropriate federal banking regulatory agencies. In 1987, System examiners made 2,560 on-site inspections and 73 off-site inspections. State examiners made 43 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 and 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 1987 the Reserve Banks recommended and the Board's staff initiated and worked on 131 enforcement cases that involved 341 separate actions, such as cease and desist orders, removals, and civil money penalties, most dealing with unsafe or unsound banking practices; 33 cases involving 62 actions were completed by year-end. The Board completed 17 civil money penalty actions and assessed a total of $204,100 against a bank holding company and 9 individuals; by year-end 1987, the Board collected $82,750, with the remainder of the assessments to be paid in accordance with agreed-upon schedules. A description of all formal supervisory actions during the year and the reasons for them are made available to the public in the Board's twice-yearly "Report on Formal Enforcement Actions."

International Activities

The Federal Reserve is responsible for supervising several international 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, especially exports. An agreement corporation is a company that enters into an agreement with the Board not to exercise any power that is impermissible for an Edge corporation.

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In 1987 the Federal Reserve conducted examinations of 64 Edge and agreement corporations.

Foreign-Office Operations of U.S. Banking Organizations
The Federal Reserve conducts examinations of the international operations of state member banks, Edge corporations, and bank holding companies primarily 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, the Federal Reserve performs on-site reviews of important foreign offices at least every three years. In 1987 the Federal Reserve examined 10 foreign branches of state member banks and 28 foreign subsidiaries of Edge corporations and bank holding companies. In 1987 the Federal Reserve System, in coordination with the Office of the Comptroller of the Currency, conducted extensive on-site examinations of merchant banking activities of U.S. banking organizations in the United Kingdom and Australia. All the examinations abroad were conducted with the cooperation of the local supervisory authorities.

U.S. Activities of Foreign Banks
Foreign banks continue to be significant participants in the U.S. banking system. As of December 31, 1987, 246 foreign banks operated 428 state-licensed branches and agencies, of which 32 are insured by the Federal Deposit Insurance Corporation; at year-end these foreign banks also operated 85 branches and agencies licensed by the Office of the Comptroller of the Currency, of which 2 have FDIC insurance. Foreign banks also directly owned 18 Edge corporations and 12 commercial lending companies. In addition, foreign banks held a 25 percent or greater interest in 85 U.S. commercial banks. Together, these foreign banks at year-end controlled approximately 20 percent of U.S. banking assets.

The Federal Reserve has broad authority to supervise and regulate 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 federal or state regulatory agency. Although states have primary authority for examining state-licensed, uninsured branches and agencies, the Federal Reserve participated in the examination of 100 such offices during the past year.

Specialized Examinations

The Federal Reserve conducts specialized examinations in the following areas of bank activity: electronic data processing, trust activities, government securities dealing and brokering, municipal securities dealing and clearing, and securities transferring.

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. In 1987, System examiners conducted 233 on-site EDP reviews. In addition, the Federal Reserve reviews reports of EDP examinations 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 member banks, trust

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companies that are members of the Federal Reserve System, and certain foreign and domestic trust company subsidiaries of bank holding companies. At the end of 1987, 454 of these institutions existed, about 10 percent of the total number of institutions in the industry. These 454 institutions held about 45 percent of the total assets administered by all such banks, trust companies, and subsidiaries. During 1987, Federal Reserve Examiners conducted 180 examinations to review the trust functions of these institutions.

Government Securities Dealers and Brokers

Under the Government Securities Act of 1986, the Board is responsible for examining government securities dealers and brokerage activities of state member banks and foreign banks for compliance with the act and the Treasury Department's implementing regulations, which became effective July 25, 1987. Forty-four state member banks and one agency of a foreign bank filed notices with the Board that they are government securities dealers or brokers not otherwise exempt by Treasury Department regulations. Specialized examination procedures relating to government securities activities were adopted by the Federal Reserve in November 1987.

Municipal Securities Dealers and Clearing Agents

The Securities Act Amendments of 1975 made the Board responsible for supervising state member banks and bank holding companies that act as municipal securities dealers or as clearing agencies. In 1987 the Board examined 27 of the 52 state member banks registered with the Board that deal in municipal securities. A clearing agency acts as a custodian of securities involved in transactions settled by bookkeeping entries. The four agencies registered with the Board were examined in 1987.

Transfer Agents

System examiners conducted 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 1987 the Board examined 72 of the 162 banks and bank holding companies registered as transfer agents with the Board.

Surveillance and Monitoring

The Federal Reserve monitors the financial condition of state member banks and bank holding companies. The surveillance program supplements the Federal Reserve's on-site examination program with automated screening systems that identify organizations with poor or deteriorating financial profiles. These automated systems rely heavily on quarterly financial statements submitted by the banking organizations. The surveillance program also aids in the allocation of the System's examination resources by focusing early attention on those banking institutions that appear to have recently encountered financial problems. These organizations may then be subject to accelerated examinations or may warrant closer supervision.

In 1987 the System continued to strengthen its surveillance program by revising its screening techniques while maintaining the electronic transmission of surveillance results between the Reserve Banks and the Board. The exchange of automated information expedites the surveillance process and makes current information more readily available to the System. In addition, procedures to monitor stock prices of bank holding companies were strengthened.

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These procedures are designed to aid the search for causes of any decline in market value relative to the overall market, possibly before a deterioration is reflected in the next quarterly financial statements.

Also in 1987 changes were made to the Bank Holding Company Performance Report, which is used as a surveillance tool, to reflect new capital requirements and their associated reporting requirements. The report is distributed to the reporting bank holding companies and is available to the public.

Supervisory Policy

In 1987 the Board made or initiated several changes in its supervisory guidelines. The following sections summarize these changes and review other activities during the year to enhance the supervisory program.

Supplemental Measure of Adjusted Capital

In February 1987 the Federal Reserve issued for public comment a joint proposal between the three U.S. bank regulatory authorities (the Federal Deposit Insurance Corporation, the Federal Reserve, and the Office of the Comptroller of the Currency) and the Bank of England to supplement its capital adequacy guidelines for state member banks and bank holding companies. This joint proposal superseded the proposed risk-based capital measure issued for public comment in January 1986.

After receiving most of the public comments on the 1987 proposal, the four institutions deferred action in order to seek agreement on a risk-based capital measure with a larger number of countries. As a result of those discussions, a proposed framework for risk-based capital was developed by the Basle Committee on Banking Regulations and Supervisory Practices, which comprises the Group of Ten countries plus Luxembourg.

The specific objectives of the risk-based capital framework are to (1) help strengthen the stability of the international financial system; (2) provide a fairer and more consistent system for comparing the capital positions of banking organizations from different countries; (3) take risk considerations into explicit account in assessing capital adequacy, including risks associated with off-balance-sheet activities; and (4) avoid discouraging banks from holding liquid, low-risk assets. The Basle Agreement provides a common framework for defining the elements of capital—with emphasis on common stockholders' equity—and a single capital adequacy standard to be met after a five-year transitional period.

The Board issued for public comment on March 1, 1988, the revised risk-based capital measure in the Basle Agreement.

Problem Loans in Agriculture

The policy of forbearance introduced by the three federal bank regulatory agencies in 1986 for banks with problem loans in the agricultural sector continued in 1987. This policy calls for the Reserve Banks to exercise appropriate forbearance in applying capital adequacy guidelines for banks that are essentially sound and well-managed if they demonstrate a clear potential for restoring their capital position over a reasonable period of time. Banks seeking such "capital forbearance" are required to notify their Reserve Bank when loan losses have caused their capital ratios to fall to levels materially below the minimum regulatory standards. Notification is to be followed by a comprehensive operating

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plan for restoring capital to normal levels. In 1987, four state member banks were approved for capital forbearance.

In 1987 the Congress enacted the Competitive Equality Banking Act of 1987 (CEBA), requiring the three federal bank regulatory agencies to issue regulations permitting agricultural banks with assets of less than $100 million to amortize losses on agricultural loans and related real or personal property over a period not to exceed seven years. To implement this statute, Regulation H was amended, effective November 9, 1987. However, the period for public comments extends to January 1988. Banks seeking to amortize losses on qualified agricultural loans are required to apply to their Reserve Bank for acceptance into the program, must have capital in need of restoration, and must have reasonable procedures for restoring capital to acceptable levels.

In a related action, effective December 31, 1987, the Federal Financial Institutions Examination Council amended the regulatory reports for these banks. These revised reports permit losses eligible for deferral to be reinstated as new items in the asset and equity sections of the balance sheet. The resulting increases in the capital account shall be treated as primary capital for purposes of determining the adequacy of the bank's capital.

Relations with the States

The Board in 1987 provided $100,000 to the Education Foundation of State Bank Supervisors. Established by the Conference of State Bank Supervisors, the foundation offers technical courses to state bank examiners. The Board also authorized the Federal Reserve Banks to provide scholarships to examiners employed by state banking agencies to help them cover expenses in attending training courses offered by the Federal Reserve and by the Federal Financial Institutions Examination Council (see the section below on staff training).

Work on Accounting Standards

The Board and its staff are continuing to work on eliminating, to the greatest extent possible, differences between regulatory reporting requirements and generally accepted accounting principles. Board staff members have served on various advisory committees of the Financial Accounting Standards Board (FASB) and are participating in that group's project on financial instruments. Staff members also provide commentary on proposals issued by FASB and by the American Institute of Certified Public Accountants that affect banking organizations.

Reducing Risk in Large-Dollar Electronic Payment Systems

In July 1987 the Board adopted an interim statement of its policy on reducing risks on large-dollar transfer systems. This interim policy supercedes the policy statement adopted by the Board in May 1985 and implemented in March 1986.

Large-dollar funds transfer networks are an integral part of the payments and clearing mechanism. A daylight overdraft occurs when a depository institution sends funds over Fedwire in excess of the balance in its reserve or clearing account, or sends more funds over a private network than it has received.

The Board's May 1985 policy statement required privately owned large-dollar payment networks using Federal Reserve net settlement services to (1) require each of its participants to establish a limit on the maximum net transfer amount that it is willing to receive from each other participant ("bilateral net

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credit limit") and (2) establish for each of its participants a maximum amount of net transfers ("sender net debit cap") that the participant can transfer over that network. The policy also strongly encouraged each depository institution incurring daylight overdrafts on Fedwire or participating on a private network to adopt a cross-system sender net debit cap designed to limit the amount of risk an institution presents across all systems combined. The interim policy statement modifies the May 1985 policy as follows:

- Reduces the current sender net debit cap by 25 percent in two stages—15 percent on January 14, 1988, and the balance on May 19, 1988, unless subsequent events suggest that the second step would disrupt the payments system or financial markets.
- Exempts depository institutions from self-evaluation guidelines if their board of directors approves a de minimis net debit cap of the smaller of 20 percent of adjusted primary capital or $500,000.
- Imposes a $50 million limit on book-entry securities transfers over Fedwire.
- Subjects the clearing procedures of primary dealers to review by the Federal Reserve Bank of New York.
- Permits interaffiliate Fedwire transfers resulting in daylight overdrafts, provided certain safeguards are observed.
- Permits holding companies of depository institutions to centralize their wire transfer operations at one or more of their subsidiaries, provided certain safeguards are observed.

The interim policy will remain in effect pending reevaluation of the Board's risk reduction program.

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 1987 the Federal Reserve conducted sixty-seven sessions of various courses. The core banking program comprised four sessions of an introductory course, six sessions of an intermediate course, and five sessions of an advanced course; each course lasted three weeks. A new course was presented this year, bank holding company inspections, with sixteen sessions. The other offerings were twenty-one sessions of a course on effective writing for banking supervision staff, nine sessions of a credit analysis course, two sessions of a bank holding company applications course, one session on cash flow and liquidity analysis, and three courses of one session each on consumer compliance. Also, System staff attended seven courses conducted jointly by a financial institutions regulator and the Federal Bureau of Investigation on white-collar crime and bank failures.

The System participated in courses offered by the Federal Financial Institutions Examination Council (FFIEC) in specialized areas of income property lending, trust departments, off-balance-sheet risk, international banking, electronic data processing, activities of municipal securities dealers, asset and liability management, payment system risks, white-collar crime, management, conducting meetings with management, and instructor training. The FFIEC conducted 115 sessions of these programs during 1987.

During 1987 the Federal Reserve System provided scholarship assistance to the states for training their examiners in Federal Reserve and FFIEC schools. Through this program, 499 state examiners were trained, 312 of them in Federal Reserve courses and 187 in FFIEC programs.

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In 1987 the Federal Reserve trained 1,424 persons in System schools and 884 in FFIEC schools, for a total of 2,308: 1,731 from the System, 499 from the states, and 78 from foreign central banks.

Federal Financial Institutions Examination Council

During 1987 the Federal Reserve Board of Governors adopted several policies recommended by the FFIEC.[2] The Board joined the other constituent agencies of the FFIEC in approving a policy statement encouraging trade associations and individual depository institutions to offer basic financial services to low- and moderate-income consumers.

The Federal Reserve also endorsed a FFIEC recommendation when it encouraged all state member banks and bank holding companies to adopt internal codes of conduct or written procedures to assist officers, directors, employees, agents, and attorneys in complying with the 1986 amendments to the Bank Bribery Act.

The Federal Reserve joined with the other FFIEC agencies in awarding a contract to CompuServe, Inc., under which the company would be the collection agent for the electronic transfer of Call Reports by banks. The new system should be in operation by March 1988.

The FFIEC also approved changes in reporting requirements to reduce the burden on financial institutions.

2. The FFIEC 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.

Regulation of the U.S. Banking Structure

The Board 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 the structure of U.S. banking 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. banking operations of foreign banks, whether conducted 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 if it is to form a bank holding company by acquiring 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 factors relating to the convenience and needs of the community to be served, the applicant's financial and managerial resources, the prospects of both the applicant and the firm to be acquired, and the competitive effects of the proposal.

In 1987 the Federal Reserve acted on 1,631 bank holding company and related applications. The Federal Reserve approved 446 proposals to organize bank

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Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1987

Proposal	Direct action by the Board of Governors		Action under authority delegated by Board of Governors					Total
			Staff Director of Division of Banking Supervision and Regulation[1]		Office of the Secretary[1]	Federal Reserve Banks		
	Approved	Denied	Approved	Denied	Approved	Approved	Permitted	
Formation of holding company . . .	40	1	0	0	3	403	0	447
Merger of holding company	12	1	0	0	4	75	0	92
Retention of bank	0	0	0	0	0	0	0	0
Acquisition								
Bank	55	1	0	0	22	298	0	376
Nonbank	245	2	0	0	23	173	210	653
Acquisition of bank service corporation[2]	0	0	0	0	0	4	43	47
Other	2	0	14	0	0	0	0	16
Total	**354**	**5**	**14**	**0**	**52**	**953**	**253**	**1,631**

1. Official staff of the Board of Governors.
2. Approved under the Bank Service Corporation Act, which contains standards patterned after those of the Bank Holding Company Act.

holding companies and denied 1, approved 375 bank acquisitions by existing bank holding companies and denied 1, and approved 651 requests to acquire nonbank companies that are engaged in activities closely related to banking and denied 2. Data on these and related bank holding company decisions are shown in the accompanying table.

Bank Merger Act

The Bank Merger Act requires that all proposed bank mergers be acted upon by the appropriate federal bank regulatory agency. If the bank surviving the merger is a state member bank, the Federal Reserve has primary jurisdiction. Before acting on a proposed bank merger, the Federal Reserve considers factors relating to 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 1987 the Federal Reserve approved 87 merger applications: 5 were approved by the Board; and under authority delegated by the Board, the Secretary of the Board approved 3 and the Reserve Banks approved 79. As required by law, each merger is described in this REPORT, in table 16 of the Statistical Tables section.

When the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation has jurisdiction over a merger, the Board is asked to comment on the competitive factors to assure comparable enforcement of the antitrust provisions of the act. The Board and those agencies have adopted standard terminology for assessing competitive factors in bank merger cases to assure consistency in administering the act. On behalf of the Board, the Reserve Banks submitted 822 reports on competitive factors to the OCC and the FDIC in 1987.

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Change in Bank Control Act

The Change in Bank Control Act of 1978 requires persons seeking control of a bank or bank holding company to obtain approval from the appropriate federal banking agency before the transaction occurs. Under the act, the Board is responsible for reviewing changes in the control of state member banks and of bank holding companies. In so doing, it must review the financial condition, competence, experience, and integrity of the acquiring person; it must consider the effect on the financial condition of the bank or bank holding company to be acquired; and it must determine the effect on competition in any relevant market.

The federal banking agencies are required to publish notice of each proposed change in control and to invite public comment, particularly from persons located in the markets served by the institution to be acquired. The federal banking agencies are also required to assess the qualifications of each person seeking control; the Board routinely makes such a determination and verifies information contained in the proposal. In 1987 the Federal Reserve System acted on 204 proposed changes in control of state member banks and bank holding companies. The Reserve Banks consented to 189 proposals; under authority delegated by the Board, the Secretary of the Board consented to 4; and the Board consented to 11 and disapproved 1.

Delegation of Applications

The Board has delegated certain regulatory functions—including the authority to approve, but not to deny, certain types of applications—to the Reserve Banks, to the Staff Director of the Board's Division of Banking Supervision and Regulation, and to the Secretary of the Board.

The delegation of responsibility for applications permits staff members to work more efficiently at both the Board and the Reserve Banks by removing routine cases from the Board's agenda. During 1987, 83 percent of the applications were acted on under delegated authority.

Timely Processing of Applications

The Federal Reserve maintains target dates and procedures for the processing of applications. These target dates promote efficiency at the Board and the Reserve Banks and reduce the burden on applicants. The time allowed for a decision is 60 days; during 1987, 93 percent of the decisions met this standard.

In 1987, all but 1 of the 87 applications for bank mergers were processed within 60 days. Nearly all of the 822 reports on the competitive factors of proposed mergers were processed within 30 days. Of the 204 change of control notices involving state member banks or bank holding companies, 183 were handled within 60 days.

The Federal Reserve also holds its processing of international applications to a 60-day standard. In 1987 the Federal Reserve acted on 86 international applications, 92 percent of which it handled within the time allowed.

Board Policy Decisions and Developments in Bank-Related Activities

In 1987 the Board approved several new nonbanking activities for individual bank holding companies. It also had under consideration other proposed nonbanking activities, including real estate

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investment and development, the operation of healthy thrift institutions, and expanded securities brokerage.

Approval of Permissible Nonbanking Activities

In 1987 the Board for the first time approved the following activities for individual bank holding companies: (1) underwriting and dealing on a limited basis in commercial paper, certain municipal revenue bonds of investment quality (including "public ownership" industrial development bonds), mortgage-related securities on 1–4 family residential real estate, and third-party securities representing an interest in or backed by a diversified pool of consumer loans or receivables; and (2) engaging in securities brokerage, clearing, and other services in connection with a system for the trading of options on U.S. government securities. However, the Competitive Equality Banking Act of 1987, enacted on August 10, 1987, included a moratorium that prohibited bank holding companies from utilizing these new securities powers until March 1, 1988.

The Board also approved the following activities for individual bank holding companies: (1) furnishing their institutional brokerage customers with combined brokerage, investment advisory, and discretionary investment management services in limited instances; (2) providing cash management services and discretionary management of short-term monies for institutional clients in a brokerage subsidiary; (3) providing advisory services as a futures commission merchant with respect to futures contracts on stock indexes and options on such futures contracts; and (4) providing economic and community development advice to organizations and institutions that operate programs designed primarily to promote community welfare.

Proposals to Engage in New Nonbanking Activities

At year-end the Board had under consideration proposals to engage in several new nonbank activities. A pending application requested permission to provide full-service retail securities brokerage by combining the execution of securities transactions with the provision of investment advice. Also, in light of changing economic and regulatory circumstances, the Board solicited public comment on whether it should amend Regulation Y to permit the acquisition and operation of healthy thrift institutions. The Board also had under consideration a proposal to permit bank holding companies to engage in real estate investment activities under specific conditions. The conditions are designed to ensure that the activity does not result in unsafe or unsound banking practices, unfair competition, conflicts of interest, or other adverse effects.

In connection with the Board's proposed rulemaking governing real estate activities by bank holding companies, the Board solicited public comment on whether it should attempt to better insulate banks and savings banks from the related risks by requiring that these real estate activities be conducted through a nonbank subsidiary of the bank holding company. The Board also solicited public comment on the need for imposing special capital requirements for bank holding companies that control banks engaged in such real estate activities.

In 1987 the Board approved the formation of bank holding companies in connection with the conversion of mutual savings banks to stock savings banks. In this regard certain mutual savings banks that established bank holding companies also engaged in real estate investment and development under the explicit authorization of the Competitive Equality Banking Act of 1987 (see the

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chapter, elsewhere in this volume, on legislation enacted).

Applications by State Member Banks

State member banks must obtain the permission of the Board 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. State member banks must also give six months' notice of their intention to withdraw from membership in the Federal Reserve, although the Board may shorten or eliminate the notice period in specific cases. These matters are normally handled under delegated authority by the Federal Reserve Banks or, in the case of certain investments in bank premises or proposed sales of subordinated debt, by the Staff 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. When the company borrows the money to buy the shares, the transaction increases the debt of the bank holding company and simultaneously decreases its equity. Relatively large repurchases may undermine the financial condition of a bank holding company and its bank subsidiaries. The Board's regulations require 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 by holding companies that fail to meet certain standards, including the Board's capital guidelines. During 1987 the Federal Reserve reviewed 91 proposed stock repurchases by bank holding companies, 89 of which were acted on by the Reserve Banks on behalf of the Board.

Public Notice of Board Decisions

Each decision 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; they are also reported in the Board's weekly H.2 statistical release and in the monthly *Federal Reserve Bulletin*. Announcements of applications and notices received by the System but not yet acted on are made in the H.2 release.

International Activities of U.S. Banking Organizations

The Board has four principal statutory responsibilities in supervising the international operations of U.S. banking organizations. It must provide authorization and regulation of foreign branches of member banks; of overseas investments by member banks, Edge corporations, and bank holding companies; and of investments by bank holding companies in export trading companies. In addition the Board is required to charter and regulate Edge corporations and their investments.

Foreign Branches of Member Banks

Under provisions of the Federal Reserve Act and of Regulation K, member banks in most cases must seek Board approval to establish branches in foreign countries. In reviewing proposed foreign

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branches, the Board considers the requirements of the law, the condition of the bank, and the bank's experience in international business. In 1987 the Board approved the opening of five foreign branches.

By the end of 1987, 153 member banks were operating 902 branches in foreign countries and overseas areas of the United States; 127 national banks were operating 772 of these branches, and 26 state member banks were operating the remaining 130 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 the accounts of the office establishing the IBF. Deposits from, and credit extended to, foreign residents or other IBFs generally may 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 1987, 543 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 the following powers: (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) their powers to make foreign investments are broader than those of member banks because they may invest in foreign financial organizations, such as finance companies and leasing companies, as well as in foreign banks. By the end of 1987, there were 119 Edge corporations, which had 60 branches. The Board requires each Edge corporation that is engaged in banking to maintain a ratio of equity to risk-assets of at least 7 percent.

Foreign Investments

Under authority of the Federal Reserve Act and the Bank Holding Company Act, U.S. banking organizations may engage in activities overseas with the authorization of the Board. To a significant extent, the Board's Regulation K permits such investments without prior Board review. In 1987 the Board reviewed and permitted 53 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. In 1987 the Federal Reserve acted affirmatively on the 3 notifications received for the establishment of export

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trading companies. Since 1982 the Board has acted affirmatively on such notifications by 45 bank holding companies.

Enforcement of Other Laws and Regulations

This section describes the Board's responsibilities for the enforcement of laws, rules, and regulations other than those specifically related to bank safety and soundness and the integrity of the banking structure.

Bank Secrecy Act

Through the examination process, the Federal Reserve determines whether the institutions it supervises are complying with the recordkeeping and reporting requirements of the Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act). Among the stipulations in the act to combat unlawful currency transactions is the requirement that financial institutions (and selected other businesses) report to the Internal Revenue Service certain cash transactions of more than $10,000.

As mandated by the passage of the Anti-Drug Abuse Act of 1986, Board staff members worked with the other federal financial institutions to develop regulations that ensure compliance with the Bank Secrecy Act. The regulations were enacted January 27, 1987, and became effective April 27, 1987.

In 1987 Board staff members participated in a number of industry-wide seminars sponsored by various banking trade associations. The seminars informed more than 7,000 bankers on the new regulations and law as well as recent changes to existing statutes. Board staff members continue to actively participate in the interagency working group on the Bank Secrecy Act, headed by the Department of the Treasury.

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 (Regulation U), and by other lenders (Regulation G). Regulation X extends these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Brokers and dealers are examined for compliance with Regulation T by the Securities and Exchange Commission, the National Association of Securities Dealers, and the national securities exchanges. The three federal bank supervisory agencies examine banks under their respective jurisdictions for compliance with Regulation U.

Other lenders are examined for compliance with Regulation G by the Board, the National Credit Union Administration, the Farm Credit Administration, or the Federal Home Loan Bank Board according to the jurisdiction involved. At the end of 1987 there were 531 "G-lenders," of which 313 were subject to the Board's supervision. Of these 313, 169 were subject to regular inspection by the Federal Reserve System. During the year, Federal Reserve examiners inspected 60 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 limits on loans whose purpose is the purchasing or carrying of publicly held equity securities and that

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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's Division of Banking Supervision and Regulation monitors the market activity of all over-the-counter stocks to determine what stocks are subject to the Board's margin regulations. In 1987 the Board published the resulting "List of Marginable OTC Stocks" in February, May, August, and November. The November list consisted of 3,329 stocks.

In August 1987 the Board amended Regulation T, revising the definition of "OTC margin bond" to include any "mortgage related security" as defined in the Secondary Mortgage Market Enhancement Act of 1984. The principal effect of the amendment permits a broker–dealer to give good faith loan value in a margin account to any mortgage-related security that is privately placed. Most publicly offered mortgage-related securities were already eligible for credit at a broker–dealer.

In September 1987 the Board amended Regulation U to reduce the paperwork burden for banks that take margin stock as collateral for loans. As a result, banks are no longer required to use Form FR U-1 for loans of $100,000 or less that are secured directly or indirectly by margin stocks.

In December 1987 the Board amended Regulation T, effective January 25, 1988, enabling broker–dealers to help employees exercise stock options awarded in connection with their employment. The amendment simplifies the method by which brokers and dealers may temporarily finance the acquisition of stock under employee stock option programs without violating the general principles of Regulation T. The broker will now be able to treat the receipt of an exercise notice as if it were the stock itself.

Under section 8 of the Securities Exchange Act, a nonmember domestic or foreign bank may lend to brokers or dealers posting registered securities as collateral only if the bank has filed an agreement with the Board that it will comply with all the statutes, rules, and regulations applicable to member banks regarding credit on securities. During the year, the Board processed 15 such agreements.

In 1987 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued 57 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.

Under section 15c of the Securities Exchange Act, as amended by the Government Securities Act of 1986, all financial institutions that act as government securities brokers or dealers must notify their designated federal supervisory agencies of their activities (provided they are not exempted by the U.S. Treasury). The Board has the responsibility for adopting the form for this notice, as well as for that of the notice to be filed when these institutions are no longer acting as government securities brokers or dealers. The Board adopted Form FR G-FIN and Form FR G-FINW in May 1987.

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Loans by State Member Banks to their Executive Officers, 1986–87

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
October 1–December 31, 1986	1,383	28,147,628	3.0–20
January 1–March 31, 1987	1,360	22,218,894	5.5–21
April 1–June 30, 1987	1,323	27,296,011	1.0–21
July 1–September 30, 1987	1,991	20,813,768	5.5–21

Financial Disclosure by State Member Banks

Under the Board's Regulation F, state member banks must disclose certain information of interest to investors, including financial reports and proxy statements, if they issue securities registered under the Securities Exchange Act of 1934. Board staff members review the information for compliance with the regulation. At the end of 1987, 37 state member banks, most of which are of small or medium size, were registered with the Board under Regulation F.

The disclosure rules of Regulation F are required by statute to be substantially similar to those issued by the Securities and Exchange Commission. In 1987 the Board completed a comprehensive revision of Regulation F. To ease compliance, the revision requires banks subject to Regulation F to use the forms prescribed by the Securities and Exchange Commission and receive annual audits of their financial statements. Small banks would have the option of filing simplified quarterly reports.

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 1986 and the first three quarters of 1987.

Federal Reserve Membership

At the end of 1987, 5,751 banks were members of the Federal Reserve System, a decrease of 244 from the previous year.

Member banks operated 30,021 branches on December 31, 1987, a net increase of 1,565 for the year. Member banks accounted for 41 percent of all commercial banks in the United States and for 65 percent of all commercial banking offices.

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Regulatory Simplification

The Board of Governors established the Regulatory Improvement Project in 1978 and reaffirmed its commitment to regulatory improvement by creating a Regulatory Policy and Planning Committee in 1986. The program was established to minimize the burdens imposed by regulation, to ensure that consideration is given to minimizing the economic impact of regulation on small business, to afford interested parties the opportunity to participate in designing regulations and to comment on them, and to ensure that regulations are written in simple and clear language. The program also involves periodic review of all existing regulations for adherence to these objectives.

Regulation F

The Securities Exchange Act of 1934 requires that publicly held companies make certain public disclosures and file various reports with the Securities and Exchange Commission. The act provides that the Federal Reserve Board exercise, with respect to state member banks, the authority granted to the SEC with regard to disclosure and reporting. The Board meets this responsibility through its Regulation F, which virtually duplicates the requirements of the SEC disclosure and reporting regulations.

Because only 36 state member banks are currently subject to Regulation F, and because Regulation F differs little from the rules and regulations issued by the SEC, the Board believed that it would be appropriate to replace its regulation on securities disclosure with a requirement that state member banks file with the Board the information and forms prescribed by the SEC. Because the remaining regulatory requirements are brief, the Board decided to incorporate them in Regulation H, which applies to state member banks generally, thereby eliminating Regulation F.

To ease compliance for small banks, the Board will allow banks that have no foreign offices and whose assets total less than $150 million to substitute the balance sheet and income statement from the quarterly report of condition the bank must file with the Board (Federal Financial Institutions Examination Council Form 034) for the quarterly financial statements required in the SEC's Form 10-Q. The Board concluded that no substantive purpose would be served by requiring small banks to file two forms detailing similar information.

Freedom of Information Act

In the spring of 1987, the Board issued for comment a revision of its "Rules Regarding Availability of Information." These rules cover three broad areas: requests under the Freedom of Information Act, which the Board's Secretary handles; subpoenas, inquiries regarding law enforcement, and similar matters, which the Board's General Counsel addresses; and the routine disclosure of supervisory information to other bank supervisory agencies, which the Director of the Board's Division of Banking Supervision and Regulation and staff members at the Federal Reserve Banks have traditionally handled.

This regulation was extensively revised for the first time since its promul-

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gation in 1967. The revision incorporates many procedures developed by the staff or suggested by the courts during that time that were never added to the regulation. In addition, the revision clarifies the Board's rules for responding to subpoenas as well as to requests for information from the public and from law enforcement agencies.

Beyond the simplification and clarification of its language, the regulation was divided into five parts. The regulation contains new and expanded definitions of terms and includes (1) a description of the way the Board processes requests under the Freedom of Information Act (FOIA); (2) further delegation of authority to the Board's General Counsel to act on requests for information by law enforcement agencies and others; (3) additional provisions regarding the availability of information to federal and state supervisors of financial institutions; (4) requirements for disclosure by financial institutions of examination or inspection reports to appropriate agents of such institutions; and (5) provision for notifying submitters of confidential commercial or financial information that requests for that information have been made under the FOIA, and procedures for requesting confidential treatment of such information and for addressing the proposed disclosure of information that a submitter believes should not be disclosed.

Margin Regulations

The Board amended Regulation T (credit by brokers and dealers) to enable broker–dealers to help employees exercise stock options awarded in connection with their employment.

The amendment simplifies the method by which brokers and dealers may temporarily finance the acquisition of stock under employee stock-option programs without violating the general principles of Regulation T.

In general, the structure of a cash account does not permit a person to pay for the purchase of a security with the proceeds of its sale, nor does the structure of a margin account allow a withdrawal of cash that lowers a customer's equity in the account. The amendment permits the creditor to treat the receipt of an exercise notice as if it were the stock itself.

The Board also amended the definition in Regulation T of over-the-counter margin bond so as to permit brokers and dealers to extend credit, on the basis of good faith, on any mortgage-related security. The Secondary Mortgage Market Enhancement Act of 1984 basically requires a mortgage-related security to be rated in one of the two highest rating categories by at least one nationally recognized rating organization. The securities must also be secured either directly or indirectly by residential or mixed residential-commercial mortgages.

The amendment should facilitate participation by the private sector in the secondary market for mortgages. It should also provide harmony with the recently adopted measure of the Securities and Exchange Commission regarding the maintenance margin rule of the New York Stock Exchange. The revised definition will encompass mortgage-related securities that have been privately placed and therefore did not meet the requirements in the existing definition.

In addition, the Board amended Regulation U to exempt banks from the requirement of executing Federal Reserve Form U-1 when they make loans of $100,000 or less that are secured directly or indirectly by margin stock. The elimination of this requirement is expected to reduce by nearly half the number of times a bank must complete this form.

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Regulation K

In August, the Board liberalized the provisions of Regulation K to permit certain investments abroad by U.S. banking organizations through swaps of debt for equity.

The purpose of the amendment is to provide additional flexibility to U.S. banking organizations in investing in companies whose ownership is being transferred from the public sector to the private sector in heavily indebted developing countries. The eligible countries would be those that have restructured sovereign debt held by foreign creditors since 1980.

The amendment permits a U.S. banking organization to acquire as much as 100 percent of the shares of a foreign nonfinancial company in certain circumstances; the percentage of stock held in nonfinancial corporations can generally be only 20 percent. Because the amendment is not intended to permit permanent investments in nonbank concerns, the equity interests acquired must be divested when it becomes feasible.

Regulation E

The Federal Reserve Board approved amendments to Regulation E, Electronic Fund Transfers (EFT), that eliminate the requirement for periodic statements to consumers from providers of EFT services that do not hold consumer accounts. The amendments should facilitate the development of point-of-sale EFT services that make use of the automated clearinghouse (ACH) system for processing, without imposing heavy costs on financial institutions or reducing essential consumer protections.

By exempting business like supermarkets, gasoline retailers, and other merchants, which do not hold consumer transaction accounts, the amendments will eliminate some duplication of information. Because consumers will continue to receive periodic statements from their financial institutions that reflect electronic fund transfers to and from their accounts, they will lose no information through this change. The savings to the exempted businesses and to the payments system as a whole are likely to be substantial.

The amendments will, however, require account-holding financial institutions to include a description of these EFT transactions on periodic statements to their customers even if they do not provide electronic transfers themselves. The burden of providing that information is not likely to be great for such institutions as a group. Most point-of-sale (POS) transactions will involve accounts at financial institutions that already are set up to comply with the requirements for periodic statements. Seventy-nine percent of all commercial banks already offer at least one EFT service that requires compliance with Regulation E; and larger banks, which hold most consumer asset and transaction accounts, are even more likely to offer EFT services. The Board eased the burden on institutions with assets of $25 million or less by exempting them from any requirements regarding POS/ACH transactions until July 1, 1990.

Interpretations on Payment of Interest

The statutory authority to set ceilings on interest rates on time and savings deposits and to prescribe rules regarding early withdrawals from time deposits expired on March 31, 1986. In early 1986 the Board revised and simplified its Regulation Q, which governed the payment of interest on deposits.

In 1987 the Board rescinded thirty-

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four interpretations that had become obsolete, revised the three remaining interpretations that applied to payment of interest, and transferred seven interpretations to Regulation D to help distinguish between classes of deposits for purposes of reserve requirements.

Reporting of Currency Transactions

In January 1987, as mandated by the Anti–Drug Abuse Act, the Board ordered banks to adopt procedures assuring compliance with the requirements of the Bank Secrecy Act regarding the reporting of cash transactions.

Under the regulations, a bank's compliance program must be in writing, approved by the board of directors, and noted in the minutes. It must, at a minimum, consist of internal controls to assure ongoing compliance, and it must provide for independent testing of compliance by bank personnel or by an outside party.

The regulation may be burdensome for banks whose existing internal operations are not complex and for banks that do not normally conduct large cash transactions with their customers; therefore, the Board and other federal agencies that regulate financial institutions have developed model forms for these banks to use in following the regulation.

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Federal Reserve Banks

Developments in the Pricing of Federal Reserve Services and in the Payments Mechanism

In 1987 the Federal 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 104.6 percent of its operating expenses and imputed costs, compared with 104.3 percent in 1986.

Revenue at the Reserve Banks from all priced services totaled $768.8 million, and costs were $735.2 million (see the end of this chapter for the pro forma income statement and other financial statements for priced services for 1987). These figures include the income and expenses related to clearing balances, the value of priced float, and the PSAF (the private sector adjustment factor—the taxes and costs of capital that the System would have incurred if it were a private firm). The net revenue of the Federal Reserve System from priced services in 1987 was $33.6 million.

In November 1986 the Board requested public comment on factors to be considered when it reviews proposals to consolidate Reserve Bank priced services across District lines. In July 1987 the Board approved a modified set of factors, which range from the effect of the proposed consolidation on users and other providers of the service to responsiveness to changes in the financial industry.

Check Collection

The operating and imputed costs of check collection by the Federal Reserve in 1987 were $447.1 million (see the table on income by service and note 9 in the financial statements for priced services). Check operations for the year generated $500.6 million in revenue and a net of $5.1 million in other income and expenses. The number of checks handled by the Reserve Banks was 17.0 billion, an increase of 4.8 percent from 1986.

In March the Board approved a proposal that had been issued for public comment in November 1986 to allow Federal Reserve Banks to provide a redeposit service for small-dollar checks that are returned because of insufficient or uncollected funds. Under this service, Reserve Banks intercept dishonored checks and redeposit them on behalf of the collecting institution.

In August the Congress passed the Expedited Funds Availability Act, which becomes effective September 1, 1988. Among other things, the act sets forth schedules within which depository institutions must make funds deposited in customer transaction accounts available for withdrawal and requires institutions to disclose to their customers their policies on such availability. In December the Board issued for public comment a series of proposals to implement the act, including ways to improve the return of unpaid checks to the bank of first deposit.

The Board requested comment on a proposed regulation (Regulation CC) to implement the availability and disclosure requirements and to place new responsibilities on depository institutions to speed the return of unpaid checks; these responsibilities would reduce the risk to banks of first deposit arising from the availability requirements of the act. Specifically, the proposal provides rules to (1) expedite returns to the bank of first

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deposit, (2) expand the requirements for notification of large-dollar returned checks, and (3) reduce the number of returned checks. These objectives are accomplished by modifying the duties of the paying bank, the returning bank, and the bank of first deposit in the return process.

Also proposed were several changes to Regulation J, which governs the collection of checks and other items by Federal Reserve Banks, so that it conforms to the new rules proposed in Regulation CC.

In conjunction with the proposed regulations, the Board suggested new Federal Reserve services to speed the return process. These services, which are designed to facilitate bank compliance with the proposed regulatory requirements, include acceptance and processing of any returned check by a Federal Reserve Bank and the delivery of returns by Federal Reserve Banks directly to the bank of first deposit. Reserve Banks would also speed the processing of returned checks.

Currently, the Federal Reserve does not explicitly price returned checks; instead, the costs of handling returns are incorporated in the Reserve Banks' forward collection fees. The Board proposed to price returns explicitly, imposing fees for returned checks on the paying or the returning bank that deposits returns with the Federal Reserve.

In addition, the Board proposed making the Federal Reserve's pilot program on check truncation into a permanent service. In truncation, the physical checks are not delivered to the paying bank; instead, the line of information printed along the bottom of the check is captured through the technology of magnetic-ink character recognition (MICR) and presented to the paying bank electronically. The benefits of truncation include expeditious check processing and return and a reduction in the number of times the paper check is handled. Truncation may also permit savings in transportation and in the costs of storage, equipment, and personnel for the paying bank.

The Board also proposed to make permanent its extended MICR capture service, which has also been offered on a pilot basis. Extended MICR capture offers many of the benefits of truncation without stopping the flow of the paper check.

Public comment was requested on other possible new Federal Reserve services and longer-term initiatives aimed at improving the check-collection system. The longer-term initiatives include investigation of machine-readable endorsements for checks and the potential of using digitized image processing to improve the productivity and the quality of the check-collection system. The Board also requested comment on actions it should consider regarding delayed disbursement.

Electronic Payments

The Federal Reserve System is conducting a strategic study of its electronic payments services. In 1987 the study identified business requirements for the 1990s and evaluated alternative operating systems. In 1988 the Federal Reserve will issue a request for proposals to test new equipment, and steps will be taken to improve the reliability of the Reserve Banks' operating environment. Finally, the Federal Reserve will conduct market research to define more precisely the future business requirements for its electronic payment services.

Automated Clearinghouse

Operating and imputed costs of providing automated clearinghouse (ACH) services in 1987 were $32.6 million; revenues were $37.3 million. For the

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year, 475.1 million commercial transactions were processed in 1987, a 31.0 percent increase over 1986.

In June 1987 the Board approved a change to accounting procedures that will require depository institutions to accept ACH debit transactions that settle on holidays or other days when the institutions are closed or to defer the debit until the next business day and pay for the resulting float.

In December the Board approved operational changes designed to reduce risk in the ACH mechanism. The changes require uniform procedures by the Reserve Banks to monitor ACH credit payments originated by depository institutions in weak financial position; earlier deposit deadlines for returns of ACH debit transactions of $2,500 or greater; and uniform float-accounting procedures for depository institutions originating credit transactions that settle on holidays or other days when the institutions are closed.

The staff continued its analysis of the proposal offered in December 1986 regarding ex post monitoring procedures and the finality of ACH transactions. No final action was taken in 1987.

Wire Transfer of Funds

The number of wire transfers originated during 1987 increased 7.1 percent over 1986 to 53.3 million. This service cost $59.6 million, and it generated revenue of $69.7 million.

In 1987 the basic fee for funds transfers was reduced from $0.55 to $0.50. In addition, fees for electronic access to the Reserve Banks were adjusted to reflect the actual costs of data communications.

The System made substantial progress during 1987 in converting all on-line depository institutions to standard protocols for data communications. The System also encrypted most of its data links with depository institutions and will encrypt the rest once the transition to standard communications protocols has been completed. Finally, the System is planning to employ message authentication as an additional security measure.

To reduce the risk of disruption to service, the Reserve Banks have been pursuing ways to permit one Reserve Bank to process work for another during a serious interruption in operations. In addition, the Federal Reserve Bank of New York has established its own remote contingency processing center for funds and securities processing.

For a discussion of Board efforts to reduce risk in large-dollar electronic payment systems, see pp. 182–83, in the chapter on banking supervision and regulation.

Coin and Currency

In its coin and currency operations, the Federal Reserve continued to focus on the effectiveness of controls, the efficiency in processing, and the maintenance of high quality in the currency in circulation.

In 1987, four Federal Reserve Districts provided transportation of cash by armored carrier and five Districts provided wrapped coin to depository institutions.

The System completed its testing of equipment to improve the verification, counting, sorting, and destruction of currency. In November the Board awarded a contract to Recognition Equipment, Inc., to manufacture and maintain the new equipment, which is expected to meet the System's needs for currency processing through the 1990s.

The Federal Reserve continued to work with the Department of the Treasury to deter the counterfeiting of U.S. currency.

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Definitive Securities and Noncash Collection

The System received $19.0 million in revenue for definitive safekeeping and noncash collection services in 1987; the cost of these services was $18.0 million. The average number of definitive securities issues and deposits maintained in safekeeping accounts at the Reserve Banks decreased 1.0 percent in 1987, to 163,000. The number of items for noncash collection decreased 11.8 percent, to 3.8 million. Bearer or coupon municipal securities have not been issued since 1983 because of revisions to the tax law in that year. As volume declines, Reserve Banks continue to reduce costs while maintaining high levels of service; the results on both counts at each Bank are measured against System standards.

Securities and Fiscal Agency Services

The Federal Reserve provides book-entry (computerized) securities services for the Department of the Treasury and for certain federally sponsored agencies, such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. The Treasury establishes the fees the Reserve Banks charge institutions for these transfers. Book-entry services for federal agency securities are treated as a Federal Reserve priced service; these services incurred costs of $6.6 million and earned revenue of $8.3 million in 1987. The Federal Reserve processed 2.1 million such transfers during the year, an increase of 19.9 percent from 1986.

In March, the Board reduced the fees it charges to depository institutions for transfer of book-entry securities in order to align more closely the costs and revenues from this service.

The system for handling securities transactions in book-entry form for individual investors, called Treasury Direct, was developed by the Federal Reserve on behalf of the Treasury and was completely implemented by the end of 1987.

The Federal Reserve sells Treasury securities in its role as fiscal agent. In 1987, a pilot program for savings bonds began at the Pittsburgh Branch of the Federal Reserve Bank of Cleveland, where all savings bonds previously issued over the counter by depository institutions in Ohio will be issued. The results of the pilot program, which will continue through April 1988, will be used to evaluate whether a centralized approach to processing over-the-counter bond sales is efficient, acceptable to buyers, and appropriate.

Float

Federal Reserve float increased to a daily average of $454 million in 1987, compared with $446 million in 1986. The costs of all Federal Reserve float associated with priced services are recovered each year.

Examinations

The Board's 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 given to the management and directors of the respective Banks and to the Board of Governors. Also, to assess conformance with the policies issued by the Federal Open Market Committee, 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 that Bank. 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.

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Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1987 and 1986[1]

Thousands of dollars

Item	1987	1986
Current income	17,633,012	17,464,152
Current expenses	1,146,911	1,156,868
Operating expenses[2]	1,033,288	1,049,159
Earnings credits granted	113,623	107,709
Current net income	16,486,101	16,307,284
Net addition to (deduction from) current net income	1,843,573	1,975,893
Cost of unreimbursed services to Treasury[3]	46,958	...
Assessments by the Board of Governors	252,545	278,118
For expenditures of Board	81,870	97,338
For cost of currency	170,675	180,780
Net income before payments to Treasury	18,030,171	18,005,060
Dividends paid	117,499	109,588
Payments to Treasury (interest on Federal Reserve notes)	17,738,880	17,803,518
Transferred to surplus	173,792	91,954

1. Details may not add to totals because of rounding.

2. Operating expenses reflect the 1987 implementation of Financial Accounting Standards Board Statement No. 87, Employer's Accounting for Pensions. In 1987 the effect of this statement on expenses was a credit (reduction) of $49 million.

3. In 1987 the Federal Reserve began explicitly accounting for the cost of reimbursable services performed on behalf of the U.S. Treasury for which reimbursement is not received. In the past, such reimbursed costs were reflected in "net addition to (deduction from) current net income."

Income and Expenses

The accompanying table summarizes the income, expenses, and distribution of net earnings of the Federal Reserve Banks for 1987 and 1986.

Income was $17,633 million in 1987, approximately the same as 1986. Total expenses were $1,229 million ($1,033 million in operating expenses, $114 million in earnings credits granted to depository institutions, and $82 million in assessment for expenditures by the Board of Governors). The cost of currency was $171 million. Income from financial services was $645 million.

The profit and loss account showed a net addition of $1,844 million, primarily resulting from gains on the sale of assets denominated in foreign currencies. Statutory dividends to member banks totaled $117 million, $8 million more than in 1986. The 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 $17,739 million, compared with $17,804 million in 1986. This sum consists of all net income after dividends and the amount necessary to bring the surplus of the Banks to the level of capital paid-in.

In the Statistical Tables section of this REPORT, table 6 details income and expenses of each Federal Reserve Bank for 1987, and table 7 shows a condensed statement for each Bank for 1914–87. A detailed account of the assessments and expenditures of the Board of Governors appears in the next section—Board of Governors, Financial Statements.

Federal Reserve Bank Premises

During 1987 the Board of Governors authorized construction of an operations center for the Reserve Bank of New York and a program for the construction of a new building for the Helena Branch. Construction of a new building for the Charlotte Branch continued. Table 8, 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

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Securities and Loans of Federal Reserve Banks, 1985–87

Millions of dollars, except as noted

Item and year	Total	U.S. government securities[1]	Loans
Average daily holdings[2]			
1985	176,688	175,359	1,329
1986	193,354	192,514	840
1987	217,392	216,722	670
Earnings			
1985	16,954	16,843	111
1986	16,199	16,142	57
1987	16,418	16,371	47
Average interest rate (percent)			
1985	9.60	9.60	8.38
1986	8.38	8.38	6.84
1987	7.55	7.55	6.99

1. Includes federal agency obligations.
2. Based on holdings at opening of business.

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 1985–87.

Average daily holdings of securities and loans during 1987 were $217,392 million, an increase of $24,038 million over 1986. Holdings of U.S. government securities increased $24,208 million, and loans decreased $170 million.

From 1986 to 1987, the average rate of interest decreased from 8.38 percent to 7.55 percent on holdings of U.S. government securities and increased from 6.84 percent to 6.99 percent on loans.

Volume of Operations

Table 9, 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 1984–87.

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FEDERAL RESERVE BANKS

PRO FORMA BALANCE SHEET FOR PRICED SERVICES

	As of December 31 (millions)			
	1987		1986	
SHORT-TERM ASSETS (Note 1)				
Imputed reserve requirements on clearing balances	$ 219.6		$ 251.8	
Investment in marketable securities	1,610.4		1,846.2	
Receivables	58.3		59.7	
Materials and supplies	4.9		5.1	
Prepaid expenses	6.7		6.0	
Net items in process of collection (float)	675.7		300.1	
Total short-term assets		$2,575.5		$2,468.8
LONG-TERM ASSETS (Note 2)				
Premises	224.5		200.3	
Furniture and equipment	110.9		118.2	
Leases and leasehold improvements	3.0		4.3	
Prepaid pension costs	18.7		...	
Total long-term assets		357.1		322.8
TOTAL ASSETS		$2,932.7		$2,791.6
SHORT-TERM LIABILITIES				
Clearing balances and balances arising from early credit of uncollected items	$2,505.7		$2,398.1	
Short-term debt	69.9		70.7	
Total short-term liabilities		$2,575.5		$2,468.8
LONG-TERM LIABILITIES				
Obligations under capital leases	1.2		1.6	
Long term debt	107.2		102.1	
Total long-term liabilities		108.4		103.7
TOTAL LIABILITIES		2,684.0		2,572.5
EQUITY		248.7		219.1
TOTAL LIABILITIES AND EQUITY (Note 3)		$2,932.7		$2,791.6

Details may not add to totals because of rounding.
The accompanying notes are an integral part of these financial statements.

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FEDERAL RESERVE BANKS

PRO FORMA INCOME STATEMENT FOR PRICED SERVICES

	For the years ended December 31 (millions)			
	1987		1986	
INCOME (Note 4)				
Services provided to depository institutions		$649.7		$627.7
EXPENSES (Note 5)				
Production expenses		506.8		497.5
INCOME FROM OPERATIONS		142.9		130.3
IMPUTED COSTS (Note 6)				
Interest on float	$ 27.4		$ 23.8	
Interest on debt	16.1		13.3	
Sales taxes	7.4		7.3	
FDIC insurance	1.8	52.7	1.5	45.8
INCOME FROM OPERATIONS AFTER IMPUTED COSTS		90.2		84.5
OTHER INCOME AND EXPENSES (Note 7)				
Investment income	119.1		114.2	
Earnings credits	114.1	5.0	106.3	8.0
INCOME BEFORE INCOME TAXES		95.2		92.4
IMPUTED INCOME TAXES (Note 8)		32.3		34.8
NET INCOME		$ 62.9		$ 57.6
MEMO				
Targeted return on equity (Note 8)		$ 29.3		$ 27.3

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FEDERAL RESERVE BANKS

PRO FORMA INCOME STATEMENT FOR PRICED SERVICES, BY SERVICE
(Note 9)

For the year ending December 31, 1987, in millions

	Total	Commercial check collection	Wire transfer and net settlement	Commercial ACH	Definitive safekeeping and noncash collection	Book-entry securities	Cash services
INCOME FROM SERVICES	$649.7	$500.6	$69.7	$37.3	$19.0	$8.3	$14.8
OPERATING EXPENSES	506.8	401.0	56.6	30.5	16.9	6.3	14.2
INCOME FROM OPERATIONS	142.9	99.6	13.2	6.7	2.1	2.0	.6
IMPUTED COSTS	52.7	46.1	3.0	2.1	1.1	.3	.1
INCOME FROM OPERATIONS AFTER IMPUTED COSTS	90.2	53.5	10.1	4.6	1.0	1.8	.6
OTHER INCOME AND EXPENSES, NET	5.0	5.1	(.1)	*	*	*	*
INCOME BEFORE INCOME TAXES	$ 95.2	$ 58.6	$10.1	$ 4.6	$ 1.0	$1.8	$ .5

*Less than $500,000 in absolute value.
Details may not add to totals because of rounding.
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FEDERAL RESERVE BANKS

REVENUE AND EXPENSE OF LOCALLY PRICED SERVICES
(Note 10)

Millions of dollars

	Total Revenue	Operating Cost	Float Cost	Total Cost	Net Revenue
	Commercial check collection				
Boston	35.0	27.4	3.8	31.2	3.8
New York	65.6	54.8	2.4	73.7	8.3
Philadelphia	24.0	17.8	1.0	18.8	5.2
Cleveland	29.2	24.0	1.2	25.1	4.0
Richmond	45.6	36.7	1.7	38.4	7.2
Atlanta	58.4	46.4	.8	47.2	11.2
Chicago	67.9	53.4	3.1	56.6	11.4
St. Louis	23.4	18.6	1.8	20.4	3.1
Minneapolis	28.6	23.9	(.1)	23.8	4.8
Kansas City	32.1	27.3	.9	28.2	3.9
Dallas	35.4	29.6	1.2	30.8	4.6
San Francisco	55.4	39.8	3.3	43.1	12.3
System total	500.6	399.7	21.1	420.8	79.7
	Definitive safekeeping and noncash collection				
Boston	.9	.7	*	.7	.2
New York	3.3	2.9	*	2.9	.5
Philadelphia	1.3	1.1	*	1.1	.2
Cleveland	2.0	1.9	.1	1.9	.1
Richmond	.9	1.0	*	1.0	(.1)
Atlanta	3.0	2.4	*	2.4	.5
Chicago	2.6	2.1	*	2.1	.5
St. Louis	1.1	1.2	*	1.2	(.1)
Minneapolis	1.2	1.0	.1	1.1	.1
Kansas City	1.6	1.4	*	1.4	.2
Dallas	1.2	1.1	*	1.2	*
San Francisco	*	.1	*	.1	(.1)
System total	19.0	16.9	*	17.0	2.0
	Cash services				
Boston	.6	.6	...	.6	*
New York	*	*	...	*	*
Philadelphia	1.5	1.5	...	1.5	.1
Cleveland	1.9	1.7	...	1.7	.1
Richmond	.1	.1	...	.1	*
Atlanta	.1	.1	...	.1	*
Chicago	.7	.7	...	.7	.1
St. Louis	.3	.2	...	.2	*
Minneapolis	2.4	2.3	...	2.3	.2
Kansas City	.4	.4	...	.4	*
Dallas	*	*	...	*	*
San Francisco	6.7	6.6	...	6.6	.1
System total	14.8	14.2		14.2	.6

*Less than $500,000 in absolute value.
Details may not add to totals because of rounding.
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FEDERAL RESERVE BANKS

PRICED SERVICES VOLUMES
(Note 11)

Thousands of items, except as noted

	1987	1986	1985	Percent change 1986–87	Percent change 1985–86
Funds transfers	53,278	49,900	45,110	7.1	10.6
Commercial ACH	475,114	362,557	282,528	31.0	28.3
Commercial checks	17,007,924	16,225,812	15,450,612	4.8	5.0
Securities transfers	2,061	1,719	5,498[1]	19.9	n.a.[1]
Definitive safekeeping	163	165	159	−1.0	3.9
Noncash collection	3,803	4,312	4,637	−11.8	−7.0
Cash transportation	357	363	376	−1.4	−3.6

1. Effective Oct. 1, 1985, only the book-entry transfers of government agency securities are considered priced. Because the 1985 figures include U.S. Treasury and government agency securities for the first three quarters, any comparison of such volumes is not applicable.

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FEDERAL RESERVE BANKS

NOTES TO FINANCIAL STATEMENTS FOR PRICED SERVICES

PRO FORMA BALANCE SHEET

(1) Short-Term Assets

The imputed reserve requirement on clearing balances and investment in marketable securities reflect the Federal Reserve's treatment of clearing balances maintained on deposit with Reserve Banks by depository institutions. For presentation of the balance sheet and the income statement, clearing balances are reported in a manner comparable to the way correspondent banks report compensating balances held with them by respondent institutions. That is, respondent balances held with a correspondent are subject to a reserve requirement established by the Federal Reserve. This reserve requirement must be satisfied with either vault cash or with nonearning balances maintained at a Reserve Bank. Following this model, clearing balances maintained with Reserve Banks for priced service purposes are subjected to imputed reserve requirements. Therefore, a portion of the clearing balances held with the Federal Reserve is classified on the asset side of the balance sheet as required reserves and is reflected in a manner similar to vault cash and due from bank balances normally shown on a correspondent bank's balance sheet. The remainder of clearing balances is assumed to be available for investment. For these purposes, the Federal Reserve assumes that all such balances are invested in three-month Treasury bills.

Receivables represent (1) amounts due the Reserve Banks for priced services that have been provided to institutions for which payment has not yet been received and (2) that share of suspense-account and difference-account balances related to priced services.

The amount shown for materials and supplies represents the inventory value of such short-term assets necessary for the ongoing operations of priced service areas. Prepaid expenses represent items such as salary advances and travel advances for priced service personnel.

The account "Net items in the process of collection" represents the amount of float as of the balance-sheet date and is the difference between the value of items in the process of collection (including checks, coupons, securities, wire transfers, and automated clearinghouse (ACH) transactions) and the value of deferred-availability items. The cost base for providing services that must be recovered under the Monetary Control Act includes the cost of float incurred by the Federal Reserve during the period, valued at the federal funds rate. Conventional accounting procedures would call for the gross amount of items in the process of collection and deferred availability items to be included on a balance sheet. However, the gross amounts have no implications for income or actual or imputed costs, and inclusion of the gross amounts could lead to misinterpretations of the assets employed in the provision of priced services that must be financed. Therefore, only the net amount is shown. The net amount represents the assets that involve a financing cost.

(2) Long-Term Assets

Long-term assets on the balance sheet have been allocated to priced services with the direct determination method, which uses the Federal Reserve's Planning and Control System (PACS) to ascertain directly the value of assets used solely in priced services operations and to apportion the value of jointly used assets between priced services and nonpriced services. Also, long-term assets includes an estimate of the assets of the Board of Governors directly involved in the development of priced services.

Long-term assets include amounts for capital leases and leasehold improvements and for prepaid pension costs associated with priced services. Effective January 1, 1987, the Federal Reserve Banks implemented Financial Accounting Standards Board Statement No. 87, Employers' Accounting for Pensions. Accordingly, the Reserve Banks recognized a credit to expenses and an increase of $18.7 million in this long-term asset account in 1987.

(3) Liabilities and Equity

A matched-book capital structure has been used for those assets that are not "self-financing" in determining liability and equity amounts. Short-term assets are financed with short-term debt. Long-term assets are financed with long-term debt and equity in a proportion equal to the ratio of long-term debt to equity for the bank holding companies used in the private sector adjustment factor (PSAF) model. (The PSAF model uses the 25 largest bank holding companies as a basis to impute the taxes that would have been paid and the return on capital that would have been provided had Federal Reserve priced services been furnished by a private-sector firm.)

Other short-term liabilities include clearing balances maintained at Reserve Banks and deposit balances arising from float. Other long-term liabilities consist of obligations on capital leases.

PRO FORMA INCOME STATEMENT

The income statement reflects income and expenses for priced services. Included in these amounts are the imputed costs of float, imputed financing costs, and the income related to clearing balances.

(4) Income

Income represents charges to depository institutions for priced services. This income is realized through one of two methods: direct charges to an institution's account or charges against accumulated earnings credits.

(5) Production Expenses

Production expenses include direct, indirect, and other general administrative expenses of the Federal Reserve Banks for providing priced services. Also included are the expenses of staff members of the Board of Governors working directly on the development of priced services, which were $1.7 million in 1987 and in 1986. The credit to expenses resulting from implementation of FASB 87 (see note 2) is reflected in production expenses.

(6) Imputed Costs

Imputed float costs represent the value of float to be recovered, either explicitly or through per-item fees, dur-

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ing the period. Float costs include those for checks, book-entry securities, noncash collection, ACH, and wire transfers.

The following table depicts the daily average recovery of float by the Federal Reserve Banks for 1987, in millions of dollars.

In the table, unrecovered float includes that generated by services to government agencies or by other central bank services.

Income on clearing balances represents increased income on clearing balances as a result of reducing imputed reserve requirements through the use of a cash-items-in-process-of-collection deduction for float when calculating the reserve requirement. This income then reduces the float required to be recovered through other means.

As of adjustments and direct charges refer to midweek closing float and inter-territory check float, which may be recovered from depositing institutions through adjustments to the institution's reserve or clearing balance or by valuing the float at the federal funds rate and billing the institution directly.

Float recovered through per-item fees is valued at the federal funds rate and has been added to the cost base subject to recovery in 1987.

	Daily average (millions)
Total float	$804.8
Unrecovered float	48.2
Float subject to recovery	756.6
Sources of recovery of float	
Income on clearing balances	91.7
As of adjustments	350.8
Direct charges	128.7
Per-item fees	185.4

Also included in imputed costs is the interest on debt assumed necessary to finance priced service assets and the sales taxes and FDIC insurance assessment that the Federal Reserve would have paid had it been a private-sector firm. These imputed costs are among the components of the PSAF (see note 3).

(7) OTHER INCOME AND EXPENSES

Other income and expenses consist of income on clearing balances and the cost of earnings credits granted to depository institutions on their clearing balances. Income on clearing balances represents the average coupon-equivalent yield on three-month Treasury bills applied to the *total* clearing balance maintained, adjusted for the effect of reserve requirements on clearing balances. Expenses for earnings credits are derived by applying the average federal funds rate to the *required* portion of the clearing balances, adjusted for the net effect of reserve requirements on clearing balances.

(8) INCOME TAXES AND RETURN ON EQUITY

Imputed income taxes are calculated at the effective tax rate derived from the PSAF model (see note 3). The targeted return on equity represents the after-tax rate of return on equity that the Federal Reserve would have earned had it been a private business firm, based on the bank holding company model. These items are among the components of the PSAF (see note 6).

INCOME STATEMENT, PRO FORMA BY SERVICE

(9) The income statement by service reflects revenue, operating expenses, and imputed costs except for income taxes. The effect of implementing FASB 87 (see note 2) is reported only in the "total" column in this table and has not been allocated to individual priced services.

Imputed costs includes float and interest on debt, sales taxes, and the FDIC assessment. Float costs are based on the actual float incurred in each priced service. Other imputed costs are allocated among priced services according to the ratio of operating costs less shipping costs in each priced service to the total cost of all priced services less the total shipping costs of all priced services.

Other income and expenses consists of income on clearing balances and the cost of earnings credits for the Federal Reserve. Because clearing balances relate directly to the Federal Reserve's offering of priced services, the income and cost associated with these balances are spread to each service based on the ratio of income from each service to total income.

Taxes and the after-tax targeted rate of return on equity, as shown on the pro forma income statement, have not been spread by service since these elements relate to the organization as a whole.

REVENUE AND EXPENSES
OF LOCALLY PRICED SERVICES

(10) This table depicts the financial results for each Reserve Bank in providing locally priced services. The financial results for each Reserve Bank shown here do not include the dollars to be recovered through the PSAF and the net income on clearing balances. Therefore, to reconcile net revenue by priced service shown in this table with that shown in the preceding table, adjustments must be made for imputed interest on debt, sales taxes, FDIC assessment, Board expenses for priced services and net income on clearing balances.

PRICED SERVICES VOLUMES

(11) This table shows the number of items handled by the Federal Reserve in its priced services operations and the percentage changes in these numbers in recent years. Volume for the wire transfer of funds is the number of basic transactions originated; ACH volume is the total number of commercial items processed; commercial check volume reflects the total commercial checks collected, including both processed and fine-sort items; volume for securities transfers is the number of basic transfers originated on-line; volume for definitive safekeeping is the average number of issues or receipts maintained; noncash collection volume is the number of items assessed fees; and cash transportation volume is the number of armored-carrier stops.

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Board of Governors

Financial Statements

The financial statements of the Board for the years 1987 and 1986 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 and 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, 1987 and 1986, 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 consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and in 1987 standards for financial and compliance audits contained in the *Standards for Audits of Governmental Organizations, Programs, Activities, and Functions* issued by the General Accounting Office, 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 26, 1988

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

	As of December 31	
	1987	1986
ASSETS		
CURRENT ASSETS		
Cash	$ 7,705,996	$ 8,646,210
Accounts receivable	908,883	2,045,873
Stockroom and cafeteria inventories, at cost	244,963	285,843
Prepaid expenses and other assets	760,903	627,054
Total current assets	9,620,745	11,604,980
PROPERTY, BUILDINGS AND EQUIPMENT, Net (Note 3)	63,356,924	64,827,375
OTHER ASSETS	429,357	1,708,506
Total assets	73,407,026	78,140,861
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable	$ 4,593,746	$ 4,655,794
Accrued payroll and related taxes	2,547,172	2,861,053
Accrued annual leave	4,185,226	3,896,398
Other liabilities	237,951	478,716
Total current liabilities	11,564,095	11,891,961
COMMITMENTS AND CONTINGENCIES (Note 5)		
FUND BALANCE	61,842,931	66,248,900
Total liabilities and fund balance	$73,407,026	$78,140,861

The accompanying notes are an integral part of these statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND FUND BALANCE

	For the years ended December 31	
	1987	1986
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$ 81,869,800	$ 97,337,500
Other revenues (Note 4)	3,645,891	3,169,567
Total operating revenues	$ 85,515,691	$100,507,067
BOARD OPERATING EXPENSES		
Salaries	53,811,021	53,259,376
Retirement and insurance contributions	6,245,296	5,401,797
Depreciation and losses (gains) on disposals	7,530,325	6,156,450
Postage and supplies	3,218,518	3,490,423
Utilities	3,195,502	2,970,714
Travel	2,834,715	2,537,670
Software	2,764,635	1,957,564
Repairs and maintenance	2,731,026	2,083,894
Contractual services and professional fees	2,235,129	2,127,597
Equipment and facility rentals	1,398,787	2,598,055
Printing and binding	1,867,291	2,022,535
Other (Note 4)	2,089,415	2,150,807
Total operating expenses	89,921,660	86,756,882
BOARD OPERATING REVENUES (UNDER) OVER EXPENSES	(4,405,969)	13,750,185
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	170,700,082	180,779,673
Expenses for currency printing, issuance, retirement, shipping, and research costs	170,700,082	181,219,573
CURRENCY ASSESSMENTS (UNDER) EXPENSES	—	(439,900)
TOTAL REVENUES (UNDER) OVER EXPENSES	(4,405,969)	13,310,285
FUND BALANCE, Beginning of year	66,248,900	52,938,615
FUND BALANCE, End of year	$ 61,842,931	$ 66,248,900

The accompanying notes are an integral part of these statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	For the years ended December 31	
	1987	1986
SOURCES OF CASH		
Board operations		
Net revenues (under) over expenses	$(4,405,969)	$13,310,285
Add items not affecting cash		
Depreciation and losses (gains) on disposals	7,530,325	6,156,450
Accrued annual leave	288,828	89,350
Decrease (increase) in accounts receivable, inventories, and prepaid expenses and other assets	1,044,021	(973,764)
(Decrease) in accounts payable, accrued payroll and related taxes, and other liabilities	(616,694)	(1,564,704)
Funds provided by operations	3,840,511	17,017,617
Proceeds from disposals of furniture and equipment	33,334	2,277,264
Total sources	3,873,845	19,294,881
USES OF CASH		
Capital expenditures for:		
Buildings	841,044	303,557
Furniture and equipment	5,252,164	16,781,375
(Decrease) increase in other non-current assets	(1,279,149)	1,708,506
Total uses	4,814,059	18,793,438
(DECREASE) INCREASE IN CASH	(940,214)	501,443
CASH BALANCE, Beginning of year	8,646,210	8,144,767
CASH BALANCE, End of year	$ 7,705,996	$ 8,646,210

The accompanying notes are an integral part of these statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1987 and 1986

(1) Significant Accounting Policies

Board Operating Revenues and Expenses—Assessments made on the Federal Reserve Banks for Board operating expenses and capital expenditures are calculated based on 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 stated 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 structures.

Other Assets—The Board has made prepayments for computer equipment to be received in future years. In addition, maintenance on this and other computer equipment received during 1986 and 1987 has been prepaid through January 1989. Other Assets includes the equipment prepayments and the portion of the prepaid maintenance services which will be received in 1989. As the equipment is received and maintenance service provided, the furniture and equipment account and the appropriate expense account will be charged accordingly.

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) Retirement Benefits

Substantially all of the Board's employees participate in either the Retirement Plan for Employees of the Federal Reserve System or the Civil Service Plan. The System's Plan is a multiemployer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office. Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the plan. The Civil Service Plan is a defined contribution plan.

Contributions to the System's Plan are actuarially determined and funded by participating employers at amounts prescribed by the Plan's administrator. No separate accounting is maintained of assets contributed by the participating employers and net pension cost for the period is the required contribution for the period. As of January 1, 1987, actuarial calculations showed that the fair value of the assets of the System's Plan exceeded the projected benefit obligations by 70 percent. Based on these calculations and similar calculations performed for 1986, it was determined that employer funding contributions were not required for the years 1987 and 1986 and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions.

Board contributions to the Civil Service Plan directly match employee contributions. The Board's contributions to the Civil Service Plan totaled $547,000 in 1987 and $565,000 in 1986.

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 $1,491,000 in 1987 and $1,337,000 in 1986.

The Board also provides certain health benefits for retired employees. The cost of providing the benefits is recognized by expensing the insurance premiums which were $166,800 in 1987 and $98,300 in 1986.

(3) Property, Buildings, and Equipment

The following is a summary of the components of the Board's fixed assets, at cost, net of accumulated depreciation.

	As of December 31	
	1987	1986
Land and improvements	$ 1,301,314	$ 1,301,314
Buildings	62,903,355	62,062,311
Furniture and equipment	37,005,912	31,955,505
	101,210,581	95,319,130
Less accumulated depreciation	37,853,657	30,491,755
Total property, buildings and equipment	$ 63,356,924	$64,827,375

(4) Other Revenues and Other Expenses

The following are summaries of the components of Other Revenues and Other Expenses.

	For the years ended December 31	
	1987	1986
Other Revenues		
Contingency Processing Center fees	$1,593,050	$1,543,761
Sale of publications	1,418,513	1,124,482
Miscellaneous	634,328	501,324

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(4) Other Revenues and Other Expenses—Cont.

Total other revenues	$3,645,891	$3,169,567
Other Expenses		
Subsidies and contributions	$ 649,919	$ 703,213
Tuition, registrations and membership fees	517,097	587,670
Cafeteria operations, net	560,282	520,450
Miscellaneous	362,117	339,474
Total other expenses	$2,089,415	$2,150,807

(5) Contingencies

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 such lawsuits involving monetary awards do not represent a material liability to the Board.

(6) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1987 and 1986, the Board paid $162,000 and $137,000, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1987 and 1986.

The Board serves as custodian for the Council's cash amount. 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.

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Statistical Tables

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1. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1987[1]

Thousands of dollars

ASSETS

Item				
Gold certificate account				**11,078,290**
Special drawing rights certificate account				**5,018,000**
Coin				**408,990**
Loans and securities				
Loans to depository institutions			**3,815,798**	
Federal agency obligations				
Bought outright			**7,553,086**	
Held under repurchase agreement			**1,315,470**	
U.S. Treasury securities				
Bought outright				
Bills	**107,690,760**			
Notes	**82,973,430**			
Bonds	**28,241,544**			
Total bought outright		**218,905,734**		
Held under repurchase agreement		**3,645,235**		
Total securities			**222,550,969**	
Total loans and securities				**235,235,323**
Items in process of collection				
Transit items			6,410,778	
Other items in process of collection			1,586,402	
Total items in process of collection				**7,997,180**
Bank premises				
Land		108,704		
Buildings (including vaults)	531,660			
Building machinery and equipment	167,815			
Construction account	83,167			
Total bank premises		782,642		
Less depreciation allowance		185,531	597,111	
Bank premises, net				**705,815**
Other assets				
Furniture and equipment		562,770		
Less depreciation		309,469		
Total furniture and equipment, net			253,301	
Denominated in foreign currencies[2]			7,772,873	
Interest accrued			2,631,681	
Premium on securities			1,514,275	
Due from Federal Deposit Insurance Corporation			2,623,472	
Overdrafts			21,165	
Prepaid expenses			76,885	
Suspense account			79,209	
Real estate acquired for banking-house purposes			9,018	
Other			150,464	
Total other assets				**15,132,343**
Total assets				**275,575,941**

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1.—Continued

Liabilities		
Federal Reserve notes		
Outstanding (issued to Federal Reserve Banks)	253,312,894	
Less held by Federal Reserve Banks	40,421,693	
Total Federal Reserve notes, net		**212,891,201**
Deposits		
Depository institutions		**41,782,986**
U.S. Treasury, general account		**5,312,879**
Foreign, official accounts		**244,195**
Other deposits		
Officers' and certified checks	18,815	
International organizations	137,272	
Other[3]	875,414	
Total other deposits		**1,031,501**
Deferred credit items		**7,185,896**
Other liabilities		
Discount on securities	2,758,450	
Sundry items payable	54,166	
Suspense account	201,592	
All other	18,901	
Total other liabilities		**3,033,109**
Total liabilities		**271,481,767**
Capital Accounts		
Capital paid in		**2,047,087**
Surplus		**2,047,087**
Other capital accounts[4]		**0**
Total liabilities and capital accounts		**275,575,941**

1. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.
2. Of this amount $1,125.7 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.
3. 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.
4. During the year, includes undistributed net income, which is closed out on Dec. 31.

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2. Statement of Condition of Each Federal Reserve Bank, December 31, 1987 and 1986

Millions of dollars

Item	Total		Boston	
	1987	1986	1987	1986
ASSETS				
Gold certificate account	11,078	11,084	706	703
Special drawing rights certificate account	5,018	5,018	314	314
Coin	408	485	27	26
Loans				
To depository institutions	3,815	1,565	47	43
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	7,553	7,829	466	464
Held under repurchase agreements	1,316	2,314	0	0
U.S. Treasury securities				
Bought outright[1]	218,906	197,625	13,502	11,702
Held under repurchase agreements	3,645	13,691	0	0
Total loans and securities	235,235	223,024	14,015	12,209
Items in process of collection	7,990	10,273	501	621
Bank premises	705	661	93	92
Other assets				
Denominated in foreign currencies[2]	7,773	9,475	257	284
All other	7,359	7,345	275	209
Interdistrict Settlement Account	0	0	−1,124	1,444
Total assets	**275,566**	**267,365**	**15,064**	**15,902**
LIABILITIES				
Federal Reserve notes	212,890	195,360	12,503	12,260
Deposits				
Depository institutions	41,784	48,107	1,863	2,870
U.S. Treasury, general account	5,313	7,588	0	0
Foreign, official accounts	244	287	5	5
Other	1,027	923	34	21
Total deposits	48,368	56,905	1,902	2,896
Deferred credit items	7,179	9,012	355	497
Other liabilities and accrued dividends[3]	3,035	2,342	168	127
Total liabilities	**271,472**	**263,619**	**14,928**	**15,780**
CAPITAL ACCOUNTS				
Capital paid in	2,047	1,873	68	61
Surplus	2,047	1,873	68	61
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**275,566**	**267,365**	**15,064**	**15,902**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	253,313	231,603	15,123	14,393
LESS: Held by Bank	40,423	36,243	2,620	2,133
Federal Reserve notes, net	**212,890**	**195,360**	**12,503**	**12,260**
Collateral for Federal Reserve notes				
Gold certificate account	11,078	11,084	...	...
Special drawing rights certificate account	5,018	5,018		
Other eligible assets	0	0		...
U.S. Treasury and federal agency securities	196,794	179,258	...	...
Total collateral	**212,890**	**195,360**	...	...

For notes see end of table.

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2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1987	1986	1987	1986	1987	1986	1987	1986
3,177	3,146	385	431	664	650	933	959
1,489	1,489	162	162	314	314	461	461
16	14	24	20	28	33	63	81
2,787	134	131	178	63	206	181	231
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2,430	2,539	229	251	453	460	638	673
1,316	2,314	0	0	0	0	0	0
70,430	64,079	6,624	6,328	13,130	11,605	18,497	16,985
3,645	13,691	0	0	0	0	0	0
80,608	82,757	6,984	6,757	13,646	12,271	19,316	17,889
934	1,311	478	595	294	375	422	701
33	32	46	47	32	32	111	100
1,874	2,341	365	436	466	569	420	483
1,571	2,038	190	115	284	203	368	280
1,449	−5,576	−599	−466	136	247	−1,736	−158
91,151	**87,552**	**8,035**	**8,097**	**15,864**	**14,694**	**20,358**	**20,796**
70,471	61,693	5,706	5,513	12,987	12,482	16,550	17,150
11,653	14,639	1,648	1,945	2,124	1,528	2,902	2,645
5,313	7,588	0	0	0	0	0	0
130	174	7	7	9	9	8	8
438	516	28	8	42	27	61	45
17,534	22,917	1,683	1,960	2,175	1,564	2,971	2,698
875	1,158	369	381	317	298	383	564
1,189	852	83	71	159	128	226	182
90,069	**86,620**	**7,841**	**7,925**	**15,638**	**14,472**	**20,130**	**20,594**
541	466	97	86	113	112	114	101
541	466	97	86	113	112	114	101
0	0	0	0	0	0	0	0
91,151	**87,552**	**8,035**	**8,097**	**15,864**	**14,694**	**20,358**	**20,796**
75,709	65,671	9,048	7,908	15,192	13,896	21,052	19,955
5,238	4,068	3,342	2,395	2,205	1,414	4,502	2,805
70,471	**61,693**	**5,706**	**5,513**	**12,987**	**12,482**	**16,550**	**17,150**
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Federal Reserve Bank of St. Louis

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1987 and 1986—Continued

Millions of dollars

Item	Atlanta 1987	Atlanta 1986	Chicago 1987	Chicago 1986
ASSETS				
Gold certificate account	596	507	1,383	1,394
Special drawing rights certificate account	203	203	656	656
Coin	37	47	31	29
Loans				
To depository institutions	39	73	19	89
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	335	312	876	873
Held under repurchase agreements	0	0	0	0
U.S. Treasury securities				
Bought outright[1]	9,722	7,885	25,385	22,040
Held under repurchase agreements	0	0	0	0
Total loans and securities	10,096	8,270	26,280	23,002
Items in process of collection	615	815	620	1,013
Bank premises	57	51	70	43
Other assets				
Denominated in foreign currencies[2]	707	777	1,057	1,279
All other	228	158	3,185	3,319
Interdistrict Settlement Account	1,742	1,489	2,605	2,975
Total assets	**14,281**	**12,317**	**35,887**	**33,710**
LIABILITIES				
Federal Reserve notes	9,206	7,557	30,029	27,064
Deposits				
Depository institutions	3,922	3,430	4,325	5,008
U.S. Treasury, general account	0	0	0	0
Foreign, official accounts	14	12	20	20
Other	52	28	145	103
Total deposits	3,988	3,470	4,490	5,131
Deferred credit items	604	867	522	752
Other liabilities and accrued dividends[3]	121	87	324	261
Total liabilities	**13,919**	**11,981**	**35,365**	**33,208**
CAPITAL ACCOUNTS				
Capital paid in	181	168	261	251
Surplus	181	168	261	251
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**14,281**	**12,317**	**35,887**	**33,710**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	13,288	12,545	31,890	29,158
LESS: Held by Bank	4,082	4,988	1,861	2,094
Federal Reserve notes, net	**9,206**	**7,557**	**30,029**	**27,064**

1. Includes securities loaned—fully guaranteed by U.S. Treasury securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale-purchase transactions.
2. 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.

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2.—Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1987	1986	1987	1986	1987	1986	1987	1986	1987	1986
351	366	169	168	562	598	669	692	1,483	1,470
160	160	66	66	216	216	307	307	670	670
28	26	13	20	31	43	29	40	81	106
38	37	10	206	68	152	416	195	16	21
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
218	230	114	113	300	321	448	501	1,046	1,092
0	0	0	0	0	0	0	0	0	0
6,322	5,816	3,290	2,856	8,693	8,118	12,986	12,655	30,325	27,556
0	0	0	0	0	0	0	0	0	0
6,578	6,083	3,414	3,175	9,061	8,591	13,850	13,351	31,387	28,669
502	568	435	492	1,454	1,527	572	710	1,163	1,545
20	20	23	24	47	46	20	20	153	154
241	284	256	313	334	426	661	786	1,135	1,497
130	104	81	60	181	162	257	214	609	483
723	−1	−3	78	−100	−106	6	−80	−3,099	154
8,733	**7,610**	**4,454**	**4,396**	**11,786**	**11,503**	**16,371**	**16,040**	**33,582**	**34,748**
6,942	5,889	3,043	2,838	8,380	8,293	12,312	11,250	24,761	23,371
1,165	1,021	848	884	1,689	1,425	2,985	3,675	6,660	9,037
0	0	0	0	0	0	0	0	0	0
5	4	5	5	6	7	13	12	22	24
21	12	16	12	31	28	56	41	103	82
1,191	1,037	869	901	1,726	1,460	3,054	3,728	6,785	9,143
407	504	371	495	1,402	1,495	498	610	1,076	1,391
77	64	45	40	108	93	157	136	378	301
8,617	**7,494**	**4,328**	**4,274**	**11,616**	**11,341**	**16,021**	**15,724**	**33,000**	**34,206**
58	58	63	61	85	81	175	158	291	271
58	58	63	61	85	81	175	158	291	271
0	0	0	0	0	0	0	0	0	0
8,733	**7,610**	**4,454**	**4,396**	**11,786**	**11,503**	**16,371**	**16,040**	**33,582**	**34,748**
8,804	7,467	4,035	3,383	10,963	11,665	15,852	14,236	32,357	31,236
1,862	1,578	992	545	2,583	3,372	3,540	2,986	7,596	7,865
6,942	**5,889**	**3,043**	**2,838**	**8,380**	**8,293**	**12,312**	**11,250**	**24,761**	**23,371**

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3. Federal Reserve Open Market Transactions, 1987[1]

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
U.S. TREASURY SECURITIES				
Outright transactions (excluding matched transactions)				
Treasury bills				
Gross purchases	997	191	1,062	4,226
Gross sales	583	3,581	0	653
Exchange	0	0	0	0
Redemptions	0	800	0	0
Others within 1 year				
Gross purchases	0	0	0	1,232
Gross sales	0	0	0	0
Maturity shift	611	1,855	1,762	1,375
Exchange	0	−4,954	−1,799	−522
Redemptions	0	0	0	0
1 to 5 years				
Gross purchases	0	0	0	3,642
Gross sales	0	252	0	0
Maturity shift	−591	−1,650	−1,762	−1,373
Exchange	0	4,354	1,799	522
5 to 10 years				
Gross purchases	0	0	0	914
Gross sales	0	0	0	0
Maturity shift	−20	−204	0	−3
Exchange	0	400	0	0
More than 10 years				
Gross purchases	0	0	0	669
Gross sales	0	0	0	0
Maturity shift	0	0	0	0
Exchange	0	200	0	0
All maturities				
Gross purchases	997	191	1,062	10,683
Gross sales	583	3,833	0	653
Redemptions	0	800	0	0
Matched transactions				
Gross sales	63,865	82,086	72,306	83,822
Gross purchases	65,145	81,387	73,476	82,494
Repurchase agreements[2]				
Gross purchases	36,373	0	5,657	37,653
Gross sales	46,897	3,168	5,657	23,881
Net change in U.S. Treasury securities	−8,830	−8,308	2,231	22,474
FEDERAL AGENCY OBLIGATIONS				
Outright transactions				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Redemptions	110	0	0	37
Repurchase agreements[2]				
Gross purchases	4,714	0	897	9,265
Gross sales	6,171	857	897	5,908
Net change in agency obligations	−1,567	−857	0	3,320
Total net change in System Open Market Account	**−10,397**	**−9,165**	**2,231**	**25,794**

1. 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.

2. In July 1984 the Open Market Trading Desk discontinued accepting bankers acceptances in repurchase agreements.

*Less than $500,000 in absolute value.

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3.—Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
1,697	575	575	499	4,528	1,095	3,388	150	18,983
0	22	912	0	0	300	0	0	6,050
0	0	0	0	0	0	0	0	0
0	0	4,572	0	3,657	0	0	0	9,029
0	535	0	0	443	300	670	479	3,658
0	0	0	0	300	0	0	0	300
4,063	1,715	1,437	2,723	1,500	816	2,247	1,400	21,502
−1,336	−1,812	−613	−1,787	−917	−1,178	−3,728	−1,742	−20,388
0	0	0	0	*	0	70	0	70
0	1,394	0	5	2,551	0	50	2,589	10,231
0	0	200	0	0	0	0	0	452
−1,804	−1,715	−1,397	−2,122	−1,500	−761	−1,900	−1,400	−17,974
1,111	1,812	613	1,612	917	1,178	3,278	1,742	18,938
0	312	0	0	619	0	0	596	2,441
0	0	0	0	0	0	0	0	0
−2,259	0	−40	−601	0	−55	−347	0	−3,529
150	0	0	100	0	0	300	0	950
0	251	0	0	493	0	0	445	1,858
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
75	0	0	75	0	0	150	0	500
1,697	3,066	575	504	8,633	1,395	4,108	4,259	37,171
0	22	1,112	0	300	300	0	0	6,802
0	0	4,572	0	3,657	0	70	0	9,099
91,642	87,228	80,304	60,731	61,321	77,497	85,288	104,833	950,923
92,137	87,128	80,037	62,594	61,347	73,779	85,494	105,917	950,935
59,340	24,167	3,298	9,013	34,080	65,675	15,853	23,512	314,620
73,111	22,108	2,058	12,311	34,080	57,380	18,751	25,264	324,666
−11,580	5,002	−4,136	−931	4,702	5,673	1,346	3,591	11,235
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
*	0	59	0	0	56	1	13	276
16,071	3,907	929	2,369	7,174	18,523	6,786	9,718	80,353
19,428	2,910	996	3,298	7,174	15,607	7,425	10,679	81,351
−3,357	997	−126	−929	0	2,860	−640	−975	−1,274
−14,936	**5,999**	**−4,262**	**−1,861**	**4,702**	**8,533**	**706**	**2,617**	**9,961**

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4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities, December 31, 1985–87[1]

Millions of dollars

Description	December 31			Increase or decrease (−)	
	1987	1986	1985	1987	1986
U.S. Treasury securities, total	**222,551**	**211,316**	**181,327**	**11,235**	**29,989**
By term					
1–15 days[2]	11,364	20,480	9,307	−9,117	11,173
16–90 days	46,112	53,611	43,462	−7,499	10,148
91 days to 1 year	76,827	62,239	56,364	14,588	5,875
1–5 years	47,512	36,469	35,650	11,043	818
5–10 years	15,313	15,451	14,785	−138	666
More than 10 years	25,424	23,066	21,759	2,358	1,308
By type of holding					
Held outright					
Treasury bills[3]	107,691	103,775	85,425	3,916	18,350
Treasury notes	82,973	68,126	67,647	14,848	479
Treasury bonds	28,242	25,724	24,726	2,518	997
Held under RPs	3,645	13,691	3,529	−10,046	10,163
Federal agency obligations, total	**8,869**	**10,143**	**9,921**	**−1,274**	**222**
By term					
1–15 days[2]	1,561	2,704	1,836	−1,143	868
16–90 days	691	808	961	−118	−153
91 days to 1 year	1,653	1,224	1,471	428	−247
1–5 years	3,416	3,854	4,056	−437	−202
5–10 years	1,358	1,178	1,187	180	−9
More than 10 years	189	374	409	−185	−35
By type of holding					
Held outright					
Banks for Cooperatives[4]	0	0	21	0	−21
Federal Farm Credit Banks	2,294	2,486	2,477	−192	8
Federal Home Loan Banks	2,251	2,252	2,260	−1	−8
Federal Home Loan Mortgage Corporation	0	0	0	0	0
Federal Intermediate Credit Banks[4]	0	30	50	−30	−21
Federal Land Banks	200	236	236	−36	0
Farmers Home Administration	99	101	101	−3	0
Federal National Mortgage Association	2,490	2,490	2,847	0	−357
Government National Mortgage Association participation certificates	51	67	67	−16	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	1,315	2,314	1,693	−998	620

1. Details may not add to totals because of rounding.
2. Includes the effects of temporary transactions (repurchase agreements and matched sale–purchase agreements).
3. Includes the effects of matched sale–purchase agreements.
4. There were no outstanding issues as of December 31, 1987.

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5. Number and Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1987

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	158,500	54	3,723,400	1,306	285	37,164,817	1,646	41,046,717
New York	184,000	156	12,480,175	3,580	59	101,302,870	3,796	113,967,045
Philadelphia	139,100	53	3,720,050	1,090	102	27,698,503	1,246	31,557,653
Cleveland	130,000	60	3,823,500	1,269	59	29,606,480	1,389	33,559,980
Richmond	140,100	82	5,214,500	1,777	145	39,943,877	2,005	45,298,477
Atlanta	151,600	69	4,527,340	2,029	85	46,764,778	2,184	51,443,718
Chicago	165,900	85	5,456,350	2,468	23	60,774,081	2,577	66,396,331
St. Louis	139,000	57	3,419,000	1,194	89	27,225,940	1,341	30,783,940
Minneapolis	124,000	43	2,729,000	948	150	23,652,777	1,142	26,505,777
Kansas City	137,200	57	3,698,100	1,564	63	36,334,075	1,685	40,169,375
Dallas	134,700	58	3,650,350	1,499	50	37,985,968	1,608	41,771,018
San Francisco	158,200	105	6,962,359	2,241	70	58,228,478	2,417	65,349,037
Total	**1,762,300**	**879**	**59,404,124**	**20,965**	**1,180**	**526,682,644**	**23,036**	**587,849,068**

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6. Income and Expenses of Federal Reserve Banks, 1987

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Loans	224,337,751	1,917,148	4,067,423	2,486,347	555,846
U.S. Treasury and federal agency securities	16,371,408,317	988,284,179	5,400,422,500	497,305,569	965,834,554
Foreign currencies	343,891,458	11,370,870	82,832,938	16,170,383	20,633,487
Priced services	644,671,864	43,296,664	92,217,810	30,841,255	39,224,730
Other	48,702,234	809,719	30,526,084	889,303	524,982
Total	**17,633,011,623**	**1,045,678,580**	**5,610,066,755**	**547,692,857**	**1,026,773,599**
CURRENT EXPENSES					
Salaries and other personnel expenses	621,702,802	40,942,252	126,490,442	32,804,520	35,421,989
Retirement and other benefits[2]	72,262,440	7,700,723	21,846,131	6,846,173	7,662,126
Fees	11,356,898	2,677,871	1,715,866	396,036	1,541,325
Travel	22,154,937	989,061	2,904,949	864,401	1,848,241
Postage and other shipping costs	81,349,721	3,791,390	9,372,823	4,494,244	5,961,285
Communications	12,291,137	1,004,866	1,803,489	580,393	613,487
Materials and supplies	47,282,152	2,633,883	8,925,389	2,637,819	2,906,632
Building expenses					
Taxes on real estate	21,709,940	2,717,750	3,719,593	1,543,565	1,105,534
Property depreciation	26,078,430	2,595,585	2,804,496	1,592,223	1,392,909
Utilities	22,906,014	1,956,696	3,375,315	2,200,418	1,579,732
Rent	17,118,511	518,712	10,229,545	34,954	291,357
Other	19,568,292	1,329,624	3,612,884	1,169,662	1,256,195
Equipment					
Purchases	4,693,541	117,615	0	192,157	147,584
Rentals	33,857,448	913,218	6,403,641	941,340	3,872,916
Depreciation	75,801,603	4,811,721	13,306,148	4,037,707	4,190,763
Repairs and maintenance	42,467,351	2,695,600	7,656,658	2,230,631	1,832,152
Earnings-credit costs	113,622,771	6,967,265	12,607,198	8,970,750	10,452,713
Other	45,976,990	2,481,616	9,456,644	1,949,376	3,034,681
Shared costs, net[3]	(0)	(2,344,539)	922,741	2,422,670	(199,352)
Recoveries	(33,011,836)	(6,933,981)	(3,607,239)	(2,407,815)	(3,102,496)
Expenses capitalized[4]	(2,936,662)	(137,879)	(4,494)	(13,747)	(170,253)
Total	**1,256,252,479**	**77,429,049**	**243,542,219**	**73,487,477**	**81,639,520**
Reimbursements	(109,341,780)	(4,447,155)	(22,483,934)	(13,872,836)	(7,754,031)
Net expenses	1,146,910,699	72,981,894	221,058,285	59,614,641	73,885,489

For notes see end of table.

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6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,736,475	3,712,153	179,483,497	3,662,935	2,553,425	5,393,686	16,924,161	1,844,655
1,374,138,059	700,134,754	1,858,905,221	469,887,307	240,913,926	648,680,179	980,240,459	2,246,661,609
18,592,591	31,361,478	46,776,722	10,668,119	11,348,418	14,772,365	29,245,742	50,118,345
53,254,196	71,662,436	85,444,353	29,119,192	36,598,916	42,412,464	46,023,487	74,576,360
757,809	1,069,584	2,439,365	444,395	7,919,496	500,175	1,020,337	1,800,986
1,448,479,130	**807,940,405**	**2,173,049,158**	**513,781,948**	**299,334,181**	**711,758,869**	**1,073,454,186**	**2,375,001,954**
46,705,249	53,887,408	73,649,535	32,102,945	27,436,918	41,637,812	40,465,427	70,158,305
9,079,585	10,448,374	15,394,091	6,414,115	5,255,500	8,357,309	7,953,691	14,507,114
690,652	623,148	976,388	500,330	640,716	362,559	175,327	1,056,680
1,897,198	1,861,872	3,395,675	1,190,819	1,000,818	1,713,372	1,510,417	2,978,114
6,446,858	9,242,630	8,776,070	4,396,562	5,652,721	6,279,971	4,481,368	12,453,799
884,222	1,651,193	1,490,546	586,949	496,584	927,613	806,229	1,445,566
4,347,044	4,769,580	5,091,460	3,035,497	1,886,626	3,150,925	3,045,110	4,852,187
1,878,785	1,278,842	2,480,900	480,449	2,602,347	1,029,840	599,533	2,272,802
3,750,950	1,649,157	1,808,035	866,936	1,064,887	2,157,173	1,263,970	5,132,109
2,004,700	2,016,601	2,677,065	1,422,359	733,701	1,354,972	997,135	2,587,320
536,290	617,865	2,911,715	398,798	143,503	152,408	1,129,148	154,216
1,613,142	1,013,412	4,107,548	822,664	1,282,260	783,115	618,536	1,959,250
422,975	305,469	292,536	387,783	812,904	98,812	153,340	1,762,366
1,751,817	2,182,870	7,052,171	635,296	686,756	1,471,066	4,111,571	3,834,786
7,245,424	9,322,316	8,251,222	3,363,252	3,786,940	4,182,929	5,585,359	7,717,822
3,985,412	4,882,341	6,633,033	1,937,139	2,085,310	2,175,795	2,153,482	4,199,798
8,253,737	11,524,717	22,891,037	4,346,714	6,083,365	7,364,904	4,968,604	9,191,766
4,694,380	3,864,194	6,513,840	1,905,369	2,612,926	2,329,387	2,750,690	4,383,887
(547,415)	1,083,254	(5,698,244)	1,198,082	1,612,562	724,042	974,987	(148,789)
(4,655,683)	(1,607,276)	(2,581,148)	(1,279,644)	(649,998)	(1,054,230)	(1,854,336)	(3,277,990)
(228,842)	(246,616)	(1,194,756)	(136,362)	(40,523)	(275,552)	(431,031)	(56,607)
100,756,480	**120,371,351**	**164,918,719**	**64,576,052**	**65,186,823**	**84,924,222**	**81,458,557**	**147,164,501**
(7,278,223)	(7,657,603)	(12,305,001)	(8,008,682)	(3,137,907)	(5,285,013)	(4,762,934)	(12,348,461)
93,478,257	112,713,748	152,613,718	56,567,370	62,048,916	79,639,209	76,695,622	134,816,040

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6. Income and Expenses of Federal Reserve Banks, 1987—Continued

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	16,486,100,920	972,696,687	5,438,210,961	488,078,216	952,888,109
Additions to and deductions from current net income					
Profits on sales of U.S. Treasury and federal agency securities	41,880,453	2,581,259	13,476,274	1,268,641	2,511,011
Gains on foreign exchange transactions	1,804,276,954	59,541,139	434,830,746	84,801,017	108,256,617
Other additions	55,554,014	9,655	149,447	4,394	20,142
Total additions	1,901,711,422	62,132,054	448,456,467	86,074,051	110,787,770
Deductions from current net income	58,159,791	81,620	734,903	1,707,036	691
Net additions to or deductions (−) from current net income	1,843,551,631	62,050,433	447,721,564	84,367,015	110,787,079
Cost of unreimbursed Treasury services	46,957,714	2,401,304	7,180,347	5,692,929	3,094,742
Assessments by Board					
Board expenditures[5]	81,869,800	2,685,100	20,642,300	3,789,200	4,822,900
Cost of currency	170,674,979	10,687,354	53,905,512	4,817,304	10,906,391
Net income before payment to U.S. Treasury	18,030,150,057	1,018,973,362	5,804,204,366	558,145,797	1,044,851,155
Dividends paid	117,499,115	3,925,706	30,455,531	5,537,791	6,719,445
Payments to U.S. Treasury (interest on Federal Reserve notes)	17,738,879,542	1,007,693,456	5,698,704,285	541,827,706	1,036,752,610
Transferred to surplus	173,771,400	7,354,200	75,044,550	10,780,300	1,379,100
Surplus, January 1	1,873,315,300	60,913,200	466,001,350	86,465,500	111,314,300
Surplus, December 31	2,047,086,700	68,267,400	541,045,900	97,245,800	112,693,400

1. Details may not add to totals because of rounding.
2. The effect of the 1987 implementation of Financial Accounting Standards Board Statement No. 87—Employers' Accounting for Pensions—is recorded in the Total column only and has not been distributed to each District. Accordingly, the sum of the Districts will not equal the Total column for this category or for Total net expenses, and New York will not add to current net income.
3. Includes distribution of costs for projects performed by one Bank for the benefit of one or more other Banks.
4. Includes expenses for labor and materials temporarily capitalized and charged to activities when the products are consumed.
5. For additional details, see the last four pages of the preceding section: Board of Governors, Financial Statements.

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6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,355,000,873	695,226,657	2,020,435,439	457,214,577	237,285,265	632,119,660	996,758,564	2,240,185,913
3,539,914	1,856,554	4,853,276	1,209,895	629,043	1,664,198	2,488,080	5,802,309
97,430,956	164,189,203	245,381,666	55,932,586	59,541,139	77,583,909	153,363,541	263,424,435
55,809	54,868	11,267	11,083	5,188	6,370	55,163,681	62,111
101,026,678	166,100,625	250,246,209	57,153,564	60,175,370	79,254,476	211,015,302	269,288,855
17,474	39,828	92,749	175,233	75,795	68,889	55,112,843	52,729
101,009,204	166,060,797	250,153,460	56,978,331	60,099,575	79,185,587	155,902,459	269,236,126
3,444,186	3,418,707	5,130,721	3,395,799	1,474,494	2,317,109	2,504,748	6,902,629
4,405,700	7,318,500	10,908,600	2,502,800	2,648,900	3,486,500	6,876,700	11,782,600
14,984,887	6,603,187	23,647,602	5,146,068	2,479,900	7,246,209	9,829,561	20,421,004
1,433,175,304	843,947,060	2,230,901,976	503,148,242	290,781,546	698,255,429	1,133,450,013	2,470,315,807
6,431,001	10,391,773	15,356,719	3,462,222	3,694,052	4,897,411	9,863,209	16,764,254
1,413,975,853	821,025,637	2,205,614,207	499,441,120	285,617,694	689,209,867	1,105,796,204	2,433,220,902
12,768,450	12,529,650	9,931,050	244,900	1,469,800	4,148,150	17,790,600	20,330,650
101,151,450	168,259,850	251,372,000	57,774,950	61,134,850	80,653,350	157,534,150	270,740,350
113,919,900	180,789,500	261,303,050	58,019,850	62,604,650	84,801,500	175,324,750	291,071,000

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7. Income and Expenses of Federal Reserve Banks, 1914–87[1]

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (−)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
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.

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7.—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

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7. Income and Expenses of Federal Reserve Banks, 1914–87—Continued

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (−)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
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	12,802,319,335	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
1986	17,464,528,361	1,156,867,714	1,975,893,356	97,337,500	180,779,673
1987	17,633,011,623	1,146,910,699	1,796,593,917[2]	81,869,800	170,674,979
Total, 1914–87	**218,984,053,284**	**16,535,876,088**	**2,516,133,525**	**1,186,604,208**	**1,803,266,357**
Aggregate for each Bank, 1914-87					
Boston	10,848,879,304	1,090,535,395	72,101,026	42,930,786	105,229,233
New York	62,995,337,192	3,359,021,096	666,841,844	306,465,986	438,485,583
Philadelphia	9,265,221,643	873,121,912	112,696,756	58,146,218	86,154,009
Cleveland	15,166,380,180	1,121,951,990	95,960,801	93,502,590	114,293,705
Richmond	17,275,843,408	1,293,376,966	121,317,542	61,444,776	172,331,506
Atlanta	8,964,178,239	1,403,345,106	228,582,698	87,321,760	113,863,060
Chicago	32,269,158,745	2,175,707,020	292,710,361	169,599,672	251,920,841
St. Louis	7,613,054,013	889,177,640	60,001,912	37,308,072	69,851,972
Minneapolis	4,000,971,259	750,880,296	83,389,153	35,230,315	31,957,029
Kansas City	9,598,113,136	1,040,095,559	108,909,533	50,878,009	88,484,537
Dallas	12,505,804,676	929,860,216	254,088,197	75,535,473	107,121,445
San Francisco	28,481,111,490	1,658,005,380	419,533,698	168,240,551	223,573,437
Total	**218,984,053,284**	**16,535,876,088[4]**	**2,516,133,525**	**1,186,604,208**	**1,803,266,357**

1. Details may not add to totals because of rounding.

2. For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

3. The $2,175,758,899 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 transfer of $11,131,013 from reserves for contingencies (1945), leaving a balance of $2,047,086,698 on Dec. 31, 1987.

4. See note 2, table 6.

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7.—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
109,587,968	. . .	. . .	17,803,894,710	. . .	91,954,150
117,499,115	. . .	. . .	17,738,879,542	. . .	173,771,400
2,034,414,472	**149,138,300**	**2,188,893**	**197,612,943,251**	**(3,657)**	**2,175,758,899**[3]
84,619,472	7,111,395	280,843	9,511,775,570	135,411	78,362,225
552,984,048	68,006,262	369,116	58,408,180,374	(433,412)	578,302,471
110,896,688	5,558,901	722,406	8,131,451,583	290,661	111,576,022
168,965,677	4,842,447	82,930	13,632,784,356	(9,906)	125,927,193
101,792,775	6,200,189	172,493	15,642,114,052	(71,517)	119,799,708
136,084,434	8,950,561	79,264	7,257,055,223	5,491	186,056,040
282,238,913	25,313,526	151,045	29,380,294,602	11,682	276,631,804
65,237,538	2,755,629	7,464	6,545,604,652	(26,515)	63,139,478
56,820,217	5,202,900	55,615	3,137,667,303	64,874	66,481,863
84,874,737	6,939,100	64,213	8,346,753,737	(8,674)	88,941,450
121,480,077	560,049	102,083	11,345,575,961	55,337	179,602,228
268,419,895	7,697,341	101,421	26,273,685,838	(17,089)	300,938,417
2,034,414,472	**149,138,300**	**2,188,893**	**197,612,943,251**	**(3,657)**	**2,175,758,899**

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8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1987[1]

Dollars

Federal Reserve Bank or Branch	Aquisition costs				Net book value	Other real estate[4]
	Land	Buildings (including vaults)[2]	Building machinery and equipment	Total[3]		
BOSTON	22,036,681	80,228,571	5,360,169	107,625,421	92,004,797	...
Annex	27,840	89,202	44,538	161,580	120,441	...
NEW YORK	3,436,277	21,384,365	21,735,584	46,556,226	29,433,141	...
Annex	477,863	1,136,219	745,855	2,359,936	828,704	...
Buffalo	887,844	2,693,268	2,258,313	5,839,426	3,163,937	...
PHILADELPHIA	1,876,601	53,111,019	5,938,678	60,926,298	46,222,478	...
CLEVELAND	1,074,281	8,305,578	5,028,695	14,408,554	8,734,217	1,224,363
Cincinnati	2,246,599	13,537,723	7,528,477	23,312,798	13,630,908	...
Pittsburgh	1,658,376	7,258,210	3,307,043	12,223,629	9,899,896	...
RICHMOND	3,912,575	55,775,336	14,314,313	74,002,223	57,021,484	...
Annex	522,733	3,725,466	3,924,584	8,172,784	3,845,754	...
Baltimore	6,474,484	26,826,903	3,842,189	37,143,576	33,318,176	...
Charlotte	1,902,406	15,484,515	946,943	18,333,865	16,950,727	...
ATLANTA	1,166,106	5,422,799	3,503,791	10,092,696	4,919,404	...
Birmingham	3,000,016	1,905,770	1,046,244	5,952,029	4,164,209	...
Jacksonville	1,058,262	19,192,963	778,381	21,029,606	19,092,537	895,313
Annex	107,925	76,236	15,843	200,003	148,838	...
Miami	3,607,531	11,965,974	2,111,664	17,685,170	15,191,691	...
Nashville	592,342	1,474,678	1,269,709	3,336,729	1,454,947	...
New Orleans	3,087,693	2,792,698	1,476,257	7,356,649	4,791,145	283,753
CHICAGO	4,511,942	64,474,534	13,651,202	82,637,677	64,984,328	...
Annex	53,066	548,119	215,796	816,981	735,224	...
Detroit	797,734	3,447,307	2,857,387	7,102,428	4,848,002	...
ST. LOUIS	700,378	10,658,479	5,252,991	16,611,848	9,676,175	...
Little Rock	1,148,492	2,082,669	1,010,869	4,242,031	2,614,553	...
Louisville	700,075	2,868,417	1,131,238	4,699,730	2,751,124	...
Memphis	1,135,623	4,216,382	2,126,755	7,478,760	4,928,773	...
MINNEAPOLIS	1,394,384	26,664,805	7,692,189	35,751,378	22,623,095	...
Helena	289,619	104,184	68,689	462,491	329,872	1,262,491
KANSAS CITY	1,798,804	9,404,917	8,645,556	19,849,278	16,514,855	149,948
Denver	2,997,746	3,209,227	3,509,204	9,716,177	7,308,639	...
Oklahoma City	646,386	3,919,647	1,696,840	6,262,872	4,538,370	...
Omaha	6,534,583	11,019,238	1,401,083	18,954,904	18,424,163	2,220,765
DALLAS	3,772,588	5,960,954	3,737,706	13,471,248	10,629,464	...
El Paso	262,477	1,348,665	393,301	2,004,443	1,676,869	...
Houston	2,049,064	2,847,212	921,537	5,817,813	5,168,140	...
San Antonio	482,284	2,266,107	658,346	3,406,737	2,861,069	...
SAN FRANCISCO	15,541,937	67,431,240	16,434,132	99,407,309	87,742,694	...
Los Angeles	4,005,429	46,425,752	8,334,890	58,766,072	57,318,641	2,981,050
Portland	207,381	1,824,468	649,432	2,681,280	2,320,443	...
Salt Lake City	480,222	1,975,190	1,229,972	3,685,383	2,836,762	...
Seattle	274,772	1,977,592	1,757,520	4,009,884	2,545,548	...
Total	**108,939,420**	**607,062,597**	**168,553,906**	**884,555,923**	**698,314,232**	**9,017,682**

1. Details may not add to totals because of rounding.
2. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.
3. Excludes charge-offs of $17,698,968 before 1952.
4. Covers acquisitions for banking-house purposes and bank premises formerly occupied and being held pending sale.

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9. Operations in Principal Departments of Federal Reserve Banks, 1984–87

Operation	1987	1986	1985	1984
Millions of pieces (except as noted)				
Loans (thousands)	25	19	24	33
Currency received and counted	16,881	15,408	14,655	13,422
Currency verified and destroyed	5,217	5,584	5,744	5,329
Coin received and counted	19,871	20,461	19,691	19,201
Checks handled				
U.S. government checks	568	585	592	598
Postal money orders	146	140	130	135
All other[1]	17,006	16,226	15,965	15,178
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities	191	204	171	168
Transfer of funds[2]	53	50	45	42
Food stamps redeemed	2,210	2,216	2,322	2,536
Millions of dollars				
Loans	151,323	193,424	307,856	852,777
Currency received and counted	216,151	197,516[r]	182,095	183,419
Currency verified and destroyed	44,907	47,842	51,081	50,164
Coin received and counted	3,517	3,088	3,226	3,624
Checks handled				
U.S. government checks	610,678	606,029	538,261	529,895
Postal money checks	12,511	11,103	9,486	9,085
All other[1]	11,453,158	10,546,900[r]	9,557,753	9,553,515
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities	90,056,338	75,447,899	65,866,333	50,327,014
Transfer of funds[2]	142,046,780	125,028,070	109,126,369	98,003,445
Food stamps redeemed	10,322	10,475	10,195	9,941

1. In the Report for 1984, data included checks handled by more than one Federal Reserve office.

2. In the Report for 1984, data included transfers processed by both sending and receiving Federal Reserve offices.

r = Revised.

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10. Federal Reserve Bank Interest Rates, December 31, 1987

Bank	Loans to depository institutions		
	Adjustment credit and seasonal credit[1]	Extended credit[2]	
		First 30 days of borrowing	After 30 days of borrowing[3]
All Federal Reserve Banks. .	6	6	7.70

1. Adjustment credit is available on a short-term basis to help depository institutions meet temporary needs for funds that cannot be met through reasonable alternative sources. After May 19, 1986, the highest rate established for loans to depository institutions may be charged on adjustment credit loans of unusual size that result from a major operating problem at the borrower's facility.

Seasonal credit is available to help smaller depository institutions meet regular, seasonal needs for funds that cannot be met through special industry lenders and that arise from a combination of expected patterns of movement in their deposits and loans. A temporary simplified seasonal program was established on March 8, 1985, and the interest rate was fixed at ½ percent above the rate on adjustment credit. The program was reestablished on Feb. 18, 1986, and again on Jan. 28, 1987; the rate could be either the same as that for adjustment credit or a fixed rate ½ percent higher. See sections 201.3 (a) and 201.3 (b)(1) of Regulation A.

2. Extended credit is available to depository institutions, where similar assistance is not reasonably available from other sources, when exceptional circumstances or practices involve only a particular institution or when an institution is experiencing difficulties adjusting to changing market conditions over a longer period of time.

3. For extended-credit loans outstanding more than 30 days, a flexible rate somewhat above rates on market sources of funds ordinarily will be charged, but in no case will the rate charged be less than the basic discount rate plus 50 basis points. The flexible rate is reestablished on the first business day of each two-week reserve maintenance period. At the discretion of the Federal Reserve Bank, the time period for which the basic discount rate is applied may be shortened. See section 201.3 (b)(2) of Regulation A.

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11. Reserve Requirements of Depository Institutions[1]

Type of deposit, and deposit interval[2]	Depository institution requirements after implementation of the Monetary Control Act	
	Percent of deposits	Effective date
Net transaction accounts[3,4]		
$0 million-$40.5 million	3	12/15/87
More than $40.5 million	12	12/15/87
Nonpersonal time deposits[5]		
By original maturity		
Less than 1½ years	3	10/6/83
1½ years or more	0	10/6/83
Eurocurrency liabilities		
All types	3	11/13/80

1. Reserve requirements in effect on Dec. 31, 1987. 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.

For 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. The Garn–St Germain Depository Institutions Act of 1982 (Public Law 97–320) requires that $2 million of reservable liabilities (transaction accounts, nonpersonal time deposits, and Eurocurrency liabilities) of each depository institution be subject to 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 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. On Dec. 15, 1987 the exemption was raised from $2.9 million to $3.2 million. In determining the reserve requirements of depository institutions, the exemption shall apply in the following order: (1) net NOW accounts (NOW accounts less allowable deductions); (2) net other transaction accounts; and (3) 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.

3. 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 subject to the rules 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).

4. 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. 15, 1987, for institutions reporting quarterly and Dec. 29, 1987, for institutions reporting weekly, the amount was increased from $36.7 million to $40.5 million.

5. 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.

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12. Initial Margin Requirements under 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

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" (as defined in the regulations) when such credit is collateralized by securities. Margin requirements on securities other than options 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.

On Jan. 1, 1977, the Board of Governors for the first time established in Regulation T the initial margin required for writing options on securities, setting it at 30 percent of the current market value of the stock underlying the option. On Sept. 30, 1985, the Board changed the required initial margin, allowing it to be the same as the option maintenance margin required by the appropriate exchange or self-regulatory organization; such maintenance margin rules must be approved by the Securities and Exchange Commission. Effective Jan. 31, 1986, the SEC approved new maintenance margin rules, permitting margins to be the price of the option plus 15 percent of the market value of the stock underlying the option.

2. From Oct. 1, 1934, to Oct. 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

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13. Principal Assets and Liabilities and Number of Insured Commercial Banks, by Class of Bank, June 30, 1987 and 1986[1]

Asset and liability items shown in millions of dollars

Item	Total	Member banks			Nonmember banks
		Total	National	State	
	June 30, 1987				
Loans and investments	1,992,386	1,467,711	1,173,851	293,861	524,675
Gross loans	1,532,022	1,159,438	930,664	228,773	372,584
Net loans	1,519,130	1,150,525	923,797	226,728	368,604
Investments	460,364	308,274	243,186	65,088	152,090
U.S. Treasury and federal agency securities	292,788	191,313	154,428	36,885	101,476
Other	167,576	116,961	88,758	28,202	50,615
Cash assets	216,948	168,199	131,859	36,340	48,749
Deposits, total	1,896,414	1,365,438	1,096,984	268,454	530,975
Interbank	64,964	57,059	41,804	15,254	7,906
Other transaction	572,220	423,361	333,940	89,420	148,860
Other nontransaction	1,433,542	1,002,982	820,075	182,907	430,560
Equity capital	172,146	123,081	96,681	26,400	49,065
Number of banks	13,805	5,794	4,696	1,098	8,011
	June 30, 1986				
Loans and investments	1,847,118	1,361,849	1,087,706	274,143	485,269
Gross loans	1,429,444	1,086,336	869,688	216,648	343,108
Net loans	1,414,905	1,076,284	861,931	214,353	338,621
Investments	417,673	275,513	218,018	57,495	142,160
U.S. Treasury and federal agency securities	253,181	161,625	131,620	30,006	91,556
Other	164,492	113,888	86,398	27,489	50,604
Cash assets, total	220,130	170,619	134,416	36,203	49,511
Deposits	1,804,922	1,298,092	1,048,022	250,070	506,830
Interbank	63,272	56,239	39,361	16,878	7,034
Other demand	539,061	402,171	318,154	84,017	136,890
Other time and savings	1,342,981	933,763	769,894	163,869	409,218
Equity capital	173,517	127,067	98,440	28,627	46,450
Number of banks	14,175	5,956	4,870	1,086	8,219

1. All insured commercial banks in the United States.
Details may not add to totals because of rounding.

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14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–87, and Month-End 1987[1]

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	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	24,252	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.

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14.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings[7]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[4]	Member bank reserves[8]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10]
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

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14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–87, and Month-End 1987[1]—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	Total			
	Total	Bought outright[12]	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[3]	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
1986 . . .	221,459	205,454	16,005	1,565	1,261	0	17,475	241,760	11,084	5,018	17,567
1987 . . .	231,420	226,459	4,961	3,815	811	0	15,837	251,883	11,078	5,018	18,177
1987											
Jan. . .	211,062	207,037	4,025	513	716	0	18,040	230,331	11,075	5,018	17,611
Feb . .	201,897	201,897	0	514	1,023	0	16,746	220,180	11,059	5,018	17,656
Mar . .	204,128	204,128	0	1,587	5,241	0	16,622	227,578	11,081	5,081	17,717
Apr . .	229,922	212,795	17,127	2,464	126	0	17,194	249,706	11,076	5,018	17,764
May. .	214,987	214,987	0	832	922	0	15,139	231,880	11,070	5,018	17,810
June. .	220,985	217,931	3,054	972	1,579	0	15,680	239,216	11,069	5,018	17,851
July . .	216,723	212,494	4,229	634	507	0	16,446	234,310	11,069	5,018	17,900
Aug . .	214,861	214,861	0	566	510	0	15,752	231,689	11,068	5,018	17,952
Sept . .	219,564	219,564	0	1,941	248	0	17,070	238,823	11,075	5,018	18,014
Oct . .	228,097	216,886	11,211	587	609	0	17,738	247,031	11,085	5,018	18,071
Nov . .	228,804	221,130	7,674	790	428	0	15,450	245,472	11,082	5,018	18,127
Dec . .	231,420	226,459	4,961	3,815	811	0	15,837	251,883	11,078	5,018	18,177

1. 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.

2. Beginning with 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

3. Principally acceptances and, until Aug. 21, 1959, industrial loans, authority for which expired on that date.

4. For the period before Apr. 16, 1969, 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.

5. For the period before Jan. 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

6. Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details see "Currency and Coin in Circulation," *Treasury Bulletin*.

7. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

8. 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.

9. Between Dec. 1, 1959, and Nov. 23, 1960, part was allowed as reserves; thereafter all was allowed.

10. Estimated through 1958. Before 1929, data 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.

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14.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings[7]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[5]	Member bank reserves[8]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10,13]
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[13]
72,497	317	2,542	251	1,419[14]	0	0	2,669	27,060	6,781	35,268	−1,360
79,743	185	2,113	418	1,275[14]	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[15]
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.
211,995	447	7,588	287	917	0	1,812	6,088	46,295	n.a.	n.a.	n.a.
230,205	454	5,313	244	1,027	0	1,687	7,129	40,097	n.a.	n.a.	n.a.
205,342	465	15,746	226	453	0	1,786	7,201	32,802	n.a.	n.a.	n.a.
205,964	510	3,482	201	539	0	1,810	6,110	35,323	n.a.	n.a.	n.a.
207,799	518	3,576	268	577	0	1,817	6,682	40,156	n.a.	n.a.	n.a.
210,263	531	29,688	343	533	0	1,812	7,057	33,337	n.a.	n.a.	n.a.
213,534	514	6,383	320	372	0	1,779	6,511	36,365	n.a.	n.a.	n.a.
215,162	492	13,774	318	458	0	1,775	6,847	34,327	n.a.	n.a.	n.a.
215,898	470	5,365	262	281	0	1,747	6,520	37,754	n.a.	n.a.	n.a.
216,467	463	3,763	295	284	0	1,709	6,964	35,782	n.a.	n.a.	n.a.
216,785	460	9,120	456	419	0	1,706	6,663	37,321	n.a.	n.a.	n.a.
219,855	467	8,898	236	477	0	1,733	7,950	41,589	n.a.	n.a.	n.a.
225,090	465	3,594	352	450	0	1,717	7,968	40,064	n.a.	n.a.	n.a.
230,205	454	5,313	244	1,027	0	1,687	7,129	40,094	n.a.	n.a.	n.a.

11. Beginning on Dec. 1, 1966, includes federal agency obligations held under repurchase agreements and beginning on Sept. 29, 1971, federal agency issues bought outright.

12. Includes, beginning in 1969, securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale–purchase transactions.

13. Beginning with week ending Nov. 15, 1972, includes $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; 1974—Q1, $67; Q2, $58. The transition period ended with the second quarter of 1974.

14. For the period before July 1973, 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 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) Euro dollar liabilities.

15. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy effective Nov. 19, 1975.

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15. Changes in Number of Banking Offices in the United States, 1987[1]

Type of office and change	All banks	Commercial banks[2]						Mutual savings banks	
		Total	Member			Nonmember			
			Total	National	State	Insured	Non-insured[3]	Insured	Non-insured
Banks, Dec. 31, 1986	15,208	14,848	5,992	4,882	1,110	8,233	623	359	1
Changes during 1987									
New banks	217	212	101	59	42	111	0	5	0
Ceased banking operation	−240	−238	−81	−66	−15	−126	−31	−2	0
Banks converted into branches	−532	−531	−274	−239	−35	−254	−3	−1	0
Other[4]	−180	−281	15	7	8	32	−328	101	0
Net change	−735	−838	−239	−239	0	−237	−362	103	0
Banks, Dec. 31, 1987	**14,473**	**14,010**	**5,753**	**4,643**	**1,110**	**7,996**	**261[5]**	**462**	**1**
Branches and additional offices, Dec. 31, 1986	46,272	43,917	28,398	23,219	5,179	15,432	87	2,350	5
Changes during 1987									
De novo	1,117	960	583	478	105	370	7	157	0
Banks converted into branches	532	531	274	239	35	254	3	1	0
Discontinued	−960	−942	−736	−638	−98	−205	−1	−18	0
Sale of branch	0	0	12	13	−1	−12	0	0	0
Other[4]	1,692	1,558	1,498	1,285	213	47	13	134	0
Net change	2,381	2,107	1,631	1,377	254	454	22	274	0
Branches and additional offices, Dec. 31, 1987	**48,653**	**46,024**	**30,029**	**24,596**	**5,433**	**15,886**	**109**	**2,624**	**5**

1. Preliminary. Final data will be available in the *Annual Statistical Digest, 1987*, forthcoming.
2. Includes stock savings banks and nondeposit trust companies.
3. As of Dec. 31, 1987, includes 2 noninsured national trust companies.
4. Includes interclass changes.
5. This figure no longer includes 344 branches of foreign banks that were previously counted as banks.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1987

Security Bank, Marshalltown, Iowa, *to acquire certain assets and liabilities of* **Hawkeye Bank & Trust, Eldora, Iowa**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/25/86)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/9/87)
Security Bank (Applicant) has assets of $163.3 million and Hawkeye Bank & Trust (Bank) has deposits of $16.0 million. Applicant and Bank are not located in the same market, and 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.

Intrawest Bank of Grand Junction, Grand Junction, Colorado, *to acquire certain deposits of* **American National Bank of Grand Junction, Grand Junction, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of American National Bank of Grand Junction.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/8/87)
Intrawest Bank of Grand Junction (Applicant) has assets of $116.0 million and American National Bank of Grand Junction (Bank) has deposits of $7.6 million.

The Office of the Comptroller of the Currency (OCC) has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Bank of New York Company, New York, New York, *to merge with* **Long Island Trust Company, N.A., Garden City, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12/17/86)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/16/87)
Bank of New York Company (Applicant) has assets of $21 billion and Long Island Trust Company, N.A. (Bank), has assets of $2 billion. Applicant and Bank are not located in the same market, and 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.

Farmers State Bank of West Concord, West Concord, Minnesota, *to acquire the deposits of* **Farmers National Bank in West Concord, West Concord, Minnesota**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Farmers National Bank in West Concord.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/5/87)
Farmers State Bank of West Concord (Applicant) has assets of $12.9 million, and Farmers National Bank in West Concord (Bank) has deposits of $9.1 million.

The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Demotte State Bank, Demotte, Indiana, *to acquire certain assets and liabilities of* **Morocco State Bank, Morocco, Indiana**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Morocco State Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/20/87)
Demotte State Bank (Applicant) has assets of $59.8 million, and Morocco State Bank has deposits of $16.2 million.

The State Banking Commissioner has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Commerce Union Bank, Nashville, Tennessee, *to merge with* **United Citizens Bank of Chatham County, Ashland City, Tennessee**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/13/87)
The proposed transaction would not be significantly adverse to competition.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1987—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/25/87)
Commerce Union Bank (Applicant) has assets of $2.3 million, and United Citizens Bank of Chatham County (Bank) has assets of $17.4 million. Applicant and Bank operate in the same banking market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Farmers Bank and Savings Company, Pomeroy, Ohio, *to acquire the assets and liabilities of* **the Tuppers Plains Branch of Bank One, Athens, N. A., Athens, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/13/87)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/26/87)
Farmers Bank and Savings Company (Applicant) has assets of $48.2 million, and the Tuppers Plains Branch (Branch) has assets of $4.2 million. Applicant and Branch are both located in the Meigs County banking market. On a pro forma basis, Applicant's market share is within Justice Department and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank of Lenawee, Adrian, Michigan, *to acquire* **Hudson State Savings Bank, Hudson, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/12/87)
The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/31/87)
Bank of Lenawee (Applicant) has assets of $96.2 million, and Hudson State Savings Bank (Bank) has assets of $38.9 million. Applicant and Bank compete in the Lenawee County, Michigan, banking market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Prudential Bank, Denver, Colorado, *to merge with* **Commonwealth State Bank, Glendale, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Commonwealth State Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/9/87)
Prudential Bank (Applicant) has assets of $15.1 million, and Commonwealth State Bank (Bank) has assets of $7.8 million.

The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

First American Bank, Rosemead, California, *to merge with* **First Arroyo Bank, South Pasadena, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (1/14/87)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/16/87)
First American Bank (Applicant) has assets of $74 million, and First Arroyo Bank (Bank) has assets of $45 million. Applicant and Bank operate in the Los Angeles metropolitan banking market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Chemical Bank Clare, Clare, Iowa, *to acquire certain assets and liabilities of* **The Mount Pleasant branch of Michigan National Bank–Valley, Midland, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/11/87)
The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/17/87)
Chemical Bank (Applicant) has assets of $122 million, and The Mount Pleasant branch of Michigan National Bank (Branch) has deposits of $4 million. Applicant and Bank operate in the same banking market. On a pro forma basis, Applicant's

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16.—Continued

market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Pacific Western Bank, San Jose, California, *to merge with* **County Bank & Trust, Santa Cruz, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/2/87)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/17/87)

Pacific Western Bank (Applicant) has assets of $470.6 million, and County Bank & Trust (Bank) has assets of $476.6 million. Applicant and Bank operate in the same banking market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Professional Bank, Englewood, Colorado, *to merge with* **American Bank of Commerce, Denver, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL

No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of American Bank of Commerce.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/6/87)

Professional Bank (Applicant) has assets of $5.0 million, and American Bank of Commerce (Bank) has assets of $22.5 million. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Farmers & Merchants B&TC, Aberdeen, South Dakota, *to acquire deposits of* **First State Bank, Sisseton, South Dakota**

SUMMARY REPORT BY THE ATTORNEY GENERAL

No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of First State Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/15/87)

Farmers & Merchants B&TC (Applicant) has assets of $68.2 million and will acquire deposits of $19.5 million from First State Bank (Bank). The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Forest Hill State Bank, Forest Hill, Maryland, *to acquire certain assets and liabilities of* **the Darlington branch of Equitable Bank, N.A., Baltimore, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (5/13/87)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/26/87)

Forest Hill State Bank (Applicant) has assets of $125 million and will acquire $7 million in assets of the Darlington branch of Equitable Bank, N.A. (Branch). Applicant and Branch operate in the Baltimore market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Provident Bank, Cincinnati, Ohio, *to merge with* **Hamilton County State Bank, Lockland, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL

No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Hamilton County State Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/12/87)

Provident Bank (Applicant) has assets of $1.4 million, and Hamilton State Bank (Bank) has assets of $8.7 million.

The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1987—Continued

Chase Bank of Ohio, Mentor, Ohio, *to acquire certain assets and liabilities of* **the Atrium I Branch of Bank One, Milford, N.A., Milford, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (5/14/87)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/18/87)

Chase Bank of Ohio (Applicant) has assets of $456.4 million, and the Atrium Branch of Bank One (Branch) has assets of $247,000 and deposits of $8.4 million. Applicant and Bank operate in the Cincinnati banking market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Prudential Bank, Denver, Colorado, *to acquire the assets and liabilities of* **Citizens Bank of Glendale, Denver, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL

No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Citizens Bank of Glendale.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8/27/87)

Prudential Bank (Applicant) has assets of $20.3 million, and Citizens Bank of Glendale (Bank) has assets of $3.6 million. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Norstar Bank of Upstate New York, Albany, New York, *to acquire certain assets and liabilities of* **six branches of United National Bank, Callicoon, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/14/87)

The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/22/87)

Norstar Bank of Upstate New York (Applicant) has assets of $3.1 billion, and the six branches of United National Bank (Branches) have assets of $95.3 million.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Farmers and Merchants Bank, Huron, South Dakota, *to acquire* **Security State Bank, Doland, South Dakota**

SUMMARY REPORT BY THE ATTORNEY GENERAL

No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Security State Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/23/87)

Farmers and Merchants Bank (Applicant) has assets of $104.5 million, and Security State Bank (Bank) has deposits of $19.5 million. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Century Bank Orchard Road, Arapahoe County, Colorado, *to merge with* **Century Bank Southeast, N.A., Greenwood Village, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL

No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Century Bank Southeast, N.A.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/24/87)

Century Bank Orchard Road (Applicant) has assets of $11.3 million, and Century Bank Southeast, N.A. (Bank), has assets of $19.7 million. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Independent Bank–South Michigan, Leslie, Michigan, *to acquire* **four branches of Michigan National Bank, Lansing, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/12/87)

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16.—Continued

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/1/87)
Independent Bank–South Michigan (Applicant) has assets of $49.4 million, and the four branches of Michigan National Bank (Branches) have deposits of $28 million. Applicant and Branches operate in the same banking market. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Star Valley State Bank, Afton, Wyoming, *to acquire the deposits of* **American National Bank of Afton, Afton, Wyoming**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of American National Bank of Afton.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/15/87)
Star Valley State Bank (Applicant) has assets of $54.6 million and American National Bank of Afton (Bank) has deposits of $10.6 million. The OCC has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Bank of Muleshoe, Muleshoe, Texas, *to merge with* **First State Bank of Bovina, Bovina, Texas**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of First State Bank of Bovina.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/22/87)
First Bank of Muleshoe (Applicant) has assets of $33.2 million, and First State Bank of Bovina (Bank) has assets of $16.3 million. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Commercial Bank, Bel Air, Maryland, *to acquire* **three branches of Maryland National Bank, Baltimore, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/25/87)
The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/23/87)
The Commercial Bank (Applicant) has assets of $150 million, and the three branches of Maryland National Bank (Branches) have deposits of $16 million. Applicant and Branches operate in separate banking markets.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Bank One Mansfield, Mansfield, Ohio, *to acquire* **the Gallion branch of Chase Bank of Ohio, Mentor, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/16/87)
The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/4/87)
Bank One Mansfield (Applicant) has assets of $318.5 million, and the Gallion branch of Chase Bank of Ohio (Branch) has assets of $17.5 million. Applicant and Branch do not operate in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Johnstown Bank & Trust Co., Johnstown, Pennsylvania, *to merge with* **The First National Bank of Avonmore, Avonmore, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/16/87)
The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/6/87)
Johnstown Bank & Trust Co. (Applicant) has assets of $417 million, and The First National Bank of Avonmore (Bank) has assets of $12.1 million. Applicant does not currently operate in Bank's market.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1987—Continued

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The Merrill Trust Company, Bangor, Maine, *to merge with* **Norstar Bank of Maine, Portland, Maine**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/23/87)
The proposed transaction would not have a significantly adverse effect on competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/9/87)
The Merrill Trust Company (Applicant) has assets of $853 million and Norstar Bank of Maine (Bank) has assets of $800 million. Applicant and Bank compete in the Bangor banking market. On a pro forma basis, Applicant's market share is within the Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Valley Bank of Nevada, Las Vegas, Nevada, *to merge with* **Security Bank of Nevada, Reno, Nevada**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/14/87)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/30/87)
Valley Bank of Nevada (Applicant) has assets of $1.5 billion and Security Bank of Nevada (Bank) has assets of $483 million. Applicant and Bank compete in four common banking markets. On a pro forma basis, Applicant's market share is within Department of Justice and Board guidelines.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Texas Capital Bank–Ft. Bend, Richmond, Texas, *to merge with* **Bancfirst–Austin, N.A., Austin, Texas**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors of Bancfirst–Austin, N.A.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/10/87)
Texas Capital Bank–Ft. Bend (Applicant) has assets of $36.2 million, and Bancfirst–Austin, N.A. (Bank), has assets of $24.6 million. Applicant and Bank do not operate in the same banking market. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to ensure continuation of Bank's services.

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

In each of the following cases, 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 prospects of the banks concerned, as well as the convenience and needs of the community to be served, were consistent with approval.

Institution[1]	Assets (millions of dollars)	Date of approval
M&I Marshall & Ilsley Bank, Milwaukee, Wisconsin	2,226	1/30/87
Merger		
M&I Bay View State Bank, Milwaukee, Wisconsin	66	
M&I Silver Spring Bank, Milwaukee, Wisconsin	67	
Commerce Union Bank of Rutherford County, Wisconsin	56	
M&I of Greenfield, Greenfield, Wisconsin	48	

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16.—Continued

Institution[1]	Assets (millions of dollars)	Date of approval
Texas Capital Bank–Richmond, Richmond, Texas	39	3/11/87
Merger		
Texas Capital Bank–Katy, N.A., Katy, Texas	24	
Community Bank–Northwest, Houston, Texas	7	4/15/87
Merger		
Community Bank I–10 West, N.A., Katy, Texas	15	
Security Bank Northeast, Richmond, Michigan	128	4/30/87
Merger		
Security Bank of Almont, Almont, Michigan	30	
Carney Bank, Boynton Beach, Florida	15	5/7/87
Merger		
Carney Bank of Broward County, Sunrise, Florida	10	
First of America Bank–Central, Lansing, Michigan	444	7/15/87
Merger		
First of America Bank–Charlotte, Charlotte, Michigan	23	
First of America Bank, Grand Ledge, Michigan	17	
Norstar Bank of Long Island, Hempstead, New York	1,176	8/4/87
Merger		
Norstar Bank of Commerce, New York, New York	449	
Norstar Bank of Upstate New York, Albany, New York	2,724	8/5/87
Merger		
Norstar Bank of Hudson Valley, N.A., Newburgh, New York	632	
Central Bank, Monroe, Louisiana	439	9/29/87
Merger		
Lincoln Bank and Trust Company, Ruston, Louisiana	90	
Provident Bank, Cincinnati, Ohio	1,084	9/23/87
Merger		
Midwest Bank and Trust Company, Cleveland, Ohio	176	
State Bank of Freeport, Freeport, Illinois	152	9/30/87
Merger		
Rock City Bank, Rock City, Illinois	15	
Old Kent Bank & Trust Co., Grand Rapids, Michigan	3,000	10/9/87
Merger		
Old Kent Bank of Kentwood, Kentwood, Michigan	23	
Central Bank of the South, Birmingham, Alabama	3,479	10/23/87
Merger		
Central Bank, Cahaba Heights, Alabama	2	
Peoples Bank of Bloomington, Bloomington, Illinois	205	10/27/87
Merger		
The First National Bank of Normal, Normal, Illinois	99	

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1987—Continued

Institution[1]	Assets (millions of dollars)	Date of approval
Old Kent Bank & Trust Company, Grand Rapids, Michigan	2,900	10/30/87
Merger		
Old Kent Bank of Greenville, Greenville, Michigan	62	
Old Kent Bank of Fremont, Fremont, Michigan	54	
Old Kent Bank and Trust Co., Grand Rapids, Michigan	2,900	10/30/87
Merger		
Old Kent Bank of Fremont, Fremont, Michigan	62	
First Community Bank–Adrian, Buckhannon, West Virginia	49	11/13/87
Merger		
First Community Bank–Princeton, Princeton, West Virginia	133	
Glendale Bank of Pennsylvania, Philadelphia, Pennsylvania	27	11/16/87
Merger		
William Penn Bank, Philadelphia, Pennsylvania	27	
Comerica Bank, Detroit, Michigan	7,324	11/25/87
Merger		
Comerica Bank, Novi, Michigan	62	
Comerica Bank, Sterling Heights, Michigan	137	
Comerica Bank, Livonia, Michigan	153	
Comerica Bank, Southfield, Michigan	198	
Comerica Bank, Troy, Michigan	192	
Comerica Bank, Warren, Michigan	330	
Chemical Bank Bay Area, Bay City, Michigan	122	11/17/87
Merger		
Chemical Bank Cass City, Cass City, Michigan	27	
First Trust & Savings Bank of Kankakee, Kankakee, Illinois	166	11/27/87
Merger		
First Trust & Savings Bank of Bradley, Bradley, Illinois	19	
Valley Bank & Trust Company, Salt Lake City, Utah	787	12/1/87
Merger		
Silver King State Bank, Park City, Utah	29	
First Virginia Bank–Commonwealth, Grafton, Virginia	40	12/1/87
Merger		
First Virginia Bank–Surry, Surry, Virginia	17	
First Nebraska Bank–Valley, Valley, Nebraska	12	12/29/87
Merger		
First Nebraska Bank, Brainard, Nebraska	16	
First Nebraska Bank, Decatur, Nebraska	6	
First Nebrasks Bank, N.A., Emerson, Nebraska	16	
First Nebraska Bank, N.A., Stanton, Nebraska	15	
First Nebraska Bank, N.A., Columbus, Nebraska	10	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

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16.—Continued

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.

Institution[1]	Assets (millions of dollars)[2]	Date of approval
Orrville Interim Bank, Orrville, Ohio	...	1/5/87
Merger		
Orrville Savings Bank, Orrville, Ohio	59	
Hardy County Bank, Inc., Wardensville, West Virginia	...	1/9/87
Merger		
Capon Valley Bank, Wardensville, West Virginia	36	
Morgan County Bank, Falkville, Alabama		1/28/87
Merger		
Madison County Bank, New Hope, Alabama	...	
Central Bank of the South, Falkville branch, Birmingham, Alabama	9	
First Virginia Bank–Clinch Valley, Richlands, Virginia	...	4/3/87
Merger		
Clinch Valley Bank & Trust Company, Richlands, Virginia	71	
The New Colonia Bank, Opelika, Alabama	...	4/9/87
Merger		
Colonial Bank, Montgomery, Alabama	150	
Alpine Bank & Trust Co., Glenwood Springs, Colorado	...	4/22/87
Merger		
Alpine Bank, Glenwood Springs, Colorado	13	
Newport News Interim Bank, Newport News, Virginia	...	5/8/87
Merger		
American Bank, Newport News, Virginia	22	
Sandusky Interim Bank, Sandusky, Ohio	...	5/28/87
Merger		
Citizens Banking Company, Sandusky, Ohio	168	
Iron and Glass Interim Bank, Pittsburgh, Pennsylvania	...	6/8/87
Merger		
Iron and Glass Bank, Pittsburgh, Pennsylvania	78	
Liberty State Interim Bank	...	8/14/87
Merger		
Liberty State Bank, Mount Carmel, Pennsylvania	47	

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1987—Continued

Institution[1]	Assets (millions of dollars)	Date of approval
Second BHN Acquisition Bank, Manchester, New Hampshire	...	9/15/87
Merger		
Suncook Bank, Suncook, New Hampshire	102	
L.T. Interim Bank, East St. Louis, Missouri	...	9/17/87
Merger		
Lindell Trust Company, St. Louis, Missouri	107	
Wiles Interim Bank, Niles, Ohio	...	9/18/87
Merger		
The Security Dollar Bank Company, Niles, Ohio	64	
First of America Bank–Manistee, Manistee, Michigan	...	10/13/87
Merger		
Manistee Bank and Trust Company, Manistee, Michigan	112	
Princeton Bank of Pennsylvania, Philadelphia, Pennsylvania	...	10/17/87
Merger		
Princeton Bank of Pennsylvania, N.A., Philadelphia, Pennsylvania	3	
CB Bank, South Haven, Michigan	...	11/9/87
Merger		
Citizens Trust & Savings Bank, South Haven, Michigan	137	
Newco Bank, Ypsilanti, Michigan	...	11/16/87
Merger		
Ypsilanti Savings Bank, Ypsilanti, Michigan	138	
New Bank of Mora, Mora, Minnesota	...	11/24/87
Merger		
Kanabee State Bank, Mora, Minnesota	39	
Traders Interim Bank, Spencer, West Virginia	...	11/26/86
Merger		
Traders Bank, Spencer, West Virginia	63	
New Valley Bank, Grand Forks, North Dakota	...	11/27/87
Merger		
Valley Bank & Trust Company, Grand Forks, North Dakota	84	
The Lunenburg County Bank, Kenbridge, Virginia	...	12/1/86
Merger		
Community Bank of Lunenburg, Kenbridge, Virginia	24	
Lapeer Interim Bank, Lapeer, Michigan	...	12/14/87
Merger		
Lapeer County Bank & Trust Company, Lapeer, Michigan	125	

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. Where no assets are listed, the bank is newly organized and not in operation.

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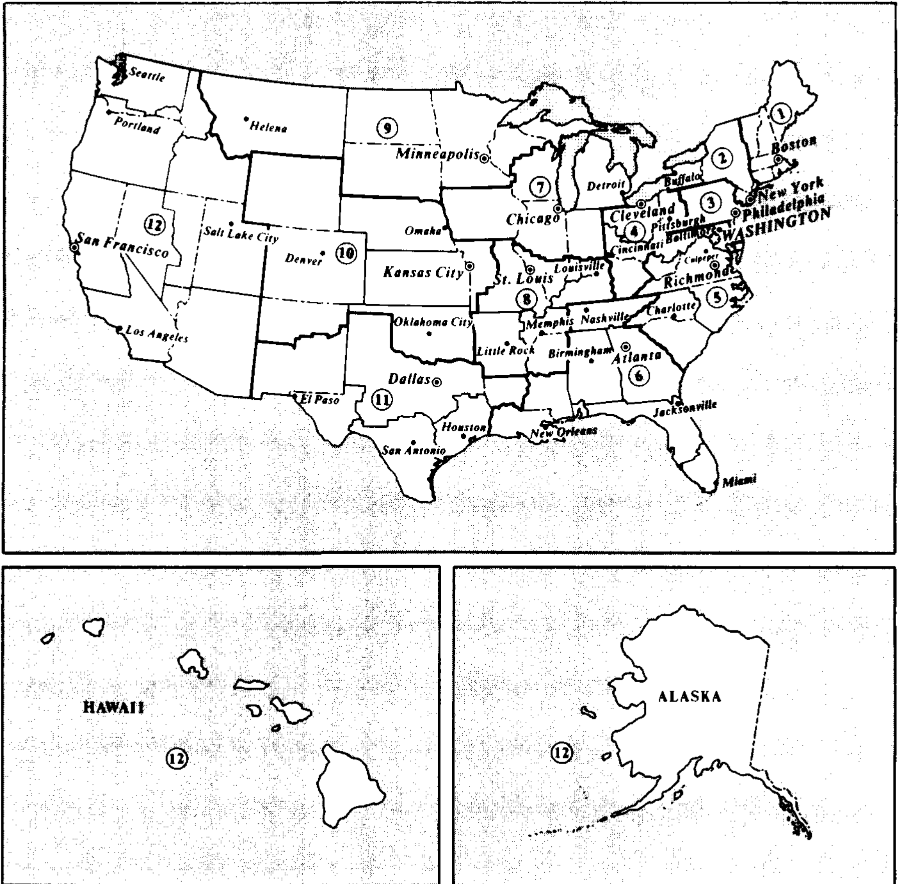
The Federal Reserve System

Boundaries of Federal Reserve Districts and their Branch Territories



Legend

—— Boundaries of Federal Reserve Districts
—— Boundaries of Federal Reserve Branch Territories
○ Board of Governors of the Federal Reserve System
◉ Federal Reserve Bank Cities
• Federal Reserve Branch Cities
· Federal Reserve Bank Facilities

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Federal Reserve Directories and Meetings

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Board of Governors of the Federal Reserve System

December 31, 1987

	Term expires
ALAN GREENSPAN of New York, *Chairman*[1]	January 31, 1992
MANUEL H. JOHNSON of Virginia, *Vice Chairman*[1]	January 31, 2000
Vacant	January 31, 1988
WAYNE D. ANGELL of Kansas	January 31, 1994
EDWARD W. KELLEY, JR., of Texas	January 31, 1990
MARTHA R. SEGER of Michigan	January 31, 1998
H. ROBERT HELLER of California	January 31, 1996

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DONALD J. WINN, *Assistant to the Board*
LYNN SMITH FOX, *Special Assistant to the Board*
BOB S. MOORE, *Special Assistant to the Board*

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DAVID E. LINDSEY, *Deputy Director*
BRIAN MADIGAN, *Assistant Director*
RICHARD D. PORTER, *Assistant Director*
NORMAND R.V. BERNARD, *Special Assistant to the Board*

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THEODORE E. ALLISON, *Staff Director*

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JOYCE ZICKLER, *Assistant Director*
LEVON H. GARABEDIAN, *Assistant Director* (Administration)

1. The designations as Chairman and Vice Chairman expire on August 10, 1991, and August 4, 1990, respectively, unless the services of these members of the Board shall have terminated sooner.

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DIVISION OF INTERNATIONAL FINANCE
EDWIN M. TRUMAN, *Staff Director*
LARRY J. PROMISEL, *Senior Associate Director*
CHARLES J. SIEGMAN, *Senior Associate Director*
DAVID H. HOWARD, *Deputy Associate Director*
ROBERT F. GEMMILL, *Staff Adviser*
DONALD B. ADAMS, *Assistant 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*
CHARLES W. BENNETT, *Assistant Director*
JACK DENNIS, JR., *Assistant Director*
EARL G. HAMILTON, *Assistant Director*
JOHN H. PARRISH, *Assistant Director*
LOUISE L. ROSEMAN, *Assistant Director*
FLORENCE M. YOUNG, *Adviser*

DIVISION OF BANKING SUPERVISION AND REGULATION
WILLIAM TAYLOR, *Staff Director*
FRANKLIN D. DREYER, *Deputy Director*[2]
DON E. KLINE, *Associate Director*
FREDERICK M. STRUBLE, *Associate Director*
WILLIAM A. RYBACK, *Deputy Associate Director*
STEPHEN C. SCHEMERING, *Deputy Associate Director*
RICHARD SPILLENKOTHEN, *Deputy Associate Director*
HERBERT A. BIERN, *Assistant Director*
JOE M. CLEAVER, *Assistant Director*
ANTHONY CORNYN, *Assistant Director*
JAMES I. GARNER, *Assistant Director*
JAMES D. GOETZINGER, *Assistant Director*
MICHAEL MARTINSON, *Assistant Director*

DIVISION OF BANKING SUPERVISION AND REGULATION—Continued
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*
GLENN E. LONEY, *Assistant Director*
ELLEN MALAND, *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*
GEORGE M. LOPEZ, *Assistant Director*
DAVID L. WILLIAMS, *Assistant Director*

OFFICE OF THE CONTROLLER
GEORGE E. LIVINGSTON, *Controller*
STEPHEN J. CLARK, *Assistant Controller*
DARRELL R. PAULEY, *Assistant Controller*

DIVISION OF HARDWARE AND SOFTWARE SYSTEMS
BRUCE M. BEARDSLEY, *Director*
THOMAS C. JUDD, *Assistant Director*
ELIZABETH B. RIGGS, *Assistant Director*
ROBERT J. ZEMEL, *Assistant Director*

DIVISION OF APPLICATIONS DEVELOPMENT AND STATISTICAL SERVICES
WILLIAM R. JONES, *Director*
DAY RADEBAUGH, *Assistant Director*
RICHARD C. STEVENS, *Assistant Director*
PATRICIA A. WELCH, *Assistant Director*

OFFICE OF THE INSPECTOR GENERAL
BRENT L. BOWEN, *Inspector General*

2. On loan from the Federal Reserve Bank of Chicago.

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Federal Open Market Committee

December 31, 1987

Members

ALAN GREENSPAN, *Chairman*, Board of Governors

E. GERALD CORRIGAN, *Vice Chairman*, elected member by Federal Reserve Bank of New York

WAYNE D. ANGELL, Board of Governors

EDWARD G. BOEHNE, elected member by Federal Reserve Banks of Boston, Philadelphia, and Richmond

ROBERT H. BOYKIN, elected member by Federal Reserve Banks of Atlanta, St. Louis, and Dallas

H. ROBERT HELLER, Board of Governors

MANUEL H. JOHNSON, Board of Governors

SILAS KEEHN, elected member by Federal Reserve Banks of Cleveland and Chicago

EDWARD W. KELLEY, JR., Board of Governors

MARTHA R. SEGER, Board of Governors

GARY H. STERN, elected member by Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco

Alternate Members

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

W. LEE HOSKINS, elected by Federal Reserve Banks of Cleveland and Chicago

ROBERT T. PARRY, elected by Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco

THOMAS M. TIMLEN, elected by Federal Reserve Bank of New York

Officers

DONALD L. KOHN, *Secretary and Staff Adviser*

NORMAND R.V. BERNARD, *Assistant Secretary*

ROSEMARY R. LONEY, *Deputy Assistant Secretary*

MICHAEL BRADFIELD, *General Counsel*

ERNEST T. PATRIKIS, *Deputy General Counsel*

EDWIN M. TRUMAN, *Economist (International)*

RICHARD W. LANG, *Associate Economist*

DAVID E. LINDSEY, *Associate Economist*

MICHAEL J. PRELL, *Associate Economist*

ARTHUR J. ROLNICK, *Associate Economist*

HARVEY ROSENBLUM, *Associate Economist*

KARL A. SCHELD, *Associate Economist*

CHARLES J. SIEGMAN, *Associate Economist*

THOMAS D. SIMPSON, *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 1987, the Federal Open Market Committee held eight regularly scheduled meetings (see Record of Policy Actions of the Federal Open Market Committee in this REPORT.)

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Federal Advisory Council

December 31, 1987

Members

District 1—John P. LaWare, *Chairman and Chief Executive Officer*, Shawmut Bank, N.A., Boston, Massachusetts

District 2—John F. McGillicuddy, *Chairman of the Board and Chief Executive Officer*, Manufacturers Hanover Trust Company, New York, New York

District 3—Samuel A. McCullough, *President and Chief Executive Officer*, Meridian Bancorp, Inc., Reading, 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—Bennett A. Brown, *Chairman and Chief Executive Officer*, Citizens and Southern Georgia Corporation and The Citizens and Southern National Bank, Atlanta, Georgia

District 7—Charles T. Fisher, III, *Chairman and President*, National Bank of Detroit, Detroit, Michigan

District 8—Donald N. Brandin, *Chairman of the Board and Chief Executive Officer*, Boatmen's Bancshares, Inc., St. Louis, Missouri

District 9—D. H. Ankeny, Jr., *Chairman and Chief Executive Officer*, First Bank System, Minneapolis, Minnesota

District 10—F. Phillips Giltner, *President*, First National Bank, Omaha, Nebraska

District 11—Gerald W. Fronterhouse, *Chairman of the Board and Chief Executive Officer*, RepublicBank Corporation, Dallas, Texas

District 12—John D. Mangels, *President*, Rainier Bancorporation, *Chairman*, Rainier National Bank, Seattle, Washington

Officers

John G. Medlin, Jr., *President*

Julien L. McCall, *Vice President*

Herbert V. Prochnow, *Secretary*

William J. Korsvik, *Associate Secretary*

Directors

John F. McGillicuddy

D.H. Ankeny, Jr.

F. Phillips Giltner

Meetings of the Federal Advisory Council were held on February 5–6, April 30–May 1, September 10–11, and December 3–4, 1987. The Board of Governors met with the council on February 6, May 1, September 11, and December 4, 1987. 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 per year and is authorized by the Federal Reserve Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

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Consumer Advisory Council

December 31, 1987

Members

EDWIN B. BROOKS, *President*, Security Federal Savings and Loan Association, Richmond, Virginia

JONATHAN A. BROWN, *Director*, BankWatch, Washington, D.C.

JUDITH N. BROWN, *Treasurer*, American Association of Retired Persons, Edina, Minnesota

MICHAEL S. CASSIDY, *Senior Vice President*, Chase Manhattan Bank, New York, New York

THERESA FAITH CUMMINGS, *Social Services Consultant*, Springfield, Illinois

RICHARD B. DOBY, *State Bank Commissioner*, State of Colorado, Denver, Colorado

RICHARD H. FINK, *President*, Citizens for a Sound Economy, Washington, D.C.

NEIL J. FOGARTY, *Attorney*, Hudson County Legal Services, Jersey City, New Jersey

STEPHEN GARDNER, *Assistant Attorney General*, State of Texas, Dallas, Texas

KENNETH A. HALL, *President*, (South Division) First United Bank, Picayune, Mississippi

STEVEN W. HAMM, *Administrator*, South Carolina Department of Consumer Affairs, Columbia, South Carolina

ELENA HANGGI, *President*, Association of Community Organizations for Reform Now (ACORN), Little Rock, Arkansas

ROBERT J. HOBBS, *Senior Attorney*, National Consumer Law Center, Boston, Massachusetts

ROBERT W. JOHNSON, *Professor of Management and Director*, Credit Research Center, Purdue University, West Lafayette, Indiana

RAMON E. JOHNSON, *Professor of Finance*, University of Utah, Salt Lake City, Utah

JOHN M. KOLESAR, *President*, Ameritrust Development Bank, Cleveland, Ohio

ALAN B. LERNER, *Senior Executive Vice President*, Associates Corporation of North America, Dallas, Texas

FRED S. MCCHESNEY, *Visiting Fellow of Law and Economics*, University of Chicago, Chicago, Illinois

RICHARD L.D. MORSE, *Professor of Family Economics*, Kansas State University, Manhattan, Kansas

HELEN E. NELSON, *President*, Consumer Research Foundation, Mill Valley, California

SANDRA R. PARKER, *Chairman*, Banking Committee, Richmond United Neighborhoods, Richmond, Virginia

JOSEPH L. PERKOWSKI, *Chief Executive Officer*, Minneapolis Federal Employees Credit Union, Minneapolis, Minnesota

BRENDA L. SCHNEIDER, *Director of Community Relations*, Manufacturers National Bank, Detroit, Michigan

JANE SHULL, *Director*, Institute for the Study of Civic Values, Philadelphia, Pennsylvania

TED L. SPURLOCK, *Vice President and Director of Credit and Consumer Banking Services*, J. C. Penney Company, Inc., Dallas, Texas

MEL STILLER, *Executive Director*, Consumer Credit Counseling Service of Eastern Massachusetts, Boston, Massachusetts

CHRISTOPHER J. SUMNER, *President and Chief Executive Officer*, Crossland Savings F.S.B., Salt Lake City, Utah

EDWARD J. WILLIAMS, *Senior Vice President*, Consumer Banking Group, Harris Trust and Savings Bank, Chicago, Illinois

MICHAEL ZOROYA, *Retail Services Consultant*, The May Department Stores, St. Louis, Missouri

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Consumer Advisory Council—Continued

Officers

EDWARD N. LANGE, *Chairman*

STEVEN HAMM, *Vice Chairman*

The Consumer Advisory Council met with members of the Board of Governors on March 19–20, June 25–26, and October 22–23, 1987. The council is composed of academics, state government officials, representatives of the financial industry, and representatives of consumer and community interests. It was established pursuant to the 1976 amendments to the Equal Credit Opportunity Act to advise the Board on consumer financial services.

Thrift Institutions Advisory Council

December 31, 1987

Members

Gerald M. Czarnecki, *President and Chief Executive Officer,* Altus Bank, A Federal Savings Bank, Mobile, Alabama

John C. Dicus, *President,* Capitol Federal Savings and Loan Association, Topeka, Kansas

Betty Gregg, *President and Chief Executive Officer,* Desert Schools Federal Credit Union, Phoenix, Arizona

Jamie J. Jackson, *President,* Commonwealth Financial Group, Houston, Texas

Thomas A. Kinst, *President and Chief Executive Officer,* Land of Lincoln Savings and Loan, Hoffman Estates, Illinois

Ray Martin, *Chairman and Chief Executive Officer,* Coast Savings and Loan Association, Los Angeles, California

Donald F. McCormick, *Chairman of the Board,* Howard Savings Bank, Livingston, New Jersey

Janet M. Pavliska, *President and Chief Executive Officer,* Bank Five for Savings, Arlington, Massachusetts

Herschel Rosenthal, *President,* Flagler Federal Savings and Loan Association, Miami, Florida

William G. Schuett, *President and Chief Executive Officer,* Security Savings and Loan Association, Milwaukee, Wisconsin

Gary L. Sirmon, *President,* First Federal Savings and Loan Association, Walla Walla, Washington

Michael R. Wise, *Chairman and Chief Executive Officer,* Silverado Banking, Denver, Colorado

Officers

MICHAEL R. WISE, *President*

JAMIE J. JACKSON, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on February 12, May 5, September 17, and November 17, 1987. 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.

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Officers of Federal Reserve Banks, Branches, and Offices

December 31, 1987[1]

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON[3]	Joseph A. Baute George N. Hatsopoulos	Frank E. Morris Robert W. Eisenmenger	
NEW YORK[3]	John R. Opel Virginia A. Dwyer	E. Gerald Corrigan Thomas M. Timlen	
Buffalo	Mary Ann Lambertsen		John T. Keane
PHILADELPHIA	Nevius M. Curtis George E. Bartol III	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND[3]	Charles W. Parry John R. Miller	W. Lee Hoskins William H. Hendricks	
Cincinnati	Owen B. Butler		Charles A. Cerino[4]
Pittsburgh	James E. Haas		Harold J. Swart[4]
RICHMOND[3]	Leroy T. Canoles, Jr. Robert A. Georgine	Robert P. Black Jimmie R. Monhollon	
Baltimore	Gloria L. Johnson		Robert D. McTeer[4]
Charlotte	Wallace J. Jorgenson		Albert D. Tinkelenberg[4]
Culpeper			John G. Stoides[4]
ATLANTA	Bradley Currey, Jr. Larry L. Prince	Robert P. Forrestal Jack Guynn	Delmar Harrison[4]
Birmingham	A.G. Trammell		Fred R. Herr[4]
Jacksonville	Andrew A. Robinson		James D. Hawkins[4]
Miami	Robert D. Apelgren		Patrick K. Barron[4]
Nashville	C. Warren Neel		Donald E. Nelson
New Orleans	Caroline G. Theus		Henry H. Bourgaux, Jr.
CHICAGO[3]	Robert J. Day Marcus Alexis	Silas Keehn Daniel M. Doyle	
Detroit	Robert E. Brewer		Roby L. Sloan[4]
ST. LOUIS	W.L. Hadley Griffin Robert L. Virgil, Jr.	Thomas C. Melzer James R. Bowen	
Little Rock	James R. Rodgers		John F. Breen
Louisville	Raymond M. Burse		James E. Conrad
Memphis	Katherine H. Smythe		Paul I. Black, Jr.
MINNEAPOLIS	John B. Davis, Jr. Michael W. Wright	Gary H. Stern Thomas E. Gainor	
Helena	Warren H. Ross		Robert F. McNellis

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BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
KANSAS CITY	Irvine O. Hockaday, Jr.	Roger Guffey	
	Robert G. Lueder	Henry R. Czerwinski	
Denver	James E. Nielson		Enis Alldredge, Jr.
Oklahoma City	Patience S. Latting		William G. Evans
Omaha	Kenneth L. Morrison		Robert D. Hamilton
DALLAS	Bobby R. Inman	Robert H. Boykin	
	Hugh G. Robinson	William H. Wallace	Tony J. Salvaggio[4]
El Paso	Mary Carmen Saucedo		Sammie C. Clay
Houston	Walter M. Mischer, Jr.		Robert Smith, III[4]
San Antonio	Robert F. McDermott		Thomas H. Robertson
SAN FRANCISCO	Fred W. Andrew	Robert T. Parry	
	Robert F. Erburu	Carl E. Powell	John F. Hoover[4]
Los Angeles	Richard C. Seaver		Thomas C. Warren[5]
Portland	Paul E. Bragdon		Angelo S. Carella[4]
Salt Lake City	Don M. Wheeler		E. Ronald Liggett[4]
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 Lewiston, 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.
5. Executive Vice President.

Conference of Chairmen

The chairmen of the Federal Reserve Banks are organized into the Conference of Chairmen, which 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 1 and 2 and December 2 and 3, 1987.

The Executive Committee of the Conference of Chairmen during 1987 comprised Joseph A. Baute, Chairman; Robert J. Day, Vice Chairman; and Leroy T. Canoles, Jr., member.

On December 3, 1987, the Conference elected its Executive Committee for 1988, naming Robert J. Day as Chairman, Robert F. Erburu as Vice Chairman, and John R. Opel as the other member.

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 6, 1986, Silas Keehn, President of the Federal Reserve Bank of Chicago, was elected Chairman of the conference for 1987, and Karen N. Horn, President of the Federal Reserve Bank of Cleveland, was elected Vice Chairman. Joan M. De Rycke of the Federal Reserve Bank of Chicago was appointed Secretary, and Robert J. Leto of the Federal Reserve Bank of Cleveland was appointed Assistant Secretary.

On February 10, 1987, Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, replaced Mrs. Horn as Vice Chairman of the conference, and Carolyn A. Verret of the Federal Reserve Bank of Minneapolis became Assistant Secretary.

Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in

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1969 to meet periodically for the consideration of operational and other matters.

On October 20, 1986, Daniel M. Doyle, First Vice President of the Federal Reserve Bank of Chicago, was elected Chairman of the conference for 1987, and William H. Hendricks, First Vice President of the Federal Reserve Bank of Cleveland, was elected Vice Chairman. Joan M. De Rycke of the Federal Reserve Bank of Chicago was appointed Secretary, and Robert J. Leto of the Federal Reserve Bank of Cleveland, was appointed Assistant Secretary.

On February 13, 1987, Thomas E. Gainor, First Vice President of the Federal Reserve Bank of Minneapolis, replaced Mr. Hendricks as Vice Chairman of the conference, and Carolyn A. Verret of that Bank became Assistant Secretary.

Directors

The following list of directors of Federal Reserve Banks and Branches shows for each director the class of directorship, the principal business affiliation, and the date the term expires. 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 or bank holding company. In addition, Class C directors may not be stockholders of any bank or bank holding company.

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, which comprises banks with similar capitalization, elects one Class A director 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 another Class C director 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.

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, see the preceding table, "Officers of Federal Reserve Banks, Branches, and Offices."

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District 1—BOSTON

Term expires Dec. 31

Class A

Name	Position	Term expires Dec. 31
Homer B. Ellis, Jr.	Director, Factory Point National Bank, Manchester Center, Vermont	1987
William C. Bullock, Jr.	Chairman and President, Merrill Bankshares Company, Bangor, Maine	1988
Robert L. Newell	Chairman, Hartford National Corporation, Hartford, Connecticut	1989

Class B

Name	Position	Term expires Dec. 31
Ralph Z. Sorenson	Chairman, President, and Chief Executive Officer, Barry Wright Corporation, Newton Lower Falls, Massachusetts	1987
Matina S. Horner	President, Radcliffe College, Cambridge, Massachusetts	1988
Richard M. Oster	President and Chief Executive Officer, Cookson America, Inc., Providence, Rhode Island	1989

Class C

Name	Position	Term expires Dec. 31
Joseph A. Baute	Chairman and Chief Executive Officer, Markem Corporation, Keene, New Hampshire	1987
George N. Hatsopoulos	Chairman of the Board and President, Thermo Electron Corporation, Waltham, Massachusetts	1988
Richard N. Cooper	Maurits C. Boas Professor of International Economics, Harvard University, Cambridge, Massachusetts	1989

District 2—NEW YORK

Class A

Name	Position	Term expires Dec. 31
Robert W. Moyer	Vice Chairman and Chief Executive Officer, Wilber National Bank, Oneonta, New York	1987
Lewis T. Preston	Chairman of the Board, Morgan Guaranty Trust Company of New York, New York, New York	1988
Alberto M. Paracchini	Chairman of the Board and President, Banco de Ponce, Ponce, Puerto Rico	1989

Class B

Name	Position	Term expires Dec. 31
John F. Welch, Jr.	Chairman and Chief Executive Officer, General Electric Company, Fairfield, Connecticut	1987
Richard L. Gelb	Chairman and Chief Executive Officer, Bristol-Myers Company, New York, New York	1988
John A. Georges	Chairman and Chief Executive Officer, International Paper Company, New York, New York	1989

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Class C		*Term expires Dec. 31*
Virginia A. Dwyer	Senior Vice President-Finance (Retired), American Telephone and Telegraph Co., New York, New York	1987
John Brademas	President, New York University, New York, New York	1988
John R. Opel	Chairman of the Executive Committee, International Business Machines Corp., Armonk, New York	1989

BUFFALO BRANCH

Appointed by the Federal Reserve Bank		
Ross B. Kenzie	Chairman and Chief Executive Officer, Goldome FSB, Buffalo, New York	1987
R. Carlos Carballada	President and Chief Executive Officer, Central Trust Company, Rochester, New York	1988
Donald I. Wickham	President, Tri-Way Farms, Inc., Stanley, New York	1988
Harry J. Sullivan	President, Salamanca Trust Company, Salamanca, New York	1989

Appointed by the Board of Governors		
Joseph Yantomasi	Consultant, United Auto Workers, Buffalo, New York	1987
Mary Ann Lambertsen	Vice President, Human Resources, Fisher-Price, East Aurora, New York	1988
Matthew Augustine	President and Chief Executive Officer, Eltrex Industries, Inc., Rochester, New York	1989

District 3—PHILADELPHIA

Class A		
Ronald H. Smith	President and Chief Executive Officer, CCNB Bank, N.A., New Cumberland, Pennsylvania	1987
Clarence D. McCormick	President, The Farmers and Merchants National Bank, Bridgeton, New Jersey	1988
George A. Butler	Chairman and Chief Executive Officer, First Pennsylvania Bank, N.A., Philadelphia, Pennsylvania	1989

Class B		
Charles F. Seymour	Chairman and Chief Executive Officer, Jackson-Cross Company, Philadelphia, Pennsylvania	1987
Nicholas Riso	President and Chief Executive Officer, Giant Food Stores, Inc., Carlisle, Pennsylvania	1988
Carl E. Singley	Partner, White, McCleland & Singley, Philadelphia, Pennsylvania	1989

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		Term expires Dec. 31
Class C		
George E. Bartol III	Chairman of the Board, Hunt Manufacturing Company, Philadelphia, Pennsylvania	1987
Nevius M. Curtis	Chairman and Chief Executive Officer, Delmarva Power, Wilmington, Delaware	1988
Peter A. Benoliel	Chairman of the Board, Quaker Chemical Corporation, Conshohocken, Pennsylvania	1989

District 4—CLEVELAND

Class A		
Raymond D. Campbell	Chairman, President, and Chief Executive Officer, Independent State Bank of Ohio, Columbus, Ohio	1987
William A. Stroud	Chairman, First–Knox National Bank, Mount Vernon, Ohio	1988
Frank Wobst	Chairman and Chief Executive Officer, Huntington Bancshares Incorporated, Columbus, Ohio	1989
Class B		
Richard D. Hannan	Chairman of the Board and President, Mercury Instruments, Inc., Cincinnati, Ohio	1987
Daniel M. Galbreath	President, John W. Galbreath, Columbus, Ohio	1988
Laban P. Jackson, Jr.	Chairman of the Board, International Spike, Inc., Lexington, Kentucky	1989
Class C		
Robert D. Storey	Partner, Burke, Haber & Berick, Cleveland, Ohio	1987
John R. Miller	Former President and Chief Operating Officer, The Standard Oil Company (Ohio), Cleveland, Ohio	1988
Charles W. Parry	Former Chairman and Chief Executive Officer, Aluminum Company of America, Pittsburgh, Pennsylvania	1989

CINCINNATI BRANCH

Appointed by the Federal Reserve Bank		
Sherrill Cleland	President, Marietta College, Marietta, Ohio	1987
Jerry L. Kirby	Chairman of the Board and President, Citizens Federal Savings & Loan Association, Dayton, Ohio	1987
Robert A. Hodson	President and Chief Executive Officer, 1st Security Bank, Hillsboro, Ohio	1988
Robert M. Duncan	President and Chief Executive Officer, First National Bank of Louisa, Louisa, Kentucky	1989

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Appointed by the Board of Governors		*Term expires Dec. 31*
Don Ross	Owner, Dunreath Farm, Lexington, Kentucky	1987
Kate Ireland	National Chairman, Frontier Nursing Service, Wendover, Kentucky	1988
Owen B. Butler	Chairman of the Board (Retired), The Procter & Gamble Company, Cincinnati, Ohio	1989

PITTSBURGH BRANCH

Appointed by the Federal Reserve Bank		
Charles L. Fuellgraf, Jr.	Chief Executive Officer, Fuellgraf Electric Company, Butler, Pennsylvania	1987
James S. Pasman, Jr.	Chairman and Chief Executive Officer, Kaiser Aluminum & Chemical Corporation, Oakland, California	1987
Lawrence F. Klima	President, The First National Bank of Pennsylvania, Erie, Pennsylvania	1988
Thomas H. O'Brien	President and Chief Executive Officer, PNC Financial Corp., Pittsburgh, Pennsylvania	1989

Appointed by the Board of Governors		
Milton A. Washington	President and Chief Executive Officer, Allegheny Housing Rehabilitation Corporation, Pittsburgh, Pennsylvania	1987
James E. Haas	President and Chief Operating Officer, National Intergroup, Inc., Pittsburgh, Pennsylvania	1988
Karl M. von der Heyden	Senior Vice President–Finance and Chief Financial Officer, H. J. Heinz Company, Pittsburgh, Pennsylvania	1989

District 5—RICHMOND

Class A		
Robert F. Baronner	Chairman of the Board and Chief Executive Officer, One Valley Bank, N.A., and President and Chief Executive Officer, One Valley Bancorp of West Virginia, Inc., Charleston, West Virginia	1987
K. Donald Menefee	Chairman of the Board and Chief Executive Officer, Madison National Bank, and Chairman of the Board and President, James Madison Limited, Washington, D.C.	1988
Chester A. Duke	President and Chief Executive Officer, Marion National Bank, Marion, South Carolina	1989

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		Term expires Dec. 31
Class B		
Floyd D. Gottwald, Jr.	Chairman of the Board and Chief Executive Officer, Ethyl Corporation, Richmond, Virginia	1987
Edward H. Covell	President, The Covell Company, Easton, Maryland	1988
Thomas B. Cookerly	President, Broadcast Division, Allbritton Communications, Washington, D.C.	1989
Class C		
Hanne M. Merriman	Washington, D.C.	1987
Robert A. Georgine	President, Building & Construction Trades Department, AFL–CIO, Washington, D.C.	1988
Leroy T. Canoles, Jr.	President, Kaufman & Canoles, Norfolk, Virginia	1989

BALTIMORE BRANCH

Appointed by the Federal Reserve Bank		
Raymond V. Haysbert, Sr.	President and Chief Executive Officer, Parks Sausage Company, Baltimore, Maryland	1987
H. Grant Hathaway	Chairman of the Board, Equitable Bank, N.A., Baltimore, Maryland	1988
Joseph W. Mosmiller	Chairman of the Board, Loyola Federal Savings and Loan Association, Baltimore, Maryland	1988
Charles W. Hoff III	President and Chief Executive Officer, Farmers and Mechanics National Bank, Frederick, Maryland	1989
Appointed by the Board of Governors		
Gloria L. Johnson	Regional Vice President and Director of Stores, Bloomingdale's Department Stores, Kensington, Maryland	1987
Thomas R. Shelton	President, Case Foods, Inc., Salisbury, Maryland	1988
John R. Hardesty, Jr.	President, Preston Energy, Inc., Kingwood, West Virginia	1989

CHARLOTTE BRANCH

Appointed by the Federal Reserve Bank		
James M. Culberson, Jr.	Chairman and President, The First National Bank of Randolph County, Asheboro, North Carolina	1987
J. Donald Collier	Orangeburg, South Carolina	1988

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		Term expires Dec. 31
James G. Lindley	Chairman and Chief Executive Officer, South Carolina National Corporation, and Chairman, President, and Chief Executive Officer, The South Carolina National Bank, Columbia, South Carolina	1988
John A. Hardin	Chairman of the Board and President, First Federal Savings Bank, Rock Hill, South Carolina	1989

Appointed by the Board of Governors

Vacancy		1987
G. Alex Bernhardt	President, Bernhardt Industries, Inc., Lenoir, North Carolina	1988
Wallace J. Jorgenson	President, Jefferson–Pilot Communications Company, Charlotte, North Carolina	1989

District 6—ATLANTA

Class A

E. B. Robinson, Jr.	Chairman and Chief Executive Officer, Deposit Guaranty National Bank and Deposit Guaranty Corporation, Jackson, Mississippi	1987
Virgil H. Moore, Jr.	Chairman and Chief Executive Officer, First Farmers and Merchants National Bank, Columbia, Tennessee	1988
Mary W. Walker	Vice Chairman, The National Bank of Walton County, Monroe, Georgia	1989

Class B

Horatio C. Thompson	President, Horatio Thompson Investments, Inc., Baton Rouge, Louisiana	1987
Bernard F. Sliger	President, Florida State University, Tallahassee, Florida	1988
Paul W. Green	President and Chief Executive Officer, American Cast Iron Pipe Company, Birmingham, Alabama	1989

Class C

Jane C. Cousins	President, Cousins Properties, Miami, Florida	1987
Larry L. Prince	President and Chief Operating Officer, Genuine Parts Company, Atlanta, Georgia	1988
Bradley Currey, Jr.	President, Rock–Tenn Company, Norcross, Georgia	1989

BIRMINGHAM BRANCH

Appointed by the Federal Reserve Bank

Willard L. Hurley	Chairman and Chief Executive Officer, First Alabama Bancshares, Inc., Birmingham, Alabama	1987

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		Term expires Dec. 31
William F. Childress	President, First American Federal Savings and Loan Association, Huntsville, Alabama	1988
Milton A. Wendland	Owner–Operator, Autauga Farming Company, Autaugaville, Alabama	1988
John H. Newman	President and Chief Executive Officer, First National Bank of Scottsboro, Scottsboro, Alabama	1989

Appointed by the Board of Governors

A. G. Trammell	President, Alabama Labor Council, AFL–CIO, Birmingham, Alabama	1987
Roy D. Terry	President and Chief Executive Officer, Terry Manufacturing Company, Inc., Roanoke, Alabama	1988
Nelda P. Stephenson	President, Nelda Stephenson Chevrolet, Inc., Florence, Alabama	1989

JACKSONVILLE BRANCH

Appointed by the Federal Reserve Bank

Buell G. Duncan, Jr.	Chairman of the Board and Chief Executive Officer, Sun Bank, N.A., Orlando, Florida	1987
Robert R. Deison	Chairman of the Board and President, Andrew Jackson State Savings and Loan Association, Tallahassee, Florida	1988
George W. Gibbs III	President, Atlantic Dry Dock Corporation, Jacksonville, Florida	1988
A. Bronson Thayer	Chairman and Chief Executive Officer, First Florida Banks, Inc., Tampa, Florida	1989

Appointed by the Board of Governors

Andrew A. Robinson	Director, Florida Institute of Education, University of North Florida, Jacksonville, Florida	1987
E. William Nash, Jr.	President, South-Central Operations, The Prudential Insurance Company of America, Jacksonville, Florida	1988
Saundra H. Gray	Co-Owner, Gemini Springs Farm, DeBary, Florida	1989

MIAMI BRANCH

Appointed by the Federal Reserve Bank

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
William H. Losner	President and Chief Executive Officer, The First National Bank of Homestead, Homestead, Florida	1988
James H. Robinson	President, Sun Bank/South Florida, N.A., Fort Lauderdale, Florida	1989

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Appointed by the Board of Governors		*Term expires Dec. 31*
Robert D. Apelgren	President, Apelgren Corporation, Pahokee, Florida	1987
Sue McCourt Cobb	Attorney, Greenberg, Traurig, Askew, Hoffman, Lipoff, Rosen, and Quentel, P.A., Miami, Florida	1988
Jose L. Saumat	President, Kaufman and Roberts, Inc., Miami, Florida	1989

NASHVILLE BRANCH

Appointed by the Federal Reserve Bank		
Will A. Hildreth	President and Chief Executive Officer, First National Bank of Loudon County, Lenoir City, Tennessee	1987
W. L. Calloway, Jr.	Chairman, Quality Lawn Systems, Inc., Nashville, Tennessee	1988
Shirley A. Zeitlin	President, Shirley Zeitlin & Co. Realtors, Nashville, Tennessee	1988
Dennis C. Bottorff	Chairman and Chief Executive Officer, Sovran Financial Corporation/Central South, Nashville, Tennessee	1989

Appointed by the Board of Governors		
C. Warren Neel	Dean, College of Business Administration, The University of Tennessee, Knoxville, Tennessee	1987
Condon S. Bush	President, Bush Brothers & Company, Dandridge, Tennessee	1988
Patsy R. Williams	Partner, Rhyne Lumber Company, Newport, Tennessee	1989

NEW ORLEANS BRANCH

Appointed by the Federal Reserve Bank		
James G. Boyer	Chairman, President, and Chief Executive Officer, Premier Bank of Lake Charles, N.A., Lake Charles, Louisiana	1987
Alan R. Barton	President and Chief Executive Officer, Mississippi Power Company, Gulfport, Mississippi	1988
Robert M. Shofstahl	President and Chief Executive Officer, Pelican Homestead and Savings Association, Metairie, Louisiana	1988
Robert S. Gaddis	President and Chief Executive Officer, Commercial National Bank & Trust Co., Laurel, Mississippi	1989

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Appointed by the Board of Governors		*Term expires Dec. 31*
Caroline G. Theus	President, Inglewood Land and Development Company, Alexandria, Louisiana	1987
Sharon A. Perlis	President, Sharon A. Perlis, (APLC), Metairie, Louisiana	1988
James A. Hefner	President, Jackson State University, Jackson, Mississippi	1989

District 7—CHICAGO

Class A

Barry F. Sullivan	Chairman of the Board and Chief Executive Officer, First National Bank of Chicago, Chicago, Illinois	1987
John W. Gabbert	President and Chief Executive Officer, First of America Bank–LaPorte, N.A., LaPorte, Indiana	1988
B. F. Backlund	President and Chief Executive Officer, Bartonville Bank, Bartonville, Illinois	1989

Class B

Edward D. Powers	Chairman of the Board, Mueller Company, Decatur, Illinois	1987
Max J. Naylor	Farmer, Jefferson, Iowa	1988
Paul J. Schierl	President and Chief Executive Officer, Fort Howard Paper Company, Green Bay, Wisconsin	1989

Class C

Marcus Alexis	Dean, College of Business Administration, University of Illinois at Chicago, Chicago, Illinois	1987
Charles S. McNeer	Chairman of the Board and Chief Executive Officer, Wisconsin Electric Power Company, Milwaukee, Wisconsin	1988
Robert J. Day	Chairman and Chief Executive Officer, USG Corporation, Chicago, Illinois	1989

DETROIT BRANCH

Appointed by the Federal Reserve Bank

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
Donald R. Mandich	Chairman and Chief Executive Officer, Comerica Bank–Detroit, Detroit, Michigan	1988
Ronald D. Story	Chairman and President, The Ionia County National Bank of Ionia, Ionia, Michigan	1989

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		Term expires Dec. 31
Appointed by the Board of Governors		
Robert E. Brewer	Senior Vice President (Retired), Accounting Administration & Financial Services, K Mart Corporation, Troy, Michigan	1987
Phyllis E. Peters	Director, Professional Standards Review, Touche Ross & Company, Detroit, Michigan	1988
Richard T. Lindgren	President and Chief Executive Officer, Cross & Trecker Corporation, Bloomfield Hills, Michigan	1989

District 8—ST. LOUIS

Class A		
H. L. Hembree III	Chairman of the Board and Chief Executive Officer, Arkansas Best Corporation, Fort Smith, Arkansas	1987
Paul K. Reynolds	President and Chief Executive Officer, The First National Bank of Pittsfield, Pittsfield, Illinois	1988
David W. Kemper II	Chairman and Chief Executive Officer, Commerce Bank of St. Louis, N.A., Clayton, Missouri, and President and Chief Executive Officer, Commerce Bancshares, Inc., Kansas City, Missouri	1989
Class B		
Jesse M. Shaver	President, JMS Corporation, Louisville, Kentucky	1987
Robert J. Sweeney	President and Chief Executive Officer, Murphy Oil Corporation, El Dorado, Arkansas	1988
Frank M. Mitchener, Jr.	President, Mitchener Farms, Inc., Sumner, Mississippi	1989
Class C		
W. L. Hadley Griffin	Chairman of the Executive Committee, Brown Group, Inc., St. Louis, Missouri	1987
Robert L. Virgil, Jr.	Dean, Washington University School of Business, St. Louis, Missouri	1988
H. Edwin Trusheim	Chairman, President, and Chief Executive Officer, General American Life Insurance Company, St. Louis, Missouri	1989

LITTLE ROCK BRANCH

Appointed by the Federal Reserve Bank		
Wilbur P. Gulley, Jr.	Chairman of the Board, Savers Federal Savings and Loan Association, Little Rock, Arkansas	1987
W. Wayne Hartsfield	President and Chief Executive Officer, First National Bank, Searcy, Arkansas	1987

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		Term expires Dec. 31
Robert C. Connor, Jr.	President, Union National Bank of Little Rock, Little Rock, Arkansas	1988
Patricia M. Townsend	President, Townsend Company, Stuttgart, Arkansas	1989

Appointed by the Board of Governors

Sheffield Nelson	Attorney at Law, Little Rock, Arkansas	1987
James R. Rodgers	Airport Manager, Little Rock Regional Airport, Little Rock, Arkansas	1988
L. Dickson Flake	President, Barnes, Quinn, Flake & Anderson, Inc., Little Rock, Arkansas	1989

LOUISVILLE BRANCH

Appointed by the Federal Reserve Bank

John E. Darnell, Jr.	Chairman of the Board, The Owensboro National Bank, Owensboro, Kentucky	1987
R. I. Kerr, Jr.	Chairman of the Board and Chief Executive Officer, Great Financial Federal, Louisville, Kentucky	1987
Allan S. Hanks	Director, The Anderson National Bank of Lawrenceburg, Lawrenceburg, Kentucky	1988
Morton Boyd	President, First Kentucky National Corporation, Louisville, Kentucky	1989

Appointed by the Board of Governors

Raymond M. Burse	President, Kentucky State University, Frankfort, Kentucky	1987
Lois H. Gray	Chairman of the Board, James N. Gray Construction Company, Inc., Glasgow, Kentucky	1988
Thomas A. Alvey	Delegate and Past President, Owensboro Council of Labor, Owensboro, Kentucky	1989

MEMPHIS BRANCH

Appointed by the Federal Reserve Bank

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
William H. Brandon, Jr.	President, First National Bank of Phillips County, Helena, Arkansas	1988
Michael J. Hennessey	President, Munro & Company, Inc., Wynne, Arkansas	1989

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Appointed by the Board of Governors		*Term expires Dec. 31*
G. Rives Neblett	Neblett and Havens, Attorneys at Law, Shelby, Mississippi	1987
Katherine Hinds Smythe	President, Memorial Park, Inc., Memphis, Tennessee	1988
Sandra B. Sanderson	President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi	1989

District 9—MINNEAPOLIS

Class A

Thomas M. Strong	President, Citizens State Bank, Ontonagon, Michigan	1987
Duane W. Ring	President, Norwest Bank La Crosse, N.A., La Crosse, Wisconsin	1988
Charles W. Ekstrum	President and Chief Executive Officer, First National Bank, Philip, South Dakota	1989

Class B

William L. Mathers	President, Mathers Land Company, Miles City, Montana	1987
Richard L. Falconer	District Staff Manager, Northwestern Bell, Minneapolis, Minnesota	1988
Keith D. Bjerke	Owner, Spruce Row Farm, Northwood, North Dakota	1989

Class C

Michael W. Wright	Chairman and Chief Executive Officer, Super Valu Stores, Inc., Minneapolis, Minnesota	1987
John A. Rollwagen	Chairman and Chief Executive Officer, Cray Research, Inc., Minneapolis, Minnesota	1988
John B. Davis, Jr.	President Emeritus, Macalester College, St. Paul, Minnesota	1989

HELENA BRANCH

Appointed by the Federal Reserve Bank

F. Charles Mercord	President and Managing Officer, First Federal Savings Bank of Montana, Kalispell, Montana	1987
Noble E. Vosburg	President and Chief Executive Officer, Pacific Hide and Fur Corporation, Great Falls, Montana	1988
Robert H. Waller	President and Chief Executive Officer, First Interstate Bank of Billings, N.A., Billings, Montana	1988

Appointed by the Board of Governors

Warren H. Ross	President, Ross 8–7 Ranch, Inc., Chinook, Montana	1987
Marcia S. Anderson	President, Bridger Canyon Stallion Station, Inc., Bozeman, Montana	1988

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District 10—KANSAS CITY

		Term expires Dec. 31
Class A		
Donald D. Hoffman	Chairman of the Board, Central Bank of Denver, Denver, Colorado	1987
Robert L. Hollis	Chairman of the Board and Chief Executive Officer, First National Bank & Trust Co., Okmulgee, Oklahoma	1988
Harold L. Gerhart, Jr.	President and Chief Executive Officer, First National Bank, Newman Grove, Nebraska	1989
Class B		
S. Dean Evans, Sr.	Partner, Evans Grain Company, Salina, Kansas	1987
Jerry D. Geist	Chairman and President, Public Service Company of New Mexico, Albuquerque, New Mexico	1988
Richard D. Harrison	Chairman and Chief Executive Officer, Fleming Companies, Inc., Oklahoma City, Oklahoma	1989
Class C		
Robert G. Lueder	Chairman of the Board, Lueder Construction Company, Omaha, Nebraska	1987
Irvine O. Hockaday, Jr.	President and Chief Executive Officer, Hallmark Cards, Inc., Kansas City, Missouri	1988
Fred W. Lyons, Jr.	President and Chief Executive Officer, Marion Laboratories, Inc., Kansas City, Missouri	1989

DENVER BRANCH

Appointed by the Federal Reserve Bank		
Junius F. Baxter	Chairman of the Board and Chief Executive Officer, Bank Western Federal Savings Bank, Denver, Colorado	1987
George S. Jenks	President and Chief Executive Officer, Sunwest Financial Services, Inc., Albuquerque, New Mexico	1988
W. Richard Scarlett III	President, Jackson State Bank, Jackson Hole, Wyoming	1988
Roger L. Reisher	Co-Chairman, FirstBank Holding Company of Colorado, Lakewood, Colorado	1989
Appointed by the Board of Governors		
James E. Nielson	President and Chief Executive Officer, JN Incorporated, Cody, Wyoming	1987
Anthony W. Williams	Attorney, Williams, Turner, & Holmes, P.C., Grand Junction, Colorado	1988
James C. Wilson	Management Consultant, Longmont, Colorado	1989

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OKLAHOMA CITY BRANCH

		Term expires Dec. 31
Appointed by the Federal Reserve Bank		
William H. Crawford	Chairman and Chief Executive Officer, First National Bank and Trust Company, Frederick, Oklahoma	1987
William O. Alexander	Chairman, Continental Federal Savings and Loan Association, Oklahoma City, Oklahoma	1988
W. Dean Hidy	Chairman of the Board, Triad Bank, N.A., Tulsa, Oklahoma	1988
Appointed by the Board of Governors		
Patience S. Latting	Oklahoma City, Oklahoma	1987
John F. Snodgrass	President and Trustee, The Samuel Roberts Noble Foundation, Inc., Ardmore, Oklahoma	1988

OMAHA BRANCH

Appointed by the Federal Reserve Bank		
John T. Selzer	President, Scottsbluff National Bank and Trust Company, Scottsbluff, Nebraska	1987
Charles H. Thorne	Chairman of the Board and Chief Executive Officer, First Federal Savings and Loan Association of Lincoln, Lincoln, Nebraska	1987
John R. Cochran	President and Chief Executive Officer, Norwest Bank Nebraska, N.A., Omaha, Nebraska	1988
Appointed by the Board of Governors		
Kenneth L. Morrison	President, Morrison Enterprises, Hastings, Nebraska	1987
Janice D. Stoney	President and Chief Executive Officer, Northwestern Bell Telephone Company, Omaha, Nebraska	1988

District 11—DALLAS

Class A		
Gene Edwards	Director and Consultant, First National Bank of Amarillo, Amarillo, Texas	1987
Charles T. Doyle	Chairman and Chief Executive Officer, Gulf National Bank, Texas City, Texas	1988
Robert G. Greer	Chairman of the Board, Tanglewood Bank, N.A., Houston, Texas	1989
Class B		
Robert L. Pfluger	Rancher, San Angelo, Texas	1987
Robert Ted Enloe III	President, Lomas & Nettleton Financial Corporation, Dallas, Texas	1988
Gary E. Wood	Director of Governmental Relations, Baylor University, Waco, Texas	1989

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Class C		Term expires Dec. 31
Bobby R. Inman	Chairman of the Board and Chief Executive Officer, Westmark Systems Inc., Austin, Texas	1987
Hugh G. Robinson	President, Cityplace Development Corporation, Dallas, Texas	1988
Leo E. Linbeck, Jr.	Chairman and Chief Executive Officer, Linbeck Construction Corporation, Houston, Texas	1989

EL PASO BRANCH

Appointed by the Federal Reserve Bank

Henry B. Ellis	President and Chief Credit Officer, MBank El Paso, N.A., El Paso, 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
Humberto F. Sambrano	Partner, Urban General Contractors, Inc., El Paso, Texas	1988
David L. Stone	President, The Portales National Bank, Portales, New Mexico	1989

Appointed by the Board of Governors

Mary Carmen Saucedo	Vice President, Saucedo Brothers, Inc., El Paso, Texas	1987
Peyton Yates	President, Yates Drilling Company, Artesia, New Mexico	1988
John R. Sibley	President, Delaware Mountain Enterprises, Carlsbad, New Mexico	1989

HOUSTON BRANCH

Appointed by the Federal Reserve Bank

Thomas B. McDade	Vice Chairman (Retired), Texas Commerce Bancshares, Inc., Houston, Texas	1987
David E. Sheffield	Director, First Victoria National Bank, Victoria, Texas	1987
Jeff Austin, Jr.	President, First National Bank of Jacksonville, Jacksonville, Texas	1988
Jenard M. Gross	Chairman of the Board and Chief Executive Officer, United Savings Association of Texas, Houston, Texas	1989

Appointed by the Board of Governors

Andrew L. Jefferson, Jr.	Attorney, Jefferson, Mims and Plummer, Houston, Texas	1987
Gilbert D. Gaedcke, Jr.	Chairman of the Board and Chief Executive Officer, Gaedcke Equipment Company, Houston, Texas	1988
Walter M. Mischer, Jr.	President, The Mischer Corporation, Houston, Texas	1989

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SAN ANTONIO BRANCH		*Term expires Dec. 31*
Appointed by the Federal Reserve Bank		
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, First RepublicBank Austin, Austin, Texas	1987
Jane Flato Smith	Rancher, San Antonio, Texas	1988
C. Ivan Wilson	Chairman of the Board and Chief Executive Officer, First City Bank of Corpus Christi, Corpus Christi, Texas	1989
Appointed by the Board of Governors		
Ruben M. Garcia	Chief Executive Officer, Modern Machine Shop, Inc., Laredo, Texas	1987
Robert F. McDermott	Chairman of the Board and President, United Services Automobile Association, San Antonio, Texas	1988
Lawrence E. Jenkins	Vice President, Austin Division, Lockheed Missiles & Space Co., Inc., Austin, Texas	1989

District 12—SAN FRANCISCO

Class A		
Donald J. Gehb	President and Chief Executive Officer, Alameda Bancorporation and Alameda First National Bank, Alameda, California	1987
Spencer F. Eccles	Chairman and Chief Executive Officer, First Security Corporation, Salt Lake City, Utah	1988
Rayburn S. Dezember	Chairman, President, and Chief Executive Officer, Central Pacific Corporation, and Chairman, American National Bank, Bakersfield, California	1989
Class B		
George H. Weyerhaeuser	President and Chief Executive Officer, Weyerhaeuser Company, Tacoma, Washington	1987
Togo W. Tanaka	Chairman, Gramercy Enterprises, Inc., Los Angeles, California	1988
John C. Hampton	President, Willamina Lumber Company, Portland, Oregon	1989
Class C		
Fred W. Andrew	Partner, Andrew & Williamson Sales Co., Bakersfield, California	1987

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		Term expires Dec. 31
Carolyn S. Chambers	President and Chief Executive Officer, Chambers Communications Corp., Eugene, Oregon	1988
Robert F. Erburu	Chairman of the Board and Chief Executive Officer, The Times Mirror Company, Los Angeles, California	1989

LOS ANGELES BRANCH

Appointed by the Federal Reserve Bank

Robert R. Dockson	Chairman of the Board, CalFed, Inc., and California Federal Savings and Loan Association, Los Angeles, California	1987
Howard C. McCrady	Chairman of the Board and Chief Executive Officer, Valley National Bank of Arizona, Phoenix, Arizona	1988
William L. Tooley	Chairman, Tooley & Company, Investment Builders, Los Angeles, California	1988
Fred D. Jensen	Chairman of the Board, President, and Chief Executive Officer, National Bank of Long Beach, Long Beach, California	1989

Appointed by the Board of Governors

Richard C. Seaver	Chairman, Hydril Company, Los Angeles, California	1987
Thomas R. Brown, Jr.	Chairman of the Board, Burr–Brown Corporation, Tucson, Arizona	1988
Yvonne Brathwaite Burke	Partner, Jones, Day, Reavis & Pogue, Los Angeles, California	1989

PORTLAND BRANCH

Appointed by the Federal Reserve Bank

John A. Elorriaga	Chairman of the Board and Chief Executive Officer, United States National Bank of Oregon, Portland, Oregon	1987
G. Dale Weight	Chairman of the Board and Chief Executive Officer, Benjamin Franklin Savings and Loan Association, Portland, Oregon	1987
Herman C. Bradley, Jr.	President and Chief Executive Officer, Tri-County Banking Company, Junction City, Oregon	1988
Wayne E. Phillips, Jr.	Vice President, Phillips Ranch, Inc., Baker, Oregon	1989

Appointed by the Board of Governors

Sandra A. Suran	Partner, Peat, Marwick, Mitchell & Co., Portland, Oregon	1987
G. Johnny Parks	Former Northwest Regional Director, International Longshoremen's and Warehousemen's Union, Portland, Oregon	1988
Paul E. Bragdon	President, Reed College, Portland, Oregon	1989

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SALT LAKE CITY BRANCH

		Term expires Dec. 31
Appointed by the Federal Reserve Bank		
Lela M. Ence	Executive Director, University of Utah Alumni Association, Salt Lake City, Utah	1987
Fred C. Humphreys	Director and Former Chairman of the Board, Moore Financial Group, Boise, Idaho	1987
Gerald R. Christensen	Chairman and President, First Federal Savings and Loan Association, Salt Lake City, Utah	1988
Ronald S. Hanson	President, Zions First National Bank, Salt Lake City, Utah	1989
Appointed by the Board of Governors		
Don M. Wheeler	President, Wheeler Machinery Company, Salt Lake City, Utah	1987
D. N. Rose	President and Chief Executive Officer, Mountain Fuel Supply Company, Salt Lake City, Utah	1988
Robert N. Pratt	President and Chief Operating Officer, Bonneville Pacific Corporation, Salt Lake City, Utah	1989

SEATTLE BRANCH

Appointed by the Federal Reserve Bank		
John N. Nordstrom	Co-Chairman of the Board, Nordstrom, Inc., Seattle, Washington	1987
William S. Randall	Chairman, President, and Chief Executive Officer, First Interstate Bank of Washington, N.A., Seattle, Washington	1987
W.W. Philip	Chairman of the Board and Chief Executive Officer, Puget Sound Bancorp, Tacoma, Washington	1988
H. H. Larison	President, Columbia Paint Company, Spokane, Washington	1989
Appointed by the Board of Governors		
John W. Ellis	President and Chief Executive Officer, Puget Sound Power & Light Company, Bellevue, Washington	1987
Byron I. Mallott	Chief Executive Officer, Sealaska Corporation, Juneau, Alaska	1988
Carol A. Nygren	Managing Partner, Laventhol & Horwath, Seattle, Washington	1989

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