

---

*75th Annual  
Report  
1988*



*Board of Governors of the Federal Reserve System*

---

---

*Letter of Transmittal*

**BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM**  
Washington, D.C., May 15, 1989

**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-Fifth Annual Report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 1988.

Sincerely,

Alan Greenspan, *Chairman*

---

# *Contents*

## *Part 1 Monetary Policy and the U.S. Economy in 1988*

- 3 INTRODUCTION
  
- 5 THE ECONOMY IN 1988
  - 5 The household sector
  - 7 The business sector
  - 8 The government sector
  - 9 The labor markets
  - 10 Price developments
  
- 12 MONETARY POLICY AND FINANCIAL MARKETS IN 1988
  - 12 Monetary policy in 1988
  - 15 Monetary aggregates
  - 16 Credit market developments
  
- 19 INTERNATIONAL DEVELOPMENTS
  - 20 Foreign economies
  - 22 U.S. international transactions
  - 24 Foreign currency operations
  
- 25 MONETARY POLICY REPORTS TO THE CONGRESS
  - 25 Report on February 23, 1988
  - 41 Report on July 13, 1988

---

## *Part 2 Records, Operations, and Organization*

- 63 RECORD OF POLICY ACTIONS OF THE BOARD OF GOVERNORS
- 63 Regulation C (Home Mortgage Disclosure)
- 63 Regulation D (Reserve Requirements of Depository Institutions)
- 64 Regulation K (International Banking Operations)
- 65 Regulation T (Credit by Brokers and Dealers)
- 65 Regulation Y (Bank Holding Companies and Change in Bank Control)
- 65 Regulation CC (Availability of Funds and Collection of Checks)
- 67 Policy statements
- 68 1988 discount rates
  
- 73 RECORD OF POLICY ACTIONS  
OF THE FEDERAL OPEN MARKET COMMITTEE
- 73 Authorization for domestic open market operations
- 75 Domestic policy directive
- 76 Authorization for foreign currency operations
- 78 Foreign currency directive
- 78 Meeting held on February 9–10, 1988
- 89 Meeting held on March 29, 1988
- 97 Meeting held on May 17, 1988
- 104 Meeting held on June 29–30, 1988
- 114 Meeting held on August 16, 1988
- 121 Meeting held on September 20, 1988
- 126 Meeting held on November 1, 1988
- 134 Meeting held on December 13–14, 1988
  
- 143 CONSUMER AND COMMUNITY AFFAIRS
- 143 Regulatory matters
- 147 Community affairs
- 148 Examination procedures
- 149 Compliance with consumer regulations
- 151 Economic effect of the Electronic Funds Transfer Act
- 152 Complaints against state member banks
- 153 Unregulated practices
- 154 Community Reinvestment Act
- 155 Consumer Advisory Council
- 156 Testimony and legislative recommendations
- 158 Recommendations of other agencies

---

159	<b>LITIGATION</b>
159	Bank holding companies – antitrust action
159	Bank Holding Company Act – review of Board actions
160	Other litigation involving challenges to Board procedures and regulations
163	<b>LEGISLATION ENACTED</b>
163	Omnibus Trade and Competitiveness Act of 1988
164	Management Interlocks Revision Act of 1988
164	Anti-Drug Abuse Act of 1988
165	Fair Credit and Charge Card Disclosure Act of 1988
165	Home Equity Loan Consumer Protection Act of 1988
166	Women’s Business Ownership Act of 1988
166	Housing and Community Development Act of 1987
167	<b>BANKING SUPERVISION AND REGULATION</b>
168	Risk-based capital
168	Supervision for safety and soundness
172	Supervisory policy
174	Regulation of the U.S. banking structure
178	International activities of U.S. banking organizations
179	Enforcement of other laws and regulations
182	Federal Reserve membership
183	<b>REGULATORY SIMPLIFICATION</b>
183	Availability of information
183	Home mortgage disclosure
183	Debt–equity swaps
184	Issuance of foreign currency deposits
184	OTC margin bond
184	Efforts to assist regulatory compliance
185	<b>FEDERAL RESERVE BANKS</b>
185	Regulation CC
186	Other developments in the pricing of Federal Reserve services and in the payments mechanism
189	Examinations
189	Income and expenses
190	Federal Reserve Bank premises
191	Holdings of securities and loans
191	Volume of operations
191	Financial statements for priced services

---

197 BOARD OF GOVERNORS FINANCIAL STATEMENTS

203 STATISTICAL TABLES

- 204 1. Detailed statement of condition of all Federal Reserve Banks combined, December 31, 1988
- 206 2. Statement of condition of each Federal Reserve Bank, December 31, 1988 and 1987
- 210 3. Federal Reserve open market transactions, 1988
- 212 4. Federal Reserve Bank holdings of U.S. Treasury and federal agency securities, December 31, 1986-88
- 213 5. Number and salaries of officers and employees of Federal Reserve Banks, December 31, 1988
- 214 6. Income and expenses of Federal Reserve Banks, 1988
- 218 7. Income and expenses of Federal Reserve Banks, 1914-88
- 222 8. Acquisition costs and net book value of premises of Federal Reserve Banks and Branches, December 31, 1988
- 223 9. Operations in principal departments of Federal Reserve Banks, 1985-88
- 224 10. Federal Reserve Bank interest rates, December 31, 1988
- 225 11. Reserve requirements of depository institutions
- 226 12. Initial margin requirements under Regulations T, U, G, and X
- 227 13. Principal assets and liabilities and number of insured commercial banks, by class of bank, June 30, 1988 and 1987
- 228 14. Reserves of depository institutions, Federal Reserve Bank credit, and related items - year-end 1918-88, and month-end 1988
- 232 15. Changes in number of banking offices in the United States, 1988
- 233 16. Mergers, consolidations, and acquisitions of assets or assumptions of liabilities approved by the Board of Governors, 1988

241 FEDERAL RESERVE DIRECTORIES AND MEETINGS

- 242 Board of Governors of the Federal Reserve System
- 244 Federal Open Market Committee
- 245 Federal Advisory Council
- 246 Consumer Advisory Council
- 247 Thrift Institutions Advisory Council
- 248 Officers of Federal Reserve Banks, Branches, and Offices

271 INDEX

280 MAPS OF THE FEDERAL RESERVE SYSTEM

---

*Part 1*

*Monetary Policy and  
the U.S. Economy in 1988*

## Introduction

Overall, 1988 was another year of progress for the U.S. economy, with further substantial increases in output and employment and a significant improvement in the balance of trade. Although the dramatic stock market break of October 1987 seemed to slow real activity for a time around the start of 1988, the underlying strength of the economy soon showed through, and apart from losses of farm output caused by the drought, growth proceeded at a relatively strong pace throughout the year.

Inflation remained in check during 1988. Even so, developments were a bit worrisome as, for a second year, increases in prices were somewhat larger than in earlier years of the expansion. Part of the pressure on prices in 1988 came in the food area and reflected the influence of the drought. However, with labor markets tightening, the rise of wages and total hourly compensation quickened and affected prices more generally.

Federal Reserve policy mirrored the changing economic circumstances of 1988. Early in the year, as in late 1987, the Federal Reserve sought to limit repercussions from the plunge in stock prices and, in particular, to guard against the possibility of a significant contraction in business activity. Pressures on the reserve positions of depository institutions were eased a bit further in early 1988, and interest rates edged down for a time, extending the declines

that had begun in October of 1987. Growth of M2 and M3 was fairly rapid during this period, nearly reaching the upper bounds of the annual target ranges established by the Federal Open Market Committee.

As it became clear in the spring of 1988 that the economy still was strong, the focus of Federal Reserve policy shifted. For much of the year, the rapid growth of spending and a continued tightening of markets for labor and products caused concern about a worsening of inflation. A sharp upswing in real net exports of goods and services that had begun in 1987 continued into 1988; while this upturn was a welcome and necessary part of the adjustment of the U.S. economy toward a better balance in its external accounts, it also intensified the demands on U.S. producers at a time when the utilization of domestic labor and capital already was quite high. Accommodating the improvement in our external position while limiting the risk of heightened inflation required restraint on the growth of domestic demand.

The shift by the Federal Reserve toward restraint was reflected in a tightening of the reserve market that began in late March and continued, in several steps, into 1989. Short-term market interest rates moved up during this period, influenced both by the System's tightening and the strength of the economy, and the Board of Governors approved a ½ percentage point increase in the discount rate in August, to 6½ percent. Growth of M2 moderated after the spring and ended the year just below the middle of the 1988 target range. The growth of M3 also ebbed over the last two quarters of the year as the needs of

---

NOTE. This discussion of economic and financial developments in 1988 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 1989).



banks and thrifts to fund credit expansion slackened.

Short-term interest rates at the end of 1988 were about 2½ percentage points higher than they were early in the spring. Long-term interest rates, by contrast, changed little on net over that same period; and the stock market moved up fairly steadily over the course of the year, recovering more than a third of the losses of the previous October. These favorable trends in the bond and stock markets, in the face of rising short-term interest rates, suggested that investors maintained a relatively optimistic view of the long-run prospects for the U.S. economy.

If that optimism is, in fact, to be justified by events, then both private citizens and the government must continue to work to correct economic imbalances that remain and to address new challenges. In the private sector, business and labor are in the process of adjusting to a world economy that has become far more competitive than it was over much of the postwar period, and only part of that adjustment was accomplished in 1988. Further progress will demand a continuing commitment on the part of U.S. firms to capitalize on the enhanced competitiveness resulting from the depreciation of the dollar since 1985. That commitment must take the form not only of continued cost control and price restraint but also of more intense efforts at marketing abroad and investment in new capacity where constraints are visible. Failure on these counts would almost certainly leave the U.S. economy considerably less well off over the long haul.

Government policy can encourage businesses to make the longer-range commitments needed to bring about better balance in the economy and to foster longer-run growth. A monetary policy directed steadfastly at movement toward price stability is an essential ingredient for promoting sustainable

growth. But also crucial is further progress toward balance in the federal budget, along the lines specified in the Gramm–Rudman–Hollings legislation. In that regard, any steps taken now to ensure continuing progress toward appropriate fiscal restraint over the longer term would likely have a particularly salutary effect on the expectations of businesses and investors and would thereby enhance considerably the long-run prospects for noninflationary growth. ■

## *The Economy in 1988*

The U.S. economy completed a sixth year of expansion in 1988. Real gross national product rose about 2¾ percent over the course of the year, the number of jobs increased more than 3½ million, and the unemployment rate remained on a downward course, closing the year at 5.3 percent, its lowest level in 14 years.<sup>1</sup> Progress also was made toward restoring external balance, as the merchandise trade deficit fell sharply.

The year began on a note of uncertainty. The sharp break in the stock market in the fall of 1987 had raised concern that the economy might falter, and some signs of weakness did emerge around the start of 1988. By early spring, however, it became clear that the expansion still had considerable vigor, particularly from rising exports and a boom in capital spending. Households, meanwhile, adjusted fairly readily to the loss of wealth in the stock market, and consumer spending rose at a strong pace throughout the year. Toward the end of the year, net exports and capital spending softened, but there was enough impetus from other sectors to keep real GNP on a firm upward course.

The rate of inflation, which had picked up in 1987, remained somewhat higher in 1988 than in earlier years. The step-up in 1987 had resulted mainly from a rebound in the price of oil and the passthrough of higher prices for imports. In 1988, by contrast, extra price pressures reflected the effect of drought on the price of food and, more generally, a widespread pickup in labor costs in the domestic economy.

The rise in real GNP in 1988 would have been about 3½ percent but for a severe drought, one of the worst of this century, which caused huge losses of farm output. These losses accounted for most of the slowdown in GNP growth that occurred after the first quarter of 1988. Fortunately, inventories of farm products had been sizable coming into 1988, and a drawdown of stocks helped to buffer households and others from the disruption to output. Within the farm sector, the drought strained the finances of some producers, but the financial condition of many others was not seriously affected, and the sector as a whole remained stronger fundamentally than in the first half of the 1980s, when the boom of the previous decade was unwinding.

In most of the nonfarm economy, the growth of activity was robust in 1988. Production in the manufacturing sector increased 5½ percent, nearly matching the previous year's gain, and factory employment rose sharply. Employment also continued to grow rapidly in retail and wholesale trade and among the providers of business and health services. However, oil drilling activity, which had turned up in 1987 when oil prices were rising, weakened over 1988, intensifying economic stresses in some parts of the country.

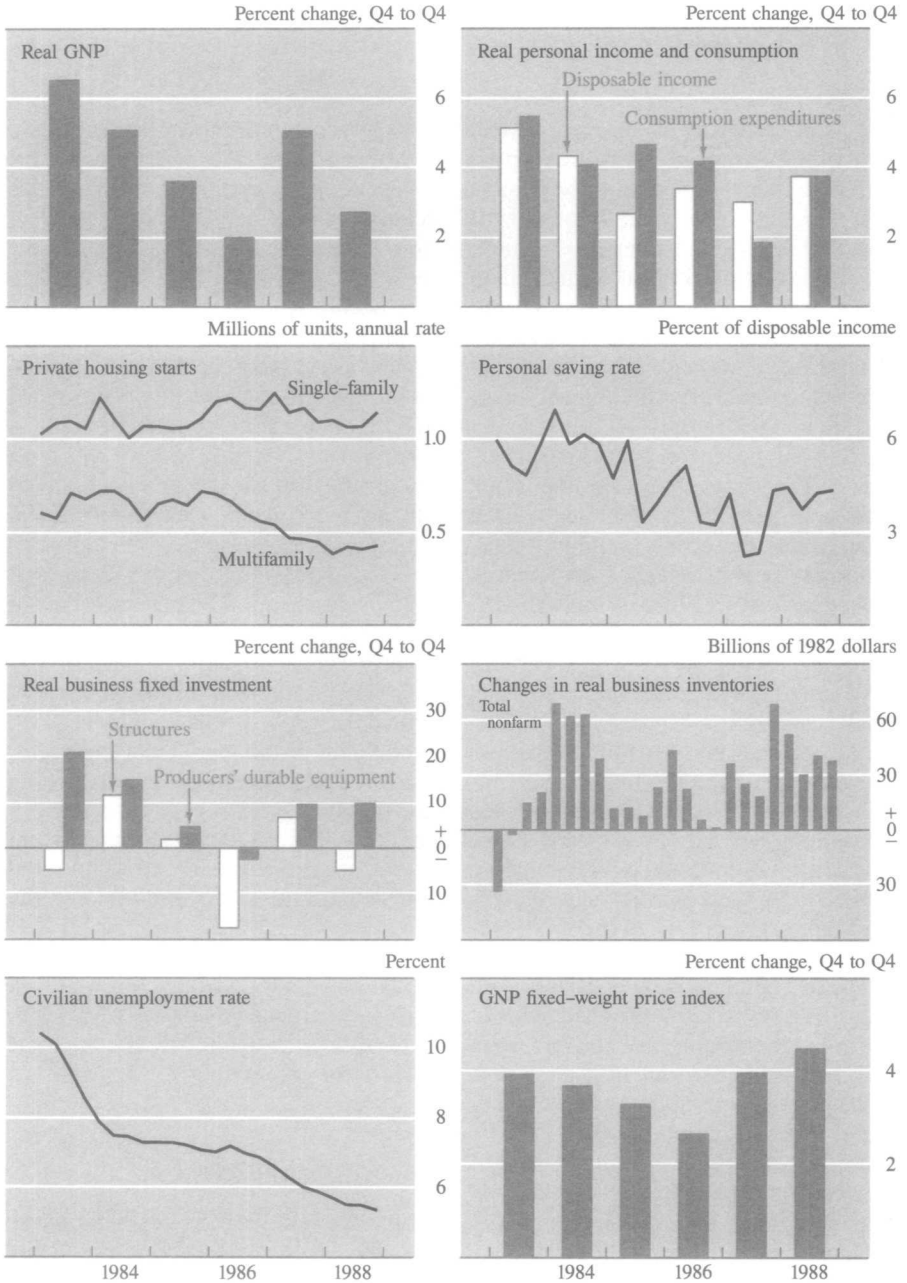
### **The Household Sector**

At the start of 1988, concern about the possible effect of the stock market break on the real economy centered on the household sector. The drop in share values had pared roughly one-half trillion dollars from household wealth, and the

---

1. Except where noted, percent changes are over the four quarters of the year indicated.

Indicators of Economic Performance



The data are seasonally adjusted. The unemployment data are from the Department of Labor; the rest are from

the Department of Commerce.

degree to which spending would be cut in response to this loss of wealth was not clear.

In the event, the loss of wealth may indeed have trimmed consumer demand. The personal saving rate rose after the crash, and over the next year it was on average about 1 percentage point higher than in the year preceding the crash. But with exports and capital investment booming, the growth of jobs and real incomes remained strong in 1988, and the uncertainties spawned by the crash soon gave way to renewed optimism among households. Thus, after the initial jump in the saving rate, real consumption expenditures grew at about the same pace as the trend in real after-tax income; the rise over the year was about 3¾ percent.

Consumer spending for durable goods was brisk in 1988. The unit sales of light trucks and vans surged in 1988, maintaining the exceptional strength that has been evident during the current expansion, and the sales of domestically produced automobiles moved up a bit from the 1987 pace. Among the household durables, real outlays for furniture and appliances, which had slowed in 1987, increased 7 percent during 1988, renewing the strength that had been evident over the 1983–86 period.

Real residential investment fell slightly in the first half of 1988; but it turned up in the second half and by the fourth quarter was a little above the level of a year earlier. Starts of multifamily housing units, which had slumped in 1987, fell further in the first quarter of 1988 and then flattened out over the remainder of the year. In the single-family sector, starts declined somewhat in the first half of 1988 but then rebounded; activity in the fourth quarter was the highest since the third quarter of 1987. By historical standards, these swings in single-family starts were relatively mild; indeed, in comparison with the boom and bust

cycles of the 1970s and early 1980s, activity in the single-family market was stable over the entire period from 1983 to 1988. Nonetheless, total housing starts in 1988 were down sharply from earlier years of the expansion because of the big drop in construction of multifamily units.

## The Business Sector

Virtually all indicators of business activity exhibited strength in 1988. Business sales, in nominal terms, rose 9 percent over the year. Hiring was brisk in most sectors, and operating rates rose further; in the industrial sector, capacity utilization at the end of 1988 was at its highest level since 1979. Corporate profits remained healthy.

A surge in spending for business equipment that had begun in 1987 extended through the first half of 1988, when outlays grew in real terms at an annual rate of about 20 percent. The surge was led by sizable investment in high-technology items—computers, communication equipment, and the like—but outlays for other types of equipment also were strong. The rise in equipment spending slowed after midyear, and some weakness became evident toward the end of the year. At year-end, however, most indicators suggested that the underlying trend in equipment spending still was positive.

Business spending for new construction declined in 1988, reversing the moderate increase of the previous year. Commercial construction, the biggest item in the total, continued to be restrained in 1988 by the big overhang of vacancies that grew out of the building boom of the mid-1980s. Gas and oil drilling, following the lead of oil prices, fell back from the pace of late 1987, but remained above the lows of 1986. Construction of buildings for industrial use was little changed over 1988; although

capacity utilization was high in manufacturing, many producers appeared to be limiting their needs for additional space by shifting toward technologies that use more compact equipment, by economizing on inventories, or by conserving on space in other ways.

Inventory investment, which had been sizable in late 1987, moderated in 1988, and with sales on an upward trajectory, stock overhangs were not a problem for most businesses. In manufacturing, stocks grew more rapidly in 1988 than they have in recent years, but much of the accumulation was in industries in which orders and shipments also were generally strong; the ratio of inventories to sales for all of manufacturing moved down during the year from the already low levels of late 1987. In retail trade, concern about a possible overhang of the stocks of nondurables eased during the year, and stocks at year-end did not appear to be burdensome. By contrast, auto dealers' stocks rose sharply in the fourth quarter; at the end of the year, auto manufacturers seemed likely to turn toward enhanced sales incentives and, perhaps, a lower assembly rate in an effort to pare inventories. For all of manufacturing and trade combined, the ratio of inventories to sales varied little over the course of 1988 and was near the lower end of the range in which it had been since the business expansion began.

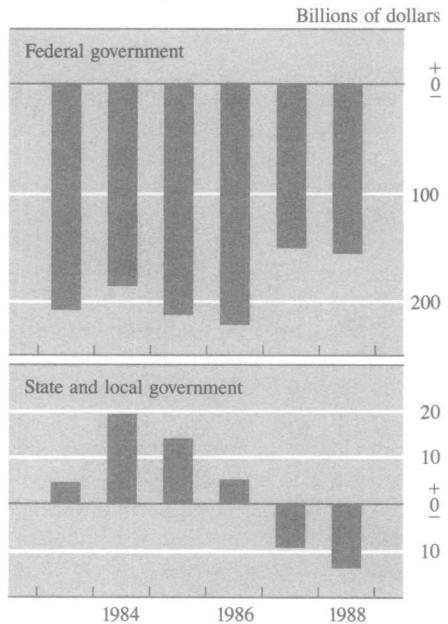
### The Government Sector

Budgetary constraints limited the growth of government purchases in 1988, both at the federal level and among many state and local governments. The federal government's purchases of goods and services—the part of federal spending that adds directly to GNP—fell 3½ percent in real terms from the fourth quarter of 1987 to the fourth quarter of 1988. Roughly two-thirds of the decline re-

flected a drought-induced reduction in the farm inventories owned or financed by the Commodity Credit Corporation (CCC), a reduction that is counted as a negative federal purchase. Excluding this inventory swing, federal purchases were down about 1 percent over the year—the first decline since 1976. Over the eight years preceding 1988, real federal purchases other than those of the CCC had risen at an average pace of nearly 5 percent, considerably faster than the growth of real GNP. The downturn in 1988 reflected cuts in the defense area; other non-CCC federal purchases rose somewhat over the year.

On a budget basis, total federal outlays, which are almost three times as great as

Government Surpluses and Deficits



The data on the federal government are for fiscal years. They are on a budget basis and come 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 come from the Department of Commerce.

federal purchases alone, were up 6 percent for fiscal 1988 as a whole. Entitlements, demands on deposit insurance agencies, and net interest payments all rose. Meanwhile, the growth of federal receipts slowed in 1988 from the rapid pace of the previous year. Receipts from social security taxes rose more than 10 percent, in part because of a rate increase in January 1988. The growth in receipts from personal income taxes slowed, however, as increases in employment and nominal incomes were offset by final reductions in income tax rates legislated in 1986. The federal budget deficit in fiscal year 1988 was \$155 billion, slightly above the level of the previous year.

The purchases of goods and services by state and local governments rose close to 3½ percent in real terms over the four quarters of 1988, more than in 1987 but less than the average rate of growth over the preceding three years. Spending for construction was little changed for 1988 as a whole, although some pickup was evident in the fourth quarter. Employment in the state and local sector increased 350,000 during 1988; a large share of the rise was among the teachers and other school workers needed to meet the growth in the number of elementary students.

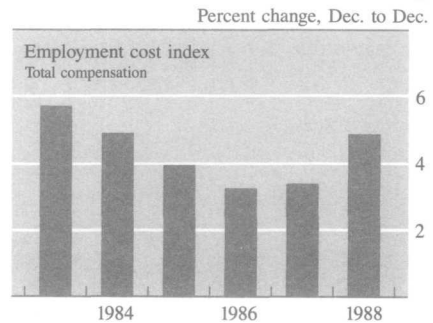
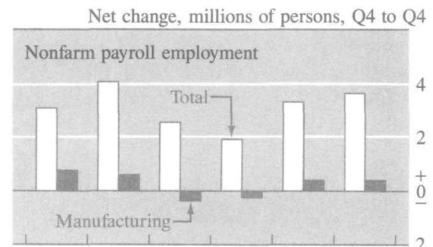
### The Labor Markets

The rise in the number of jobs during 1988 was somewhat above that of 1987 and brought the total increase in payroll employment since late 1982 to about 18½ million. Virtually all parts of the economy shared in last year's gain. Manufacturing jobs rose 400,000; construction employment was up 300,000; close to 1 million new jobs were created in retail and wholesale trade; and service employment grew by 1.3 million jobs. Except for a brief slowdown in the

summer, employment expanded strongly throughout the year.

The continued rise in employment last year led to a tightening of labor markets and called attention to limits on the potential growth of the supply of labor and of output. Growth of the working-age population has slowed in the 1980s, and the increase during 1988 was the smallest annual rise in more than two decades. This slowing of population growth in the 1980s has led in turn to a more moderate rate of growth in the labor force, even as the rate of labor force participation, especially for adult women, has continued to rise. A big boost to output during the expansion has come from the hiring of unemployed workers; however, with the unemployment rate at less than 5½ percent at the end of 1988, the labor force was more fully utilized

#### Labor Market Conditions



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

than at any time in the last decade and a half.

The tightening of labor markets in 1988 was associated with a pickup in the rise of wages and labor costs. The employment cost index for wages and salaries in the private nonfarm sector increased a bit more than 4 percent over the year—almost 1 percentage point more than in 1987. The pickup was most pronounced among white collar workers and in the service-producing industries. The cost of benefits provided to employees rose 6¾ percent over the year, nearly twice the increase of 1987; the rise reflected both the hike in the payroll tax at the start of 1988 and a surge in the cost of health benefits. Total compensation per hour—wages and salaries plus benefits—rose nearly 5 percent over the four quarters of 1988, after two years in which the annual increases had been in the neighborhood of 3¼ percent.

Productivity gains slackened somewhat in 1988. The rise in output per hour in the nonfarm business sector over the four quarters of the year was only 0.7 percent—about ½ percentage point below the average over this decade. This slippage in productivity growth in 1988, combined with the faster rate of increase in hourly compensation, resulted in a 4 percent rise in unit labor costs in the nonfarm business sector over the four quarters of 1988—well above the average rate of increase during the previous five years.

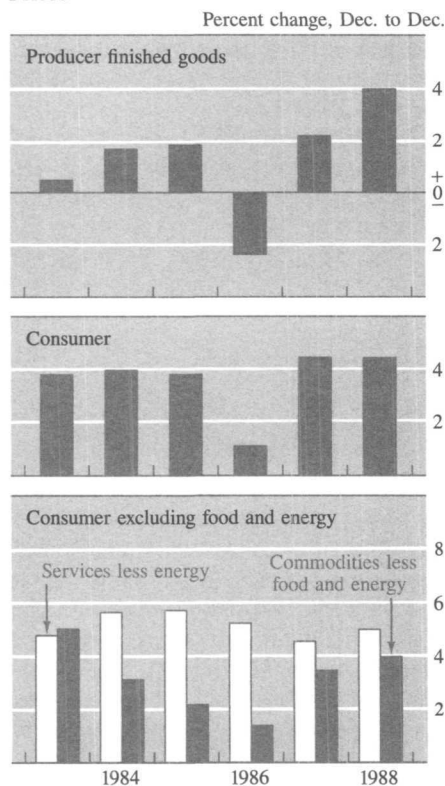
## Price Developments

The broader measures of prices—including the GNP price measures, the producer price index, and the consumer price index (the latter two measured from December to December)—all showed inflation to be in a range of 4 to 4½ percent in 1988. Except for the CPI, which had moved up at a 4½ percent rate in 1987, these measures showed some acceleration from

the previous year, and all of them—including the CPI—rose more rapidly than in earlier years of the expansion. In contrast to 1987, when the indexes were boosted by a rebound in energy prices and rising prices for imports, the inflationary pressures in 1988 were augmented by larger increases in labor costs in the U.S. economy and the drought's influence on agricultural prices.

The drought's effects on retail food prices appeared quickly, with increases on a wide variety of items evident by summer. Over the year as a whole, the increase in consumer food prices was 5¼ percent—about 2 percentage points above the average of the preceding five years.

## Prices



The data are from the Department of Labor.

Energy prices at the consumer level, particularly for oil and gasoline, had risen sharply in 1987 but were little changed in 1988—a pattern that resulted mainly from the continued gyrations in world oil markets. The price of crude oil moved lower for much of 1988 as the efforts of OPEC to restrain production unraveled. In late 1988, however, a new agreement by OPEC to limit production, coupled with production shortfalls in non-OPEC countries and higher-than-expected oil consumption, caused spot prices to rise sharply once again, back toward the upper end of the range in which they generally have been since the summer of 1986.

Price increases for goods and services other than food and energy were larger in 1988 than in 1987. The pickup, while fairly moderate, was widespread and probably reflected, in large part, the acceleration in hourly compensation and unit labor costs. By contrast, the pressures from rising import prices appeared to be a bit less pronounced than in 1987. Even so, higher prices for imports probably were an influence in some areas; the retail prices of apparel, for example, rose nearly 5 percent for the second year in a row. The price increases for industrial commodities slowed in 1988 after steep increases during 1987; by most measures, however, the year-to-year rate of rise in these prices remained somewhat above that of inflation in general. The producer prices of intermediate inputs, excluding food and energy, rose more than 7 percent during 1988, reflecting the high levels of capacity utilization in a number of industries, as well as the tightening of labor markets. ■



## *Monetary Policy and Financial Markets in 1988*

In 1988, as in other recent years, the Federal Reserve maintained a flexible approach to monetary targeting by responding to emerging conditions in the economy and in financial markets as well as to growth of the monetary aggregates themselves.

Early in the year, when the potential for fallout from the stock market crash still was an overriding concern, monetary policy was eased, augmenting policy moves that had been taken in the fourth quarter of 1987. But as it became clear that the economy still was strong and that the potential for heightened inflation was increasing, the Federal Open Market Committee tightened reserve conditions in a series of steps beginning in the spring and continuing into 1989.

Before the tightening began, the monetary aggregates had been running close to the top of their 1988 growth ranges; but growth of the aggregates slowed after the spring, and they closed the year in the middle portions of their 1988 target ranges.

In the credit markets the growth of domestic nonfinancial debt in 1988 was slightly below that of 1987 and noticeably slower than in previous years of the expansion. Even so, debt continued to grow faster than nominal GNP, largely reflecting the continued heavy demands of the federal government and the increased financing needs of corporations. With the overall economy still quite healthy in 1988, the incidence of financial stress among households and nonfinancial businesses was not widespread. However, in the financial sector, the problems of the thrift institutions worsened.

### **Monetary Policy in 1988**

During the early months of 1988, the Federal Open Market Committee sought to counter any economic weakness that could result from the stock market break and to ensure the smooth functioning of domestic financial markets. In the real economy, sales had softened late in 1987, and inventories had risen sharply. Coupled with some softening in labor market indicators early in 1988, these data seemed to point toward a greater risk of cumulative weakening in real activity. In addition, the financial markets remained somewhat unsettled during this period, and the Federal Reserve placed special emphasis on monitoring domestic financial markets for signs of any new distress. Against this backdrop, reserve conditions were eased slightly in early February, contributing to reductions in short- and long-term interest rates.

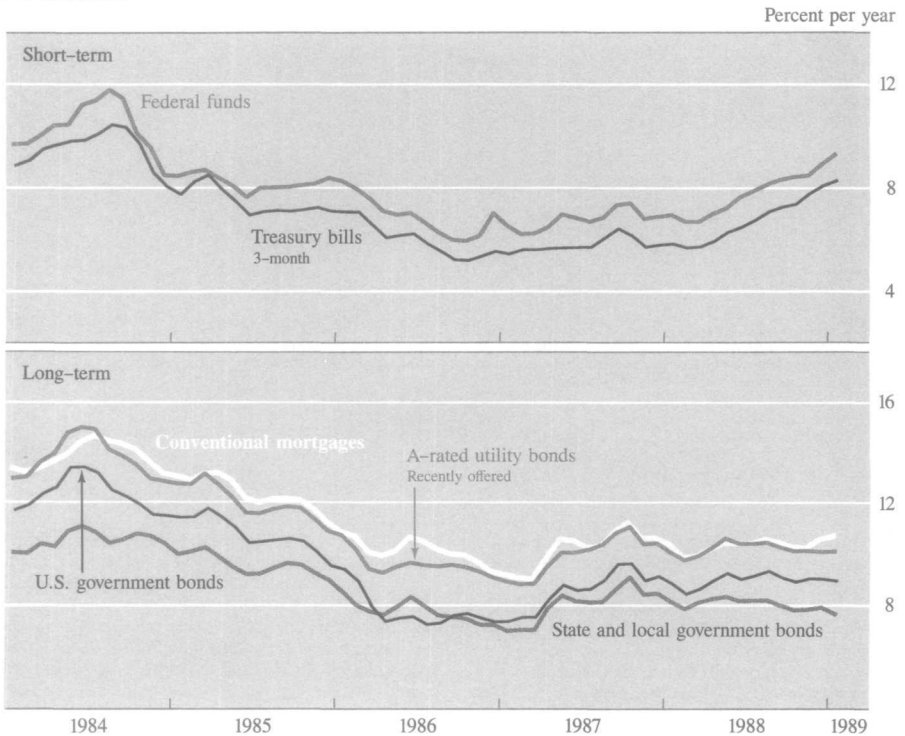
By early spring, however, the incoming economic data were suggesting that the real economy, rather than weakening, actually was still moving ahead with considerable momentum. Bond yields increased during this period, as the indications of economic strength contradicted the earlier market forecasts of a slowing economy and raised concerns about an uptrend in inflation. Because of the increased risk for higher wage and price inflation—and in the context of rapid growth in M2 and M3—the Federal Reserve firmed reserve conditions in a series of steps beginning in March and culminating in early August, when the discount rate was hiked  $\frac{1}{2}$  percentage point, to  $6\frac{1}{2}$  percent. These moves brought about substantial increases in short-term interest rates; but they were

accompanied by only small increases in Treasury bond yields, as investors viewed Federal Reserve actions as heading off a long-term acceleration of inflation. The upturn in short-term interest rates, coupled with more optimistic expectations of future inflation, also helped boost the foreign exchange value of the dollar during this period.

In late summer and early autumn, some indicators suggested that economic growth might have started to moderate.

In view of the policy restraint already in place—which was being reflected in a slower rate of growth in the monetary aggregates—the Federal Open Market Committee postponed any further action pending more information on the course of the economy. The foreign exchange value of the dollar declined through much of the autumn, partly in response to a rise in foreign interest rates relative to those in the United States and partly in response to investors' concern over the lack of

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 for 30-year fixed-rate mortgages with level payments 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 for 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.

progress in reducing the U.S. federal budget deficit and a slower rate of improvement in the U.S. trade deficit.

In late fall, data suggested that previous monetary restraint had not been sufficient to relieve the potential for higher inflation, and the Federal Open Market Com-

mittee resumed a tightening of reserve conditions that began in November and extended into the new year. As a result, short-term market interest rates rose. In contrast, bond yields continued to fluctuate narrowly, signaling the market's continued confidence that inflationary

### Reserves, Money Stock, and Debt Aggregates

Annual rate of change based on seasonally adjusted data unless otherwise noted, in percent<sup>1</sup>

Item	1986	1987	1988	1987	1988				
				Q4	Q1	Q2	Q3	Q4	
<b>Depository institution reserves<sup>2</sup></b>									
Total	19.8	6.0	3.2	2.5	3.5	5.8	4.3	-7	
Nonborrowed	21.7	6.1	.7	2.4	1.5	-6.5	2.5	5.3	
Required	19.9	6.1	3.2	1.4	2.9	7.2	4.0	-1.4	
Monetary base <sup>3</sup>	9.8	7.9	7.0	8.2	8.1	7.4	6.7	5.0	
<b>Concepts of money<sup>4</sup></b>									
M1	15.6	6.4	4.3	5.0	3.2	6.4	5.2	2.3	
Currency and travelers checks	7.5	8.6	8.0	9.8	9.5	7.9	7.2	6.7	
Demand deposits	11.7	-8	-1.2	1.1	-4.7	1.1	.4	-1.8	
Other checkable deposits	29.4	13.8	7.7	5.7	7.1	11.0	8.7	3.3	
M2	9.3	4.2	5.2	4.9	6.1	6.9	3.8	3.6	
Non-M2 component	7.3	3.5	5.5	4.9	7.1	7.1	3.3	4.1	
MMDAs (n.s.a.), savings, and small-denomination time deposits	6.0	3.2	5.8	3.8	7.9	7.2	3.9	3.6	
General-purpose and broker/dealer money market mutual fund assets (n.s.a.)	17.4	5.8	7.5	11.8	19.5	3.2	-2.9	9.8	
Overnight RPs and Eurodollars (n.s.a.)	16.0	4.3	-5.8	9.2	-14.0	2.6	-3.3	-8.8	
M3	9.1	5.7	6.4	6.4	6.7	7.2	5.8	5.1	
Non-M2 components	8.2	11.8	10.7	12.1	9.1	8.3	13.4	10.5	
Large-denomination time deposits	1.7	9.3	11.0	13.8	8.5	9.1	13.4	11.3	
Institution-only money market mutual fund assets (n.s.a.)	32.1	2.9	-7	19.9	44.3	-30.8	-23.3	11.1	
Term RPs (n.s.a.)	31.7	33.2	15.0	.9	7.5	28.4	13.0	8.3	
Term Eurodollars (n.s.a.)	4.3	13.9	14.5	11.2	-22.7	20.1	47.7	13.1	
<b>Domestic nonfinancial sector debt</b>	13.3	9.8	8.7	9.9	8.0	8.6	8.4	8.8	
Federal	14.7	9.0	8.1	7.6	8.0	8.3	7.1	8.0	
Nonfederal	12.9	10.0	8.9	10.7	8.0	8.7	8.8	9.0	

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 regulatory changes in 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 institutions, less cash items in the process of collection and Federal Reserve float; and other checkable deposits, which consist of negotiable orders of withdrawal and automatic transfer service accounts at depository institutions, credit union

share draft accounts, and demand deposits at thrift institutions. M2 is M1 plus money market deposit accounts (MMDAs); savings and small-denomination time deposits at all depository institutions (including retail repurchase agreements), from which have been subtracted all individual retirement accounts (IRAs) and Keogh accounts at commercial banks and thrift institutions; taxable and tax-exempt general-purpose and broker/dealer money market mutual funds, excluding IRAs and Keogh accounts; wholesale overnight and continuing-contract repurchase agreements (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; wholesale 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.

pressures would be contained. This confidence, together with the firming of policy, contributed to a renewed strengthening of the foreign exchange value of the dollar toward the end of the year.

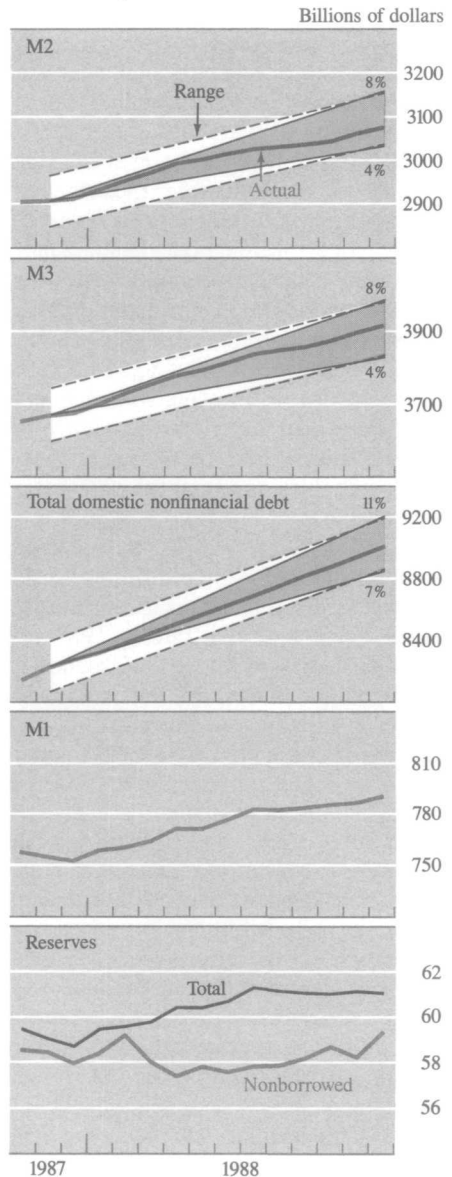
### Monetary Aggregates

M2 expanded 5¼ percent over the four quarters of 1988, a rate just below the middle of its 4-to-8 percent target range. Although demands for M2 were supported by strong growth in income and spending, they were reduced by increases in its opportunity cost—that is, the difference between market interest rates and the yields on M2-type instruments. Early in the year, the opportunity cost of holding M2 had declined in response to decreases in market interest rates in late 1987 and early 1988 relative to deposit rates. The lower opportunity cost led to strong growth in M2 and a decline in its velocity—the ratio of nominal GNP to M2—in the first quarter. But after March, deposit rates lagged behind the rise in market rates, and the velocity of M2 increased; over the year, the rise in velocity was close to 2 percent.

The response of offering rates on deposit accounts to changes in market rates was especially sluggish in the last part of 1988. One reason for this sluggishness may have been regulatory pressure on thrifts and the closing of many insolvent institutions, which often had been overly aggressive in pricing deposits. The extent to which thrifts were offering higher rates than banks on small time deposits was greatly reduced during this period, and partly as a consequence, growth of retail deposits was much stronger at banks than at thrifts.

The patterns of change in deposit rates and market interest rates also affected the composition of M2 growth during 1988. During the first half of 1988, liquid retail deposits (such as interest-bearing check-

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 1987:4 to 1988:4.

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.

ing accounts) expanded at a strong pace, largely reflecting increases in their relative attractiveness stemming from declines in market interest rates and, to a lesser extent, in rates on small time deposits. However, the growth of these deposits slowed markedly over the last half of 1988, following the reversal in the pattern of interest rate movements. Growth in small time deposits was particularly robust throughout 1988. Their expansion in the early months of the year may have resulted, in part, from shifts in household investment preferences away from stocks and toward the safety of these savings instruments. Later, rising yields on small time deposits relative to those on more liquid deposits led households to shift funds from the latter accounts to the former.

M3 grew 6½ percent last year, placing it slightly above the midpoint of its 4-to-8 percent target range. This increase from a 5¼ percent growth rate in 1987 reflected a modest pickup in the issuance of managed liabilities in M3 to fund credit expansion at banks and thrift institutions. M3 followed a trajectory near the upper end of its target range in the first half of 1988, but moderated thereafter in association with slowing credit growth at depository institutions. For the year, large time deposits and other managed liabilities included in M3 but not in M2 grew rapidly, as inflows into M2-type deposits were insufficient for banks to finance their desired pace of asset expansion. This was particularly true in the second half of the year, when M2 growth moderated.

To some extent, the pickup in M3 growth last year also reflected a greater reliance by banks on managed liabilities included in M3 than on non-money-stock instruments, such as bank borrowings from overseas branches. In contrast, as in other recent years, thrift institutions' heavy use of Federal Home Loan Bank

advances—which are not included in M3—had a moderating effect on the growth of M3 in 1988.

At 4¼ percent, M1 growth last year was down more than 2 percentage points from its rate in 1987. Growth of interest-bearing checking accounts moderated, while demand deposits continued running off. As in recent years, the growth of M1 displayed great sensitivity to changes in market rates of interest. Households shifted savings balances between NOW accounts and those M2 components, such as small time deposits, whose yields responded to increases in market rates much more quickly than those on NOW accounts. Because substitutions of this type are internalized within M2, M2 has displayed less sensitivity to interest rates than has M1 in this decade. Demand deposits are the other component of M1 highly sensitive to interest rates; they declined again in 1988, partly reflecting increases in their opportunity costs and declines in compensating balances. Compensating balances, funds that businesses must hold in non-interest-bearing accounts to compensate banks for services, fall when interest rates rise.

### Credit Market Developments

The debt of domestic nonfinancial sectors increased nearly 8¼ percent during 1988, placing it near the midpoint of the Federal Open Market Committee's monitoring range of 7 to 11 percent and somewhat below the 9¾ percent rise of the previous year. The growth of federal debt slowed a little from the 1987 pace. In addition, the expansion in nonfederal debt moderated as state and local governments trimmed debt issuance and as households expanded their mortgage debt at a less robust pace in response to higher mortgage rates. Growth of business debt picked up a bit from its 1987 pace, with short-term debt growing faster than long-

term debt. Corporate borrowing was particularly strong, reflecting increased external financing needs for capital investment and for mergers, buyouts, and stock repurchases. Overall, the expansion of debt in the nonfinancial sectors in 1988 was well below the pace of the mid-1980s but still exceeded the growth of nominal GNP.

With the economy growing strongly and the financial markets settling down after their initial skittishness following the stock market break, evidence of financial stress among businesses and households was not widely apparent in 1988. Nevertheless, financial developments in certain markets and sectors warranted the attention of policymakers. Of particular note were the worsening condition of the thrift industry, the need to achieve sounder capitalization of commercial banking organizations, and the rising indebtedness of businesses involved in restructuring activity.

As the year wore on, the dimensions of the problems facing the thrift industry became clearer. The losses of the industry declined somewhat during the second half of the year, but this relative improvement appeared largely to reflect the assistance provided to more than 200 institutions by the Federal Savings and Loan Insurance Corporation. For the year as a whole, the industry's losses exceeded \$12 billion.

The turmoil in the thrift industry has not noticeably disrupted mortgage activity. In part, the development of a deep secondary mortgage market has separated the origination of loans from the need to fund them. For this reason, the base of mortgage credit has been broadened in recent years, making the provision of mortgages far less dependent on the condition of any one type of financial institution or on the regional supply of loanable funds. During the 1980s the share of home mortgage credit held in

securitized form has increased from about one-tenth to more than one-third. The spread between interest rates on fixed-rate mortgages, which have an average life of roughly 10 years, and yields on 10-year Treasury notes did not change appreciably over 1988, which also indicates that the mortgage markets continued functioning well despite the problems of many savings and loan associations.

In contrast to those of the thrift industry, profits of U.S. commercial banks were reasonably strong in 1988, even after excluding the one-time jump in fourth quarter earnings associated with the resumption of debt payments by Brazil. Moreover, most large money-center banks with a significant amount of loans to developing countries have continued to build capital, which provides a cushion against default losses. Efforts to raise equity gained force from the agreement by bank supervisory authorities of major industrial countries to set more stringent, risk-based standards of capital adequacy. These standards, to be fully phased in by 1992, place a greater emphasis on equity capital, take into account the off-balance-sheet activities of banks, and provide a more uniform regulatory treatment of banks based in different countries.

In 1988, as in 1987, banks lent considerable sums to finance mergers and leveraged buyouts. Although banks have reported that these loans have had a lower rate of loss than all other business loans combined, and although LBO borrowers typically obtain some insurance against higher loan rates, concern remains about bank exposure to losses in the event of an adverse turn in business conditions. For this reason, the Federal Reserve is monitoring closely the developments in this area; in particular, it has revised its bank examination guidelines to ensure that loans from member banks used to finance

buyouts and other highly levered corporate restructurings meet prudent credit standards.

Leveraged buyouts and other mergers and restructurings led to a record pace of net equity retirements by nonfinancial corporations in 1988. Despite the large volume of this activity in recent years, the overall corporate debt-to-equity ratio is not out of line with observations since the early 1970s, a stability that reflects the increased market valuation of equities since the early 1980s.

Much of the financial restructuring of recent years has been a response to fundamental economic factors; it may impose a discipline on corporate management, which in turn can stimulate efforts to improve productivity. Nevertheless, heavy commitments of cash flow to service debt reduce a firm's ability to cope with stresses or industry-specific shocks. To some extent, the substitution of debt for equity is motivated by simple tax-saving considerations, such as the full deduction for interest payments and the double taxation of dividends. For these reasons, reforming the corporate tax system should be a component of public policy in addressing this difficult issue. ■

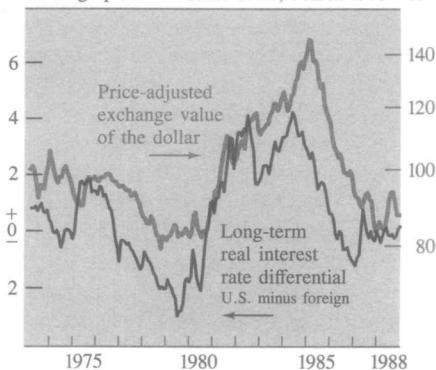
## International Developments

Economic growth in 10 major foreign industrial countries continued strong at a  $3\frac{1}{4}$  percent pace over the four quarters of 1988. Growth in non-OPEC developing countries averaged about 4 percent in 1988, nearly the same as in the previous year. Some progress toward the adjustment of external imbalances among major industrial countries was achieved. Real net exports by the United States (national income accounts, 1982 dollars) rose \$20 billion, contributing nearly  $\frac{1}{2}$  percentage point to the rise in gross national product. Nearly all of this increase in real net exports was in the first half of the year, however, as the rate of growth of domestic demand picked up in the second half while it slowed in several of the major foreign countries. In nominal terms the U.S. trade deficit declined to \$127 billion for 1988, \$33 billion less than in 1987. The current account deficit totaled \$135 billion, a \$19 billion improvement from the previous year.

The dollar moved over a considerable range in exchange markets during 1988, but on a weighted average basis, its net change over the year was fairly small. After recovering from its year-end 1987 lows, the dollar fluctuated narrowly until mid-April, when it began to appreciate sharply. The dollar rose from mid-April to late August, at first under the influence of Federal Reserve monetary tightening and subsequently of monthly trade reports that brightened the market's outlook for U.S. external adjustment. The dollar held fairly steady through September; then it declined in October and November with a reversal of market perceptions of relative monetary stances among major countries and with trade reports that seemed to suggest a stalling of the

adjustment process. The dollar recovered somewhat in December on the basis of further tightening by the Federal Reserve. On balance, the dollar appreciated about  $3\frac{1}{2}$  percent in nominal terms, December to December, against a weighted average of the currencies of the foreign Group-of-10 (G-10) countries. The dollar appreciated substantially against continental European currencies, while declining moderately against the Japanese yen and more against the Canadian dollar. When adjusted for relative consumer price levels, the dollar appreciated somewhat more than in nominal terms, as the U.S. inflation rate exceeded the weighted average inflation rate of other major industrial countries.

Exchange Value of the Dollar  
and Interest Rate Differential  
Percentage points      Ratio scale, March 1973 = 100



The exchange value of the U.S. dollar is its weighted average exchange value against currencies of other Group of 10 (G-10) industrial 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.



Central bank interventions, frequently concerted pursuant to G-7 understandings on exchange market arrangements, sought to limit the extremes of the dollar's movements, and gross official purchases and sales of dollars were quite large during the year. Net intervention purchases of dollars by 14 major central banks were quite small, however, amounting to only about \$2 billion, in sharp contrast to the 1987 total of \$100 billion by these same central banks. U.S. intervention, alone, amounted to net sales of a little more than \$1 billion for the combined accounts of the Federal Reserve and of the Exchange Stabilization Fund of the Treasury.

### Foreign Economies

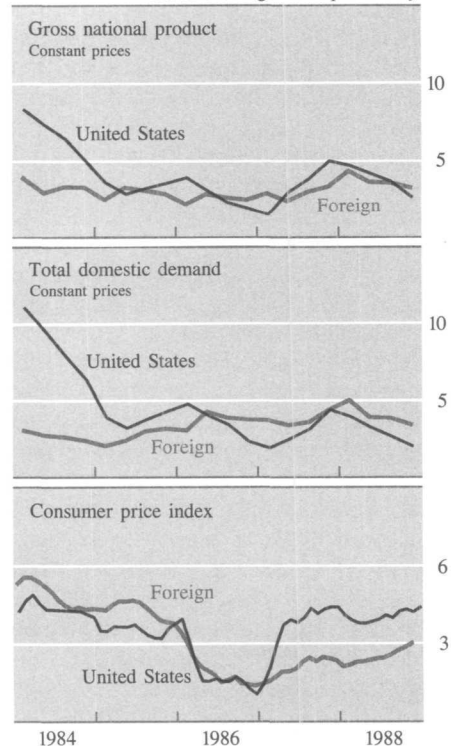
Strong economic growth in the major foreign industrial countries continued in 1988, although some signs of slowing were evident near year-end. Real growth in Japan was particularly noteworthy, with significant strength in both exports and virtually all major components of private demand. Germany and the related economies of continental Europe expanded somewhat less rapidly, though still at rates above most expectations, as the investment boom of the previous year carried over into 1988. In the United Kingdom, rapid growth was supported primarily by a surge in both consumption and investment. In Canada, strong investment expenditures sustained vigorous activity during the first half of the year, with some evidence of slower growth emerging in later months.

Unemployment rates in foreign industrial economies continued to move downward on average. Although unemployment levels in many instances still were high by historical standards, signs of labor market tightness were evident in some countries. Unemployment in the United Kingdom declined about 2 per-

centage points in 1988 amid increases in wage pressure, and unemployment in both Germany and Italy also moved lower. After registering a sharp decline in the previous year, the Canadian unemployment rate edged down further in 1988 to a low level for that economy. Japanese unemployment rates remained in a very low range—even falling slightly during the year—amid additional signs that Japanese labor markets were tight. Unemployment rates in most other industrial countries were about unchanged.

### GNP, Demand, and Prices

Percent change from previous year



Foreign data are multilaterally weighted averages for the (G-10) 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.

Monetary conditions were generally easier early in the year in the wake of the October 1987 stock market crash, but economic activity proved more robust than expected. As the year wore on, indications of increased inflationary pressure prompted authorities in many countries to tighten monetary conditions. Increases in inflation rates were relatively small in most countries, with the conspicuous exception of the United Kingdom, but signs of a pick-up in some other countries emerged toward the end of the year. U.K. authorities engineered a sharp increase in short-term interest rates after mid-year as the rate of inflation in that country moved above 6 percent.

Despite the general shift to less accommodative monetary stances as 1988 progressed, monetary growth exceeded official targets in several countries during the year. Key money aggregates in both Germany and the United Kingdom came in above target ranges; money growth in Japan remained quite rapid but was a bit below its 1987 pace. Fiscal policy abroad, as gauged by cyclically adjusted budget deficits calculated by the Organization for Economic Cooperation and Development, was broadly neutral in its impact on aggregate demand.

The combined current account surplus of the foreign G-10 countries declined about \$30 billion in 1988, with much of the change attributable to a significant deterioration in the U.K. current account position. Germany, among the countries with large surpluses, maintained a strong volume of exports, and had a current account surplus that was little changed on balance. In Japan, the growth of imports rose, and the current account surplus contracted by \$7.5 billion, but export volume also remained strong, and the pace of external adjustment seemed to slow toward year-end.

The combined current account surplus of the newly industrializing economies of

Asia, which had been increasing for several years, fell more than \$3 billion in 1988, apparently having peaked in 1987 at \$31 billion. The \$8 billion decline in Taiwan's surplus more than accounted for the decline in the surplus of this group; imports to Taiwan surged as a result of exchange rate appreciation, the liberalization of import restrictions, and increased official imports of gold.

The current account deficit of OPEC countries increased \$10 billion in 1988, to \$15 billion. Oil export revenues declined somewhat, with the effect of lower oil prices more than offsetting higher export volumes. The combined current account balance of non-OPEC developing countries in 1988 fell about \$8 billion, to a \$3 billion deficit in 1988. The trade surplus of this group fell \$4 billion, to \$15 billion. Rising prices of manufactures and commodities and rising volumes contributed to the growth of trade in non-OPEC developing countries. Imports expanded significantly for the second year in a row.

The current account deficit of the heavily indebted countries targeted by the U.S. debt initiative announced by Secretary of the Treasury Baker in 1985 was roughly unchanged from a year earlier, at about \$9 billion. The trade surplus of this group expanded nearly \$4 billion in 1988, to about \$30 billion. Brazil posted a record trade surplus of about \$19 billion.

Economic progress in the heavily indebted developing countries continued to be uneven in 1988. Several countries (Chile, Colombia, Morocco, and the Philippines) continued to achieve good rates of economic growth, while economic activity in other countries stagnated. Brazil, which had interrupted some interest payments to banks in February 1987, normalized its relations with the international community in 1988. A stand-by agreement with the

International Monetary Fund, a \$62 billion rescheduling package, and \$5.2 billion in new loans enabled Brazil to clear all its arrears to banks. Chile continued to make progress in managing its external debts in 1988 through buy-backs, conversions, and debt for equity swaps, thereby reducing its external debt to banks further in 1988. Argentina, on the other hand, began in 1988 to incur significant interest arrearages to banks.

During 1988, Mexico implemented a sustained adjustment program aimed at inflation control, fiscal consolidation, and structural transformation of its external sector. In support of these policies, the U.S. Treasury and the Federal Reserve announced in October 1988 that they were prepared to develop a short-term bridge loan of up to \$3.5 billion pending Mexico's development of loan programs with the World Bank and the IMF. Early in 1989, however, Mexico indicated that it would not need this facility.

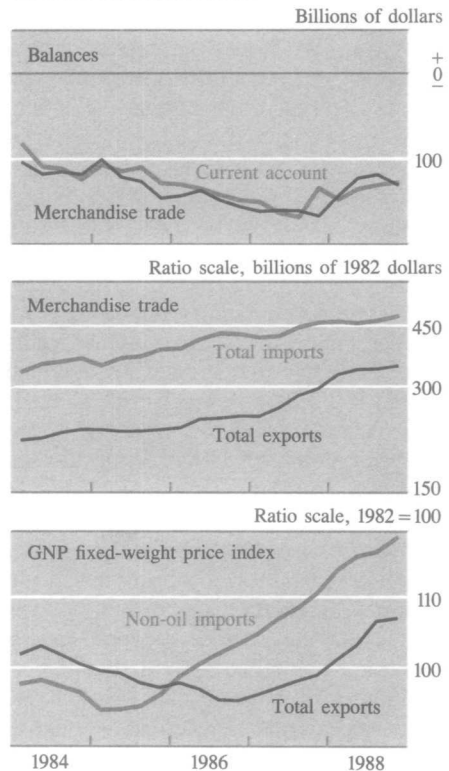
### U.S. International Transactions

The U.S. merchandise trade and current account deficits fell substantially in 1988. A \$70 billion increase in merchandise exports and a \$37 billion increase in merchandise imports yielded a trade deficit of \$127 billion for the year, compared with a deficit of \$160 billion in 1987. Meanwhile, a \$15 billion decline in net receipts on service transactions mainly reflected a reversal of capital gains on the stock of U.S. direct investment abroad as the 1987 depreciation of the dollar was followed by a small appreciation in 1988. Excluding the influence of capital gains and losses, net services improved by \$3 billion in 1988 as increases in operating income from U.S. direct investment income abroad and receipts from other services were not quite offset by rising payments to foreigners on their portfolio investments. The

current account deficit for 1988 was \$135 billion, down from \$154 billion in 1987.

The rise in the value of merchandise exports in 1988 largely reflected a strong increase in the volume of nonagricultural exports, which rose almost 20 percent over the four quarters of 1988, a rate only a bit below that over the preceding four quarters. Much of the rise in U.S. exports appeared to be associated with an improvement in the price competitiveness of U.S. products, resulting from the earlier depreciation of the dollar and the continued good performance of productivity and unit labor costs in U.S. manufacturing.

### U.S. International Trade



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

Demand for U.S. exports was also supported by fairly strong economic growth in the rest of the world. The growth in export volume was spread over most major categories of trade and was especially strong in capital goods (particularly computers and computer parts). Although the fourth-quarter volume of agricultural exports was about the same in 1988 as in 1987, increased deliveries in the first half of 1988 (particularly to the Soviet Union) raised the total for the year 8 percent above that for 1987. Prices rose because of the drought, and the value of agricultural exports in 1988 was 30 percent higher than in 1987.

The increase in the value of merchandise imports over the four quarters of

1988 reflected developments on pricing and volume. Significant price rises were recorded for industrial supplies (excluding oil), and smaller rises were recorded for consumer goods, automotive products, and various categories of machinery. However, prices of some items, notably oil and computers, fell and thereby held down significantly the increase in the implicit deflator for imports in the national income accounts. On a fixed-weight basis, non-oil import prices rose 7.4 percent. Most of the increase in the volume of non-oil imports was concentrated in capital goods, especially computers and computer parts. Excluding computers and parts, the volume of non-oil imports increased 1 percent.

### U.S. International Transactions<sup>1</sup>

Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
	1987	1988	1987	1988			
			Q4	Q1	Q2	Q3	Q4
<b>Current account</b> .....	<b>-154</b>	<b>-135</b>	<b>-34</b>	<b>-37</b>	<b>-34</b>	<b>-33</b>	<b>-32</b>
Merchandise trade balance .....	-160	-127	-41	-35	-30	-29	-32
Exports .....	250	320	68	75	79	82	84
Imports .....	410	446	109	110	110	111	116
Investment income, net .....	20	3	13	1	-2	-1	5
Direct investment, net .....	42	31	19	7	5	6	12
Portfolio investment, net .....	-21	-28	-6	-6	-7	-7	-7
Other services (including military transactions) .....	-1	2	*	*	1	1	*
Unilateral transfers, private and government .....	-13	-14	-4	-3	-3	-3	-4
<b>Private capital flows</b> .....	<b>80</b>	<b>80</b>	<b>-8</b>	<b>7</b>	<b>41</b>	<b>17</b>	<b>14</b>
Bank-related capital, net (outflows, -) .....	47	21	6	*	18	1	2
U.S. net purchases (-) of foreign securities .....	-4	-7	-2	-4	2	-2	-3
Foreign net purchases (+) of U.S. Treasury securities .....	-8	20	*	7	5	3	4
Foreign net purchases of U.S. corporate bonds .....	27	28	3	3	9	7	9
Foreign net purchases of U.S. corporate stock .....	15	-1	-8	*	1	1	-2
U.S. direct investment abroad .....	-44	-20	20	-7	1	-5	-9
Foreign direct investment in United States .....	42	42	12	7	13	8	13
Other corporate capital flows, net .....	5	-3	*	2	-7	2	n.a.
<b>Foreign official assets in United States (increase, +) .....</b>	<b>45</b>	<b>39</b>	<b>20</b>	<b>25</b>	<b>6</b>	<b>-3</b>	<b>11</b>
<b>U.S. official reserve assets, net (increase, -) .....</b>	<b>9</b>	<b>-4</b>	<b>4</b>	<b>2</b>	<b>*</b>	<b>-7</b>	<b>2</b>
<b>U.S. government foreign credits and other claims, net .....</b>	<b>1</b>	<b>4</b>	<b>1</b>	<b>-1</b>	<b>-1</b>	<b>2</b>	<b>3</b>
<b>Total discrepancy</b> .....	<b>18</b>	<b>17</b>	<b>16</b>	<b>4</b>	<b>-13</b>	<b>24</b>	<b>1</b>
Seasonal adjustment discrepancy .....	0	0	3	4	-3	-5	5
Statistical discrepancy .....	18	17	13	0	-10	29	-4

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

SOURCE: Department of Commerce, Bureau of Economic Analysis.

The value of oil imports declined in 1988 as a decline in price more than offset an increase in volume. The price of oil dropped about \$5 per barrel during 1988, reaching a low point of \$12.90 per barrel in the fourth quarter. The average price of oil in 1988 was about \$14.40 per barrel, less than the 1987 average, \$17.33 per barrel, and well below the range recorded during the 1980-1985 period, \$25-\$35 per barrel. Oil prices declined during 1988 in response to OPEC oil production in excess of quotas. In an accord reached in December, however, OPEC agreed to limit production, and spot prices moved up sharply. The volume of U.S. oil imports rose from an average of 7.4 million barrels per day in the first three quarters of the year to almost 8 million barrels per day in the fourth quarter in response to the earlier price decline. Oil imports in 1987 had averaged 6.8 million barrels per day.

The substantial U.S. current account deficit in 1988 (\$135 billion) was balanced by recorded net capital inflows of \$119 billion and a statistical discrepancy of \$17 billion. These net capital inflows brought the officially recorded U.S. net indebtedness to foreigners to about \$500 billion at the end of 1988, though this is probably overstated if full account were taken of current market values of U.S. direct investment assets abroad.

Official reserve holders, both U.S. and foreign, accounted for a large part of the recorded capital inflow in 1988 (\$35 billion). The bulk of the foreign official inflows of \$39 billion were invested in U.S. Treasury securities. Increases in reserves held in the United States were particularly large for certain smaller industrial countries and newly industrialized countries. Reserve holdings in the United States by the G-10 countries also increased; this change largely reflected the shifting of dollar investments from the Euromarkets and the accumulation of

interest earnings rather than exchange market intervention during 1988.

Private capital inflows were also large (\$75 billion) and were mainly accounted for by securities transactions. Private foreigners purchased, net, \$20 billion in U.S. Treasury securities in 1988, in contrast to \$8 billion in net sales in 1987. Private foreign purchases of U.S. corporate bonds were substantial, as in 1987, but there were small net sales of U.S. corporate stocks.

Recorded U.S. direct investment abroad fell in 1988, in part because of the effect of currency translation on reinvested earnings and also because of the sale of assets by petroleum companies. Acquisitions of European companies by U.S. investors accelerated sharply in anticipation of the 1992 unification of the European market, but they were of far smaller scale than foreign acquisitions of U.S. companies.

### Foreign Currency Operations

Intervention sales of dollars against marks by U.S. authorities exceeded their purchases of dollars against yen. Of the net intervention total of \$1,039 million sold, \$600 million was for the Federal Reserve System account. The System realized profits of \$435 million from its intervention transactions. The rise in the value of the dollar against foreign currencies over the year resulted in translation losses of \$1,121 million on System holdings of foreign currencies. At year-end the value of those balances, primarily marks, was \$9,129 million. The System added to its balances of foreign currencies during the year through purchases against dollars from other official institutions. The only activity in the Federal Reserve's Reciprocal Currency (Swap) Network was a drawing of \$700 million by the Bank of Mexico in August, a drawing completely repaid in September. ■

## *Monetary Policy Reports to the Congress*

*Given below are reports submitted to the Congress by the Federal Reserve on February 23, 1988, and July 13, 1988, pursuant to the Full Employment and Balanced Growth Act of 1978.*

### **Report on February 23, 1988**

#### **Monetary Policy and the Economic Outlook for 1988**

The national economy has scored major gains in the past year. Growth of real gross national product at 3¾ percent over the four quarters of 1987 outstripped most expectations, and the unemployment rate dropped below 6 percent for the first time in this decade. 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.

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 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 the year 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 since that time interest rates have reversed a good part of the rise that occurred earlier in 1987.

However, conditions in financial markets have yet to return fully to "normal," and the edginess of participants continues to be reflected in volatility and fairly sizable risk premia. Moreover, there have been some signs of weakness in the economy recently. In particular, the fourth quarter of 1987 was marked by a sharp rise in inventories in a few sectors, and there were indications of a slackening in labor demand early this year. Against this backdrop, the system eased a bit further the pressures on reserve positions of depository institutions in the past several weeks.

But while the Federal Reserve has had to be responsive to the 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 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 high rates of capacity utilization and low unemployment 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 earlier this month to chart its monetary policy strategy for 1988. Such considerations 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 up 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.

#### *Monetary Policy Plans for 1988*

Decisions regarding the ranges for money and credit growth in 1988 were shaped in part by the experience of 1987. Last February, the FOMC established annual target ranges of 5½ to 8½ percent for both M2 and M3; both aggregates had increased 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 inflation forces

#### Ranges of Growth for Monetary and Debt Aggregates

Percent change, fourth quarter to fourth quarter

Aggregate	1988	1987
M2.....	4 to 8	5½ to 8½
M3.....	4 to 8	5½ to 8½
Debt.....	7 to 11	8 to 11

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. 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. Although deregulation has made it possible for 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 seemingly 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, resulting in increases in their velocities. 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.

For 1988, the Committee set ranges of 4 to 8 percent for growth of M2 and M3. Expansion of money within these ranges,

whose midpoints are one percentage point lower than those of the ranges for last year, would be expected to support economic growth at a pace that is consistent with continued external adjustment and progress over time toward price stability. In light of the experience of recent years, which have been marked by large swings in velocity, the ranges were widened somewhat. Institutional change is a source of continuing "noise" in the relationship of money growth to economic activity; in addition, there clearly is a strong, systematic sensitivity of velocity to changes in market rates of interest. This sensitivity means that even small changes in rates occasioned by variations in spending or prices can have sizable effects on the quantity of money the public wishes to hold. Combined with an uncertain outlook for the economy and inflation, this implies that wider ranges are needed to encompass possible outcomes for monetary growth consistent with satisfactory economic performance in 1988. Thus, while the Committee at this time expects that growth of M2 and M3 will be around the middle of their ranges, the outcome could differ if significant changes in interest rates are required to counter unanticipated weakness in aggregate demand or an intensification of inflation. In carrying out policy, the Committee will continue to assess the behavior of the aggregates in light of information about the pace of business expansion and the source and strength of price pressures, with attention to the performance of the dollar on foreign exchange markets and other indicators of the impact of monetary policy.

The Committee will continue to monitor the growth of debt in 1988. The expansion of the debt of domestic nonfinancial sectors is expected to slow somewhat from the 9½ percent pace of 1987, to around the middle portion of a 7 to 11 percent range. Growth of debt, however,

appears likely to outpace that of income, as it has for the past several years; although the debt of governmental units may not grow as rapidly as it did last year, continued rapid expansion of private debt is probable, unless the current tide of corporate restructurings ebbs.

The Committee decided not to establish a range for M1 in 1988. It is especially difficult to anticipate the relationship between growth in this aggregate and the performance of the economy. The character of this aggregate had been affected more than the broader monetary aggregates by deregulation, because it now contains a large volume of interest-earning accounts that serve as savings as well as transactions vehicles. The rates on these accounts have proven especially slow to respond to market rates, and inflows to these accounts are very sensitive to differentials in interest returns. Because flows into and out of NOW accounts frequently involve other retail deposits, they do not greatly affect M2 or M3, but do result in sizable variations in M1 growth. Moreover, demand deposits, which have demonstrated increased sensitivity to rate movements in recent years, also are being affected by evolving practices in payments for bank services and in business cash management.

### *Economic Projections*

As table 2 indicates, the uncertainties attending the present economic situation are reflected in a considerable range of forecasts among Committee members and other Reserve Bank presidents. However, the central-tendency ranges shown encompass the vast majority of forecasts and point to growth in real GNP of 2 to 2½ percent in 1988.

This pace of activity would be expected to generate appreciable gains in employment over the year—about in line with labor force growth—and the civilian unemployment rate is projected to change



## Economic Projections for 1988

Percent

Measure	FOMC members and other FRB Presidents		Admini- stration
	Range	Central tendency	
GNP, change from fourth quarter to fourth quarter			
Nominal.....	4 to 6½	5¼ to 6	6.4
Real.....	½ to 3	2 to 2½	2.4
Implicit deflator.....	2½ to 4	3¼ to 3¾	3.9
Unemployment rate, average level in the fourth quarter.....	5½ to 6¾	5¾ to 6	5.8 <sup>1</sup>

little on balance between now and the end of 1988. Prices, as measured by the implicit price deflator for GNP, are expected to rise 3¼ to 3¾ percent, not appreciably different from the pace last year; consumer prices likely will increase a little faster than the deflator. The central-tendency forecasts encompass the administration's projections for real GNP, but are a bit more optimistic on prospects for price inflation.

Higher real net exports of goods and service are expected to provide a major impetus to U.S. economic activity in 1988. As reflected by the rapid growth of real exports of goods and services of more than 15 percent last year, the international competitiveness of U.S. producers has improved significantly. By and large, U.S. manufacturers have let the foreign currency prices of their products decline with the depreciation of the dollar, achieving enhanced profitability through greater volume and aggressive efforts to increase efficiency and control costs. This enhanced competitiveness is expected to provide a further boost to export growth this year, while the increases in the relative prices of foreign goods apparently now in train should curb import growth. As a result, some improvement in the nation's current account balance is anticipated this year.

In contrast, domestic demand is expected to remain relatively subdued in

1988, as the economy moves toward a better balance between domestic spending and domestic production. Consumer demand probably will be damped to a degree by the loss of household wealth associated with the decline in stock prices last fall. Some increase in personal saving would be beneficial to the economy, as it would aid investment and help reduce our dependence on foreign capital. However, a severe retrenchment by consumers could have a significant deflationary effect; fortunately, the indications from surveys of household attitudes are that the sharp drop in confidence that occurred immediately after the October shock has been substantially reversed. Housing activity should pick up some in coming months as a result of the recent decline in mortgage rates. In addition, business spending on plant and equipment should be buttressed by the desire to build upon the progress made in regaining international competitiveness and by already high levels of capacity utilization in a number of major industries.

Although real GNP should rise moderately for the year as a whole, the pattern of growth may be uneven over time. An adjustment to the runup in inventories that occurred in the fourth quarter of 1987 could produce relatively slow output growth during the first part of the year. Such an adjustment appears in process in the auto sector, in light of

domestic automakers' current assembly schedules; there may also be similar patterns in a few other sectors, but at this time there are no signs that deep cutbacks in production will be necessary.

Although no significant change is anticipated in the overall pace of inflation this year, the primary source of the rise in prices is likely to change. Assuming relative stability in world oil prices, domestic energy prices should increase only a bit this year after their sharp rebound in 1987. However, prices of non-oil imports likely will continue to rise substantially further in the wake of the decline in the foreign exchange value of the dollar in 1987, providing continuing impetus to domestic inflation. This impulse to prices associated with the dollar's depreciation is an unavoidable component of the process of correcting external imbalance, as an increase in the relative price of foreign goods encourages exports and discourages imports. However, if we are to maintain and extend the progress made in the 1980s toward price stability, it is crucial that business and labor continue to exercise restraint in price and wage behavior. The forecasts of the FOMC members and other Reserve Bank presidents anticipate that such a pattern will persist through this year. It is important, too, that the Congress remain mindful of the effects of legislation on the cost structure of American industry.

The forecasts of the Federal Reserve policymakers also assume 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 to an improved pattern of international transactions. It is critical, in that regard, that the package of deficit-reduction measures agreed to in December for 1988 and 1989 be fully implemented.

## The Performance of the Economy During the Past Year

The economy completed a fifth consecutive year of expansion in 1987, with real gross national product increasing about 3½ percent over the four quarters of the year.<sup>1</sup> The overall growth in output not only was greater than in 1986, but was better balanced across industries and regions of the country. In addition, the rise in activity supported a net gain of more than three million jobs last year, and the civilian unemployment rate stood at 5.8 percent in January of this year, nearly a percentage point below its year-ago 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 sharp drop in 1986. However, prices also rose sharply for some imported consumer goods and, at the producer level, for a number of industrial commodities. 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 levels of capital spending by domestic producers. However, improve-

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

ment 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, while domestic production was supported by the increased international competitiveness of U.S. industry as 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 increased 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 substantial uncertainty to the prospects for continued economic growth at year-end. The sharp drop in stock prices reduced household wealth considerably, raising the possibility of a further slowing in consumer spending, domestic business investment, and housing construction. It is too early to assess what the ultimate economic effect of the stock market decline will be, but that effect likely will

be offset at least in part by the decline in interest rates since the crash.

### *The External Sector*

The dollar depreciated by 14 percent in nominal terms over the course of 1987 relative to a trade-weighted average of the currencies of the other G-10 countries, leaving the dollar by the end of the year at a level almost 45 percent below its February 1985 peak and close to its 1980 low. Although consumer prices in the United States rose somewhat more rapidly on average than in major foreign countries, the depreciation of the dollar was almost as great in real terms. However, the dollar fell only about 6½ percent in real terms over the year against an average of eight leading developing countries. The decline in the exchange value of the dollar was resisted by substantial official intervention purchases of dollars and an apparent movement of differentials in long-term real interest rates between the United States and major foreign countries in favor of the dollar. Nonetheless, some depreciation in the dollar evidently was seen by participants in foreign exchange markets as a necessary element in the adjustment of the huge U.S. current account deficit.

The U.S. merchandise trade deficit widened for 1987 as a whole, but leveled off on balance in the latter part of the year. The volume of imports increased, reflecting a moderate expansion in both oil and non-oil imports. Moreover, non-oil import prices moved up further in response to the continuing decline in the dollar through 1987, and, with oil prices also up sharply, imports rose substantially in value terms. Higher imports were matched, to a large extent, by merchandise exports, which also grew briskly in 1987. Most of this growth was in real terms, as prices of most exports increased only moderately in the face of the substantial decline in the dollar, and

prices of a few important products, such as computers, continued to decline. Moreover, the expansion of foreign sales last year was broadly based. Shipments abroad of capital goods showed particular strength, and the volume of agricultural exports also rose, as grain sales to the Soviet Union and China increased and as foreign soybean production dropped off.

Economic expansion abroad strengthened only slightly in 1987, providing only limited support for the improvement in the U.S. trade position. In the other industrial countries, economic activity picked up somewhat by the middle of the year after a slow start, but on average real GNP grew less than 3 percent over the year. Outside of the industrial countries, real economic growth was uneven and on average tended to slow from its pace in 1986. Activity expanded at a rapid rate in the newly industrialized countries of Asia, but slowed in Latin America, with a sharp decline in Brazilian growth more than offsetting a small expansion in Mexico. In the OPEC countries, output fell as oil export volumes were constrained in an effort to raise oil prices.

### *The Household Sector*

Spending by households, which had been a major contributor to growth in past years, slowed considerably in 1987. Real consumer spending rose less than 1 percent last year, after a 4 percent gain in 1986. In large part, the cutback in spending reflected smaller increases in real disposable income. Substantial employment growth and increases 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 real income growth to about 2 percent last year, versus 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 durables 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 last year, despite the availability much of the time of special incentive programs on a wide range of models.

Associated with the more cautious spending patterns of consumers in 1987 was a slowing in household debt accumulation. Consumer installment debt decelerated sharply as households apparently limited their borrowing because of high debt burdens and shifted toward home equity loans in response to the reduced incentive, under the new tax law, to finance expenditures with nonmortgage credit. And, despite the growing popularity of home equity loans, growth of mortgage debt also slowed last year as interest rates moved higher. Evidence as to the ability of consumers to service their existing liabilities in 1987 was mixed. Delinquency rates for mortgage loans fell somewhat, but delinquency rates for consumer loans changed little over the year while loan charge-offs rose.

Housing activity in 1987 was damped by the upward movement in mortgage rates, continued high multifamily vacancy rates, 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 rose beginning in April, reaching about 11½ percent for fixed-rate loans by mid-October. Although interest rates on mortgages have dropped substantially since then, the stimulative impact of that change on housing demand may have been offset thus far by stock market losses and reduced consumer confidence. In the multifamily market, activity also weakened over the past year, as near record-high vacancy rates on rental units and tax-law changes that reduced the profitability of rental housing continued to deter building in that sector.

### *The Business Sector*

Business spending on plant and equipment rose about 3¾ 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.

For equipment, the year began on the weak side, with first-quarter spending down sharply after firms shifted expenditures into late 1986 to 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 of last year. Much of the strength was in the computer and other office equipment area, where expenditures picked up in 1987 after 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 in spending reflected an improvement in the

energy sector in response to higher oil prices. In particular, oil and gas drilling was up more than 20 percent over the year after having dropped by 40 percent in 1986. Outside of the energy area, spending on structures was flat, after falling nearly 9 percent in 1986. Producers were somewhat less reluctant to expand industrial plant facilities owing to the substantial rise in industrial production, while office construction, although down a bit last year, held up surprisingly well in view of the very high vacancy rates that have persisted in recent years.

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, where 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 last year. Profits were especially strong in manufacturing, where the volume of shipments picked up and firming prices and good cost control contributed to improved margins. In other industries, before-tax profits were little changed

from 1986 levels. However, after-tax profits fell a bit on an annual average basis last year for the sector as a whole, as increases in corporate tax liabilities associated with the new tax laws more than offset the overall rise in profits.

### *The Government Sector*

Last year, there was significant progress toward reducing federal budget deficits. The FY1987 deficit, at \$150 billion, was about a third lower than the record level of the previous year, and the administration and Congress reached agreement on deficit reduction actions totaling more than \$30 billion in FY1988 and about \$46 billion in FY1989. However, a number of factors that raised receipts and lowered outlays in FY1987 are not likely to be repeated, and—absent further legislative action—deficits could expand again unless there are particularly favorable economic circumstances.

About half the deficit reduction 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 revenue growth and a very small underlying rise in outlays. The economic expansion boosted receipts, while, on the outlay side, lower interest rates in FY1987 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*

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. In contrast to prior years, when the labor market was characterized by sharp disparities across sectors, the strengthening in hiring in 1987 was widespread by industry. In manufacturing, employment edged up over the first half of the year and then rose substantially in the second half in response to the sharp gains in industrial production. Moreover, the expansion of jobs in the trade, service, and finance industries remained sizable during most of 1987, although hiring in trade and finance apparently slowed somewhat in the latter part of the year in the wake of sluggish consumer spending and the stock market crash.

The demand for labor considerably outpaced increases 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

decelerating for several years, leveled out; however, they showed little signs of acceleration last year. Hourly compensation, as measured by the employment cost index, advanced  $3\frac{1}{4}$  percent in the 12 months ended December, about the same pace as in 1986. The moderate rise in compensation, which was fairly widespread across industries and occupations, occurred despite a substantial pickup in consumer price inflation. As a result, real hourly compensation fell last year and has averaged only about a  $\frac{1}{2}$  percent increase annually since 1984.

Unit labor costs in the nonfarm business sector rose only  $1\frac{1}{4}$  percent last year, after a 2 percent increase in 1986. The continued restraint in labor costs primarily reflected moderate compensation growth, as 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  $3\frac{1}{2}$  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-weighted price index for GNP increased about 4 percent for the year as a whole, after a  $2\frac{1}{4}$  percent rise in 1986. The consumer price and producer price indexes suggested an even sharper acceleration in prices over 1987, owing to the greater importance of energy in those indexes. The consumer price index was up  $4\frac{1}{2}$  percent in the 12 months ended December, after a 1 percent rise in 1986,

while the producer price index, which includes only prices of domestically produced goods, rose  $2\frac{1}{4}$  percent over the year, after dropping  $2\frac{1}{4}$  percent in 1986.

The overall rise in energy prices in 1987 reflected both a sharp rebound in prices early last 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 per barrel 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 and the absence of any major disturbance in the Gulf, subsequently helped put downward pressure on crude oil prices, and oil prices since late last summer have retreated to about \$17 per barrel. Retail prices for gasoline and home heating oil closely followed movements in crude oil prices, rising around 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 last year, while prices for nonenergy services rose about  $4\frac{1}{2}$  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 in 1987. 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 last year.

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 last year, and steel scrap prices were up 36 percent by year-end. To some extent, the sharp rise in commodity prices reflects 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, but rebounded in the latter part of the year as exports picked up in response to the falling dollar.

### 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 was deemed necessary to maintain 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 aggre-

gates, M2 and M3, was permitted to run at or below the established ranges.

During episodes beginning in the spring and then again in late summer, the dollar came under sustained downward pressure and inflationary 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.

#### *Behavior of Money and Credit*

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 the sharp decline that occurred in 1985–86. The rise in velocity may have reflected in part a number of special factors affecting the public's demand for M2 balances in 1987, including 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, the latter in the wake of tax reform measures reducing deductibility of nonmortgage interest payments. However, much of the pickup in velocity 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, where rates are changed very infrequently. Early in the year, opportunity costs on these accounts were still low and inflows were large. As market rates rose, though, yields on these accounts became increasingly less attractive and growth slowed; by late in the year, there were net monthly outflows from both savings and NOW accounts. 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 prior years, reflecting in part reduced overall

needs for funds as asset expansion at banks and thrifts 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, owing to 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 a year earlier. The sharp slowing of growth and the abrupt turnabout in its velocity are indicative of the increased sensitivity to movements in market interest rates that has emerged for M1 in recent years. As suggested by its comparatively larger deceleration in 1987, 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. Because NOW accounts pay explicit interest, they serve as an attractive savings vehicle as well as a transactions account. The available information suggests that owners of NOW accounts are quite sensitive to changes in opportunity costs, shifting 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, these funds evidently were shifted 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 provide

Growth of Money and Debt<sup>1</sup>

Percent change at annual rate

Period	M1	M2	M3	Debt of domestic non-financial sectors
<i>Fourth quarter to fourth quarter</i>				
1979 .....	7.7	8.2	10.4	12.3
1980 .....	7.5	8.9	9.5	9.6
1981 .....	5.2	9.3	12.3	10.0
	(2.5) <sup>3</sup>			
1982 .....	8.7	9.1	9.9	8.9
1983 .....	10.2	12.1	9.8	11.3
1984 .....	5.3	7.6	10.4	14.2
1985 .....	12.0	8.9	7.7	13.3
	(12.9) <sup>3</sup>			
1986 .....	15.6	9.4	9.1	13.2
1987 .....	6.2	4.0	5.4	9.6
<i>Quarterly growth</i>				
1987: 1 .....	13.2	6.5	6.5	10.5
2 .....	6.6	2.6	4.7	8.7
3 .....	.8	2.8	4.5	8.1
4 .....	3.9	4.0	5.6	9.7

1. M1, M2, and M3 incorporate effects of benchmark and seasonal adjustment revisions made in February 1988. Certain technical redefinitions affecting only M1 were made at the same time.

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.

incentives to economize on balances that earn no interest. Higher rates also permit business firms to reduce the amount of balances held with banks as compensation for services provided but not paid for with fees; because banks can 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, which helps to explain a high interest elasticity for demand deposits. Over time, though, 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 account.

The collapse of equity prices boosted the average level of all the aggregates a bit in the fourth quarter, but M1 was most noticeably affected. Demand deposits rose sharply around the time of the crash, reflecting the increased volume of financial transactions arising 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, with deposits receding over the month of November.

The debt of domestic nonfinancial sectors grew 9½ percent last year, ending the year at the middle of the Committee's monitoring range of 8 to 11 percent. Debt expansion moderated considerably from the 13¼ pace of the two previous years, but still rose faster than income. Federal debt growth 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. Sluggish spending and shifts toward greater reliance on home equity lines of credit, in response to the effects of tax reform in reducing deductibility of interest payments on consumer debt, held down use of consumer credit. However, a brisk pace of

home sales over most of the year 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, business borrowing diminished in both short- and long-term markets. However, businesses continued to retire equity last year through mergers, buyouts, and share repurchases, and the credit needed to finance these retirements boosted the expansion of business indebtedness.

#### *Implementation of Monetary Policy*

During the first half of 1987, monetary policy was carried out in an atmosphere of increasing concerns about the course of inflation, arising in part from heavy downward pressure on the dollar. Growth of the economy was bringing about noticeable increases in 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 there was a broad decline in interest rates, with long-term rates falling somewhat more than short-term rates.

When the FOMC met in July to review its growth ranges for 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, however; rather, the slower money growth, and accompanying strengthening in velocity, appeared largely attributable to the rise in market rates of interest fostered in part by the Federal Reserve's response to adverse developments with respect to the dollar and inflation. The Committee decided to reaffirm 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. Long-term bond yields 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 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  $\frac{1}{2}$  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. The stock market drop prompted a marked decline in interest rates 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 ensure 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 transactions 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 unsettled over the rest of the year.

Early in 1988, as incoming data suggested that economic expansion over the first part of the year might be weak, bond rates dropped substantially and the Federal Reserve sought some slight additional easing in desired pressures on reserve positions. Better trade news bolstered confidence in the dollar, and the monetary aggregates showed signs of renewed strength.

*Other Developments in Financial Markets*  
Despite the slower growth of debt and the overall strength of the economy last year, there still were some signs of strain

and financial fragility in portions of the economy.

The nonfinancial corporate sector remained highly leveraged 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.

The household sector also exhibited a few signs of strain on personal finances. As noted previously, the pace of expansion of total household debt slowed last year, likely reflecting reduced deductibility of consumer interest under the new tax code and weaker consumer spending. However, 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 posed by high debt burdens apparently remain quite severe, as the number of personal bankruptcies has been growing rapidly over the last three years and setting new records. On the other hand, recent declines in the delinquency rate on mortgage debt have brought this indicator of financial stress more into line with historical standards.

The banking industry was under some continuing stress in 1987, primarily reflecting well-publicized difficulties with energy and developing country loans, but in some parts of the country with agricul-

tural and real estate loans as well. Although most banks continue to be healthy and 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 midwestern and southwestern portions of the country; however, problems with the quality of agricultural loans appear to be diminishing as the agricultural sector shows signs of improvement.

Provisioning by large banks for losses on troubled loan portfolios led to record losses in 1987 for the banking industry and to substantial declines in the book value of shareholder equity of affected banks. Doubts regarding 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 provisioning 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).<sup>2</sup> However, as has

been true for some years now, the aggregate condition of the industry masked extremes among individual thrifts. Many thrifts 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. Prior to the passage in 1987 of legislation authorizing a recapitalization, the FSLIC had been unable to take effective remedial action with respect to these insolvent institutions, owing to the inadequacy of its resources. Under the terms of the recapitalization plan approved as part of the Competitive Banking Equality Act, the newly-created Financing Corporation has begun raising the funds needed by the FSLIC through issuance of long-term debt.

The stock market collapse gave very 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 produced significant problems for traders, specialists, and market makers on the stock exchanges; and, more generally, financial markets gave evidence of fragility and instability that have not entirely disappeared even yet. Under the circumstances, it is essential that the reexamination of our market mechanisms and regulatory systems go forward, to identify any actions that might be needed to safeguard the strength of our capital markets and lower the risks of economic disruption.

---

institutions. The Financial Standards Accounting 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 thrifts will recover the amount of this writeoff over the next five years as new funds are raised for FSLIC.

---

2. In March 1987, the General Accounting Office declared the FSLIC was insolvent because it would be unable to meet all its future obligations on insured deposits at failed but not yet closed

## Report on July 13, 1988

### Monetary Policy and the Economic Outlook for 1988 and 1989

The economy continued to expand rapidly in the first half of 1988, displaying impressive resilience in the wake of last fall's stock market break. Especially encouraging has been the fact that the expansion in activity this year has been propelled largely by rising exports and business investment, which bodes well for the restoration of better balance in the economy.

With the industrial sector continuing to enjoy greater growth, capacity utilization rates have crept higher. At the same time, the civilian unemployment rate has declined since year-end, and the average of 5½ percent in the second quarter was the lowest in nearly 15 years. Despite the tightening of labor markets, wage increases to date have been notably restrained, on balance, helping to contain cost pressures in many sectors. Most measures of price inflation among finished goods and services also have shown little if any pickup, although basic commodity prices have risen considerably, most recently reflecting the effects of drought on agricultural markets.

During the first half of the year, the Federal Reserve continued to direct its policies toward providing monetary and financial conditions that would foster price stability over time, promote sustainable economic growth, and contribute to an improved pattern of international transactions. It was recognized that progress toward these goals in 1988 would require relatively slow growth of domestic demand, which would allow the economy to accommodate rising external demands on U.S. producers without generating overall inflationary pressures. Consistent with continued external adjustment and with its commit-

ment to achieving price stability over time, the Federal Open Market Committee (FOMC) in February lowered its 1988 target growth ranges for M2 and M3 to 4 to 8 percent.

At the beginning of the year, the conduct of monetary policy was complicated by exceptional uncertainty about the state of the economy. Some signs of weakness had begun to emerge, seemingly lending support to the widely held view that economic activity would falter after the stock market break. In particular, inventories had accumulated at a rapid rate in the fourth quarter of 1987, producing some overhang of stocks at the retail level. Moreover, other indicators suggested that the rate of increase in labor demand had slackened. At the same time, financial markets seemed to be somewhat fragile, as conditions had not yet returned to normal following the plunge in stock prices. The Federal Reserve thus was faced with the challenge of countering the apparent near-term weakness of the economy, while taking account of the longer-range need to ensure that growth in domestic demand would not become excessive.

In this situation, and with the dollar firming on foreign exchange markets, the Committee loosened slightly further the easier reserve conditions that had been adopted following the stock market plunge. Market interest rates edged down, which—in conjunction with earlier declines in rates—helped lift M2 and M3 to near the top of their 1988 target ranges and resulted in a modest fall in their velocities (the ratio of nominal GNP to the money supply) during the first quarter. Given the risk that economic activity was weakening, as well as the still unsettled conditions in financial markets, the Committee viewed the more rapid growth in money as appropriate.

By early spring, however, the bulk of the incoming data indicated that business activity had, in fact, remained robust. Additional information available later in the second quarter confirmed the strength of the economy, and high and rising levels of resource utilization pointed to a greater potential for a buildup of inflationary pressures. The costs of allowing inflation to reintensify were seen as quite high, based on the experience of the early 1980s, when the reversal of the inflation process led unavoidably to sizable losses in output and to an extended period of high unemployment.

Against this backdrop, the Committee tightened reserve conditions somewhat in a series of moves beginning in late March. Market interest rates responded to the strength in the economy and to the Federal Reserve's actions by moving upward. Over the past four months, most short-term interest rates have increased around 1 percentage point on balance. Long-term rates generally rose substantially through late May, but have declined a little on net since then. The better performance of the bond market recently has occurred at a time when investor sentiment toward investment in dollar-denominated assets has been buoyed by better trade statistics and may also have reflected favorable market response to the Federal Reserve's demonstrated resolve to fight inflation.

Despite the Committee's tightening actions, M2 and M3 continued to expand rapidly through April, in response to earlier decreases in interest rates and to a bulge in transactions balances associated with unusually large individual tax payments. As the tax-related surge unwound and the influence of higher interest rates began to be felt, the two broad aggregates grew at a reduced pace in May and June, and ended the first half of the year in the upper halves of their target ranges.

## Monetary Plans for the Remainder of 1988 and for 1989

At its meeting last month, the Federal Open Market Committee agreed to retain the target growth ranges of 4 to 8 percent for M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. In addition, the Committee retained the monitoring range of 7 to 11 percent for the debt of domestic nonfinancial sectors and again set no range for M1. Recognizing the variability of the relationship of these measures to the performance of the economy, the Committee agreed that operating decisions would continue to be made not only in light of the behavior of the monetary aggregates, but also with due regard to developments in the economy and financial markets, including attention to the sources and extent of price pressures and to the performance of the dollar in foreign exchange markets.

In the absence of any significant economic and financial disturbances, the Committee expected growth in M2 to moderate over the remainder of the year, placing the aggregate around the middle of its target range at year-end. Growth in M3 this year is expected to exceed that of M2 but to remain comfortably within its range, on the assumption that asset expansion at depository institutions would remain fairly robust in the second half. The debt of domestic nonfinancial sectors is expected to remain near the middle of its monitoring range, which would put its growth for the year around the slowest annual pace registered in the past decade.

For 1989, the Committee set, on a tentative basis, target growth ranges of 3 to 7 percent for M2 and 3½ to 7½ percent for M3, measured from the fourth quarter of 1988 to the fourth quarter of 1989; the monitoring range over the same period for domestic debt was set at 6½ to 10½

### Ranges of Growth for Monetary and Credit Aggregates

Percent change, fourth quarter to fourth quarter

Aggregate	1987	1988	Provisional for 1989
M2.....	5½ to 8½	4 to 8	3 to 7
M3.....	5½ to 8½	4 to 8	3½ to 7½
Debt.....	8 to 11	7 to 11	6½ to 10½

percent (table 1). Although uncertain about how strong the economy might be over the coming year or so, the Committee recognized that, given the current high levels of resource utilization, it was necessary to be particularly attentive to inflationary risks. An acceleration of inflation could undermine the sustainability of the economic expansion and the international competitive position of U.S. producers. The lower ranges tentatively adopted for 1989 were believed consistent with a monetary policy that would curb any tendency for inflation to worsen and would contribute over time to the restoration of price stability. However, the Committee also noted that developments over the next half year could alter substantially the rates of money growth needed to foster satisfactory economic performance in 1989 and beyond. Consequently, it stressed the provisional nature of its decision and the possibility that the ranges for 1989 might need to be adjusted when they are reviewed early next year.

The Committee again decided not to set a range for M1, given the sharp swings in its velocity in recent years, resulting in part from its increased sensitivity to movements in market interest rates since deposits were deregulated. In considering narrow monetary measures, the Committee also has discussed whether the monetary base could play a useful role in the conduct of policy. This measure comprises the major monetary liabilities of the Federal Reserve System—currency in the hands of the public and reserves of depository institutions—

and represents, in a sense, the “base” of the broader monetary aggregates.<sup>1</sup> The Committee decided against establishing a range for the monetary base because it seemed unlikely to provide a more reliable guide for policy than the aggregates for which ranges already are established. Although the base has been less variable in relation to economic activity and prices than M1, its velocity nonetheless has fluctuated appreciably and rather unpredictably from year to year.

### *Economic Projections*

As is indicated in table 2, the central tendency of the forecasts of Committee members and nonvoting Reserve Bank presidents—premised on the monetary policy objectives outlined above—is for growth in real GNP of 2¾ to 3 percent in 1988, with a modest slowing of expansion in 1989. Such a pace of growth likely would generate employment gains sufficient to hold the civilian unemployment rate close to its average second-quarter level of 5½ percent. Prices, as measured by the implicit deflator for GNP, are generally expected to rise 3 to 3¾ percent over the four quarters of 1988, similar to last year’s rate of advance. For 1989, projections of the increase in the GNP deflator are of course more uncertain, and the central-tendency range widens to 3 to 4½ percent.

The administration forecast for 1988 is quite similar to the central tendency of forecasts of FOMC members and nonvoting presidents. For 1989, the administration is projecting stronger growth of real output than indicated by the FOMC forecasts, but its expectation for inflation is in the middle of the range of FOMC forecasts. The administration’s projection of nominal GNP in both years is around the upper end of the central-

1. The characteristics of the base and its behavior are discussed in detail in the appendix to this report.



## Economic Projections for 1988 and 1989

Percent

Measure	FOMC members and nonvoting FRB presidents		Administration
	Range	Central tendency	
1988			
<i>Change, from fourth quarter to fourth quarter</i>			
Nominal GNP .....	4 to 7	5% to 6%	6.6
Real GNP .....	1 to 3½	2% to 3	3.0
Implicit deflator for GNP .....	2% to 4	3 to 3%	3.5
Civilian unemployment rate, average level in the fourth quarter .....	5¼ to 6½	5¼ to 5%	5.5
1989			
<i>Change, from fourth quarter to fourth quarter</i>			
Nominal GNP .....	4 to 7½	5 to 7	7.1
Real GNP .....	1 to 3	2 to 2½	3.3
Implicit deflator for GNP .....	2 to 5	3 to 4½	3.7
Civilian unemployment rate, average level in the fourth quarter .....	5 to 7	5½ to 6	5.3

tendency ranges and within the full ranges, suggesting that the administration's economic forecast and the FOMC's monetary ranges are broadly compatible. Continued improvement in the external sector is expected to provide the main impetus to U.S. economic growth over the next year and a half. Real exports of goods should remain on a strong upward path, reflecting the improved competitive position of U.S. producers. At the same time, the growth of real imports is likely to be restrained, owing to the lagged effects of the depreciation of the dollar through the end of last year. This continued shrinkage of the real trade deficit is expected to be sufficient to generate some reduction in the nation's deficit on current account during 1988 and a further decline in 1989. In contrast to the boost provided by the external sector, domestic demand is projected to remain relatively subdued. Consumer spending, in particular, has been on a sluggish growth trend since late 1986, and that pattern seems likely to persist. Moreover, in an environment of

more moderate growth of overall activity, economy-wide spending on new plant and equipment may not rise as swiftly as it has on average over the past year. Even so, within manufacturing, improved profitability and higher capacity utilization have stimulated a healthy pickup in capital spending, which should continue for some time. The performance of the interest-sensitive sectors, most notably homebuilding and business investment, will be influenced considerably by the extent to which the federal government is competing for available supplies of credit. Accordingly, continued fiscal restraint is essential if we are to free up resources to support private investment. In this regard, the budget summit agreement reached last December was a favorable first step, and the Federal Open Market Committee members and other Reserve Bank presidents have assumed that the necessary legislative action will be taken to implement the agreement. There is a clear need for further initiatives to deal with the out-year deficits, which remain

distressingly large; financial events later this year and in 1989 could be substantially affected by the developments in the fiscal arena. Although little change is expected in the overall pace of inflation this year, as compared with 1987, the sources of actual and potential price pressure appear to have changed. In 1987, a rebound in oil prices was a major factor boosting the general price level; assuming that world oil prices remain fairly stable, domestic energy prices should not be a significant inflationary force in 1988-89. Labor markets have tightened considerably since last year, however, and most measures of wage and compensation rates have firmed. Although the overall rate of industrial capacity utilization is not high by historical standards, plants are being used very intensively in some materials-producing sectors; sharply rising materials prices have raised costs for manufacturers generally. Food prices also have been a less favorable element in the inflation picture recently, and are likely to experience some further acceleration as a consequence of drought conditions; however, it is important to recognize the temporary nature of this phenomenon, which should have no lasting effect on overall inflation so long as it does not become embedded in wage trends.

For 1989, the FOMC central-tendency range for the GNP deflator widens on the upper end, suggesting the possibility of a pickup in inflation from the pace this year. However, this apparent acceleration of prices largely reflects the arithmetic implication of an eccentric movement in the deflator for GNP in the first quarter of this year. Shifts in the composition of output caused the deflator to rise at an annual rate of less than 1 1/2 percent during that quarter; these shifts are not expected to be so noticeable in coming quarters. The view that inflation next year will not differ significantly from the

pace anticipated over the final three quarters of 1988 reflects the expectation that business and labor—recognizing the realities of a highly competitive international marketplace—will continue to exercise restraint in setting prices and wages.

### The Performance of the Economy During the First Half of 1988

The economy continued to expand briskly in the first part of 1988. Activity was boosted by strength in capital spending and growth in foreign demand for U.S. goods. The rise in overall output during the first six months of this year supported the addition of about 1 3/4 million jobs to nonfarm payrolls, and the civilian unemployment rate, which had trended down throughout 1987, dropped somewhat further since the beginning of the year to an average level of 5 1/2 percent in the second quarter.

Despite the greater tightness in labor markets and the higher rates of capacity utilization now prevailing in some industries, tendencies toward additional inflation have been limited. Prices of materials and components have risen sharply, but for finished goods there are only hints of price acceleration outside the food sector. Wages, on the whole, have continued to be fairly well behaved, suggesting a recognition on the parts of labor and management of the need to maintain competitive cost structures.

The continued resurgence of manufacturing has been one of the most notable economic developments this year. During the first five months of 1988, industrial production expanded at nearly a 4 percent annual rate, and the rate of capacity utilization for total manufacturing rose 1/2 percentage point between December and May to just over 83 percent, the highest level during the 1980s. Owing to these advances in

production, manufacturers have embarked on substantial programs to invest in plant and equipment, pacing an economy-wide pickup in the rate of capital spending. The better balance of expansion also has been visible in agriculture, although the upturn in that sector has been jeopardized by recent drought conditions.

The improvements in manufacturing and agriculture are, in part, reflections of a broader adjustment of the U.S. external position. The combination of a lower dollar and domestic cost containment has translated into a marked turnaround in real net exports. That process also has been aided by stronger economic growth in other large industrial countries.

#### *The External Sector*

After having trended downward for nearly three years, the dollar appreciated substantially over the first half of 1988 against most major foreign currencies. The dollar rose sharply at the beginning of the year, responding in part to coordinated central bank intervention. In recent months, sentiment toward the dollar appears to have improved, owing largely to the release of better-than-expected trade reports and to firming actions by the Federal Reserve.

The U.S. merchandise trade deficit for the first quarter was \$144 billion at a seasonally adjusted annual rate, substantially below the figures for the fourth quarter and for 1987 as a whole. In April, the trade deficit narrowed further. Exports have continued to expand rapidly, while import growth has slowed considerably. The strong growth of exports can be attributed primarily to the increased price competitiveness of U.S. goods, which reflects the decline of the dollar in recent years and the tight control over production costs exercised by domestic firms. This growth of exports continues to be broadly based, and foreign sales

have been particularly strong for industrial machinery and for computing equipment. On the import side, the volume of purchases rose less than 1 percent in the first quarter and apparently declined in April. Imports of consumer goods excluding autos were essentially unchanged in the first quarter, continuing the pattern of 1987, while auto imports fell somewhat. In contrast, imports of capital goods rose considerably, stimulated by the surge in equipment outlays by domestic firms.

Economic expansion abroad has continued at a moderate pace, on balance, so far this year, providing some support for an improved U.S. trade position. Activity increased sharply in the major foreign industrial countries in early 1988, while growth in the smaller industrial nations remained subdued. In the newly industrialized countries of Asia, economic activity continued to expand rapidly. In contrast, growth slowed in Latin America, primarily due to a sharp deceleration of activity in Brazil. In the OPEC countries, activity appears to have stabilized in 1988, after a decline in 1987, as higher volumes of oil exports have offset the effects on government revenues of a slight softening in prices.

#### *The Household Sector*

Consumer spending showed some vigor in early 1988, after declining in the fourth quarter of last year. Real outlays increased at a 3½ percent annual rate in the first quarter, as purchases of motor vehicles bounced back with the expansion of manufacturers' incentive programs, outlays for other durable goods were strong, and expenditures on services continued to post appreciable gains. Data for April and May suggest, however, that the growth of consumer spending slowed from the rapid first-quarter rate.

The buoyancy of consumer spending early this year can be traced to robust income growth. Real disposable personal

income rose at a 5 percent annual rate, on average, during the fourth quarter of 1987 and the first quarter of 1988, substantially above the 2 percent rate posted for 1987 as a whole. However, disposable income growth appears to have slowed considerably in the second quarter, as a result of a spurt in nonwithheld tax payments and a slower pace of employment gains.

Although the pace of consumer spending thus far this year has been stronger than many expected, the stock market break probably did exert some restraining effect. This is evident in the personal saving rate, which has averaged 4½ percent for the seven months after October—1 percentage point above the average level during the first three quarters of 1987. While most households experienced little direct loss of wealth from the stock market decline, the startling dimensions of the event obviously affected consumer sentiment last fall. With each passing month, however, confidence has grown and helped to sustain the growth of spending.

Residential construction was weak during the first half of 1988. Total housing starts averaged about 1½ million units at an annual rate through May, almost 9 percent below the 1987 total. In the multifamily sector, building declined from the already depressed 1987 level. Starts in this sector have been falling since the end of 1985, as near-record vacancy rates and changes in the tax laws have reduced the incentive to build new units. In the single-family sector, building has fluctuated from month to month, influenced by movements in interest rates and perhaps by weather; on balance, the average level of starts through May was roughly 6 percent below the 1987 pace.

### *The Business Sector*

Business fixed investment advanced sharply in the first quarter of 1988, owing

to a large increase in purchases of equipment. In recent months, spending appears to have remained near the high first-quarter level. Surveys of capital spending plans, taken this spring, point to appreciable growth in investment outlays over the second half of 1988.

Real outlays for computing equipment jumped at more than a 90 percent annual rate in the first quarter, but fell back considerably in subsequent months. Smoothing through this volatility, it appears that demand for such equipment has emerged from the lull that prevailed during 1986 and the first half of 1987, when excess computing capacity—as well as concerns about the usefulness of available software—limited purchases. Outlays for other types of equipment also have been strong, on balance, since the turn of the year, largely reflecting the buoyancy of overall economic activity. In particular, with utilization rates now at elevated levels in many manufacturing industries, equipment investments have been an attractive way of removing bottlenecks and achieving a relatively rapid improvement in effective capacity.

Although the data for May showed a surprising jump in nonresidential construction activity, real outlays in this sector were sluggish overall during the first five months of the year. Commercial construction, the largest part of this aggregate, continues to be restrained by an overhang of vacant space. In addition, oil and gas drilling, which was up more than 20 percent in 1987, has changed little since last fall, owing in large part to the general weakness of petroleum prices over this period. Industrial construction, in contrast, has risen briskly in recent months. Nonetheless, even here, the picture is cloudy. Although capacity utilization is high in a number of sectors, manufacturers apparently remain cautious about making the large, long-range commitments involved in building new

plants, and new contracts for industrial construction actually have trended down since the beginning of the year, after rising in 1987.

The pace of business inventory investment moderated somewhat during the first four months of 1988, reducing the concern about excessive stocks that had arisen earlier this year. This concern had focused on the retail sector, where inventories at auto dealers and at certain outlets for nondurable goods (primarily general merchandise and apparel stores) appeared high relative to sales at year-end. By cutting production early in the year and offering a variety of sales incentives, automakers have been able to bring their inventories into better alignment with sales. In contrast, inventory-to-sales ratios for nondurable retail goods continue to hover at levels that are high by historical standards. At the manufacturing level, inventory positions through May appeared fairly lean in general, given the pace of shipments. Much of the recent building of factory stocks has been in industries where market demand has been robust, such as aircraft, machinery, chemicals, and paper.

Before-tax economic profits of nonfinancial corporations continued to be strong in the first quarter, with manufacturing firms posting substantial gains. After-tax profits also rose noticeably, as the maximum tax rate on corporate profits was reduced from 40 to 34 percent, a change mandated by the Tax Reform Act of 1986. Owing to the strong growth of profits, the internal cash flow of nonfinancial corporations has increased considerably since mid-1987, reversing the slide of the previous year.

### *The Government Sector*

In real terms, federal government purchases of goods and services—which add directly to GNP and account for about one-third of total federal expenditures—

fell during the first quarter and appear to have remained relatively weak in recent months. This dropoff reflects the winding down of some major defense procurement programs, restraint on domestic discretionary spending, and net reductions in farm inventories held by the Commodity Credit Corporation. However, on a budget basis, total outlays have been growing rapidly, owing to continued increases in entitlements, greater demands on deposit insurance agencies, and increasing net interest payments.

Meanwhile, growth of federal government revenue has slowed compared with the sharp increase in FY1987. Although tax receipts have been pushed up by the robust gains in income and by an increase in the payroll tax rate, this upward impetus to revenue has been tempered by the final reductions in income tax rates from the reforms enacted in 1986. In contrast to its effects this year, tax reform had provided a substantial boost to revenues in FY1987. On balance, it is quite possible that the budget deficit this year will exceed the \$150 billion shortfall recorded last year.

The state and local sector continues to operate under budgetary pressure, as operating and capital accounts (which exclude social insurance funds) have been in deficit for the past year and a half. In the first quarter of 1988, this combined deficit stood at \$9 billion, similar to the shortfall recorded during 1987. Many states have acted to curb this fiscal erosion, using a combination of tax hikes—primarily sales and excise taxes—and budget cuts. As a result, the growth of real spending slowed considerably in the first quarter, reflecting a sharp decrease in construction outlays. This was the third such decline in the past four quarters, and this downtrend in construction activity has occurred despite continuing needs to expand and upgrade the basic infrastructure.

### *Labor Markets*

Early in the year, incoming data seemed to signal some weakening of labor demand. Initial claims for unemployment insurance, which had trended up during the final months of 1987, rose even further just after the turn of the year. Moreover, the first report on nonfarm payroll employment for January showed the smallest monthly increase since mid-1986. Taken together, these indicators conveyed a picture of deterioration in the labor market. However, as subsequent data were released, it became clear that the underlying pattern of labor demand had, in fact, remained healthy. Claims for unemployment insurance dropped back to relatively low levels and the anemic employment gains for January were revised up substantially. Moreover, since January, nonfarm payroll employment has advanced more than 300,000 at a monthly rate, somewhat above the average increase in 1987. Although the gains have been concentrated in the service-producing sector, manufacturing has posted an average monthly increase of about 30,000 jobs thus far this year, with the largest advances in the machinery and metals industries.

The combination of strong gains in employment and slower growth of the labor force over the first half of 1988 lowered the civilian jobless rate to 5.3 percent in June from 5.8 percent at the end of last year. Jobless rates fell for a broad spectrum of demographic groups over the first half of the year, and the June rate of unemployment represents the lowest monthly figure since mid-1974. The June level, however, may be artificially low, owing to the difficulty of adjusting for seasonal swings in employment at the end of the school year.

As the unemployment rate dropped last year, compensation increases, which had been moderating for several years, leveled out. In the early part of this year,

there were some signs of an acceleration in labor costs. Hourly compensation, as measured by the employment cost index, advanced nearly 4 percent between the first quarter of 1987 and the first quarter of this year, about  $\frac{3}{4}$  percentage point more than in the previous 12-month period. Although this pickup was related in large part to the strength of labor demand, it was exacerbated by the rise in the payroll tax rate that took effect on January 1. By sector, the sharpest uptick in compensation rates occurred in manufacturing, where increases in production have led to a firming in labor demand. This pattern stands in contrast to trends in the early 1980s, when pay gains in manufacturing lagged far behind those in the service-producing sector.

Since 1980, output per hour in the nonfarm business sector has risen at an average  $1\frac{1}{2}$  percent annual rate. Although this rate is somewhat above the sluggish pace of the 1970s, it remains far below the advances registered earlier in the postwar period. In contrast, productivity gains in manufacturing have been quite rapid in recent years. The first-quarter rise in factory output per hour was nearly 3 percent at an annual rate, in line with the average increase registered during 1986 and 1987; these productivity advances have continued to hold down unit labor costs, which fell  $\frac{1}{2}$  percent over the year ended in the first quarter of 1988.

### *Price Developments*

Upward pressures on prices appear to have grown stronger this year, reflecting the lagged effects of the earlier depreciation of the dollar, as well as tighter markets for labor, industrial materials, and farm output. Energy prices, in contrast, have been restrained this year, on balance, and have provided some offset to these pressures. For the most part, signs of higher inflation have

been confined to price indicators for commodities and intermediate goods, which have posted sharp increases. The consumer price index—a measure of inflation for finished goods and services—showed no acceleration during the first five months of 1988, rising at the 4½ percent annual rate registered for 1987 as a whole.

In the energy sector, spot prices for crude oil plummeted after OPEC failed last December to reach a credible agreement to limit production. The contract price for West Texas Intermediate (the benchmark crude oil in the United States) fell from about \$18 per barrel in December to about \$16 per barrel in March. Reflecting these developments, retail prices for gasoline fell considerably in the first quarter. During March and April, prices for crude oil drifted up and, in response, consumer energy prices rebounded in April and May. More recently, however, crude oil prices have receded again, as OPEC's June meeting adjourned without an agreement on production cuts.

In the agricultural sector, tighter crop inventories and stronger grain exports pushed up farm-level prices early in 1988. In addition, prices for grains and soybeans recently have surged in commodity markets, owing to the drought in major growing regions. It now appears likely that retail food prices will accelerate in coming months and exert some upward pressure on aggregate consumer price inflation.

Excluding food and energy, prices at the consumer level rose at about an annual rate of about 4¾ percent during the first five months of this year. Consumer price inflation has remained at this relatively high rate partly because of continued increases in import prices spurred by the earlier depreciation of the dollar. Particularly noteworthy has been

a jump in clothing prices, which have been affected not only by the dollar's movement, but by quotas on apparel imports. In the service area, medical care costs have continued to rise rapidly.

At earlier stages of processing, inflation appears to have picked up for a wide range of items. On commodity markets, prices of crude industrial materials have remained on an upward course this year, although the price hikes have been less pervasive than in 1987. Reflecting, in part, these developments, the producer price index for intermediate materials other than food and energy rose at an annual rate of nearly 8 percent over the first five months of this year, up from the 5 percent pace registered last year. Price increases have been especially large for materials used by producers of metals, chemicals, paper, and plastic, where output has been strong or capacity utilization rates high.

The upward movement of intermediate goods prices relative to finished goods prices at the producer level has been quite substantial. Although divergences in the two series, such as the one that has arisen over the past year, are not unprecedented, disparities typically have not persisted for long. Historical evidence indicates that higher materials costs, on average, pass through rather quickly into finished goods prices. In the recent period, the effect of the sharp rise in materials prices may have been cushioned by restraint on unit labor costs, by the spreading of overhead costs over larger sales volumes, and, perhaps, by efforts to save on or substitute away from higher cost materials. Nonetheless, past experience suggests that, even if there may not be a significant delayed pass-through in coming months, the risks of an acceleration in finished goods prices would be considerable if the pressures on materials prices do not ease soon.

## Monetary Policy and Financial Developments during the First Half of 1988

The Federal Open Market Committee has sought monetary and financial conditions that promote price stability over time, support sustainable economic growth, and contribute to an improved pattern of international transactions. To this end, the Committee at its February meeting established target ranges, measured as growth rates from the fourth quarter of 1987 to the fourth quarter of 1988, of 4 to 8 percent for both M2 and M3. It also set a monitoring range of 7 to 11 percent for the growth of domestic nonfinancial debt and chose, once again, not to stipulate a range for M1 growth. The 1988 target ranges for M2 and M3 represented reductions from last year's ranges of 5½ to 8½ percent for both aggregates and resulted in a lowering of the midpoint of the target ranges by 1 full percentage point.

In widening the target ranges for M2 and M3, the Committee cited the high degree of variability in the relationship between money and aggregate demand that had appeared in recent years. As a result of this development, which stemmed largely from an increased sensitivity of money growth to interest rate changes, it was believed that a wider range of monetary growth rates could be compatible with satisfactory outcomes for the economy. At the time of the February FOMC meeting, broader ranges seemed particularly appropriate in light of the uncertain outlook for spending. More specifically, the eventual effects on domestic demand of the October stock market plunge and the subsequent drop in interest rates remained unclear. M1 had become even more interest sensitive, and it had varied more widely relative to GNP than had the

broad aggregates, thus making it even more difficult to interpret; consequently, the Committee decided against establishing a target range for this aggregate.

In setting a monitoring range for domestic nonfinancial sector debt, the Committee anticipated that debt growth would slow in 1988, owing to less government borrowing. Nonetheless, the rate of expansion of domestic debt was expected to exceed that of income. As was the case for the monetary aggregates, considerable uncertainty surrounded the prospects for debt growth, leading the Committee to widen the monitoring range by dropping the lower limit 1 percentage point from the previous year's rate.

During the first part of 1988, monetary policy was conducted against a backdrop of data suggesting some weakness in the economic expansion. Reflecting concern about the outlook for economic growth, the Committee moved in January to ease slightly the degree of pressure on reserve positions. On balance, interest rates fell during January and February, which, in conjunction with rate declines that followed the stock market drop in October, contributed to a pickup in M2 and M3 growth over the first quarter of the year.

As information suggesting greater economic strength and an increased potential for a buildup of inflationary pressures became available in March and in subsequent months, and with M2 and M3 running near the upper ends of their growth ranges, the Committee moved, in several steps, to tighten reserve pressures. Owing to the force of credit demands and the Federal Reserve's less accommodative posture, interest rates rose on balance over those months. Late in the second quarter, growth in the aggregates moderated, leaving both well within their target ranges as the first half of 1988 ended.



## Growth of Money and Debt

Percent change at annual rate

Period	M1	M2	M3	Debt of domestic non-financial sectors
<i>Fourth quarter to fourth quarter</i>				
1979 .....	7.7	8.2	10.4	12.3
1980 .....	7.5	8.9	9.5	9.6
1981 .....	5.2	9.3	12.3	10.0
	(2.5) <sup>1</sup>			
1982 .....	8.7	9.1	9.9	8.9
1983 .....	10.2	12.1	9.8	11.3
1984 .....	5.3	7.6	10.4	14.2
1985 .....	12.0	8.9	7.7	13.3
1986 .....	15.6	9.4	9.1	13.3
1987 .....	6.2	4.0	5.4	9.6
1987:4 to 1988:2 <sup>c</sup> ...	5.0	7.4	7.1	8.5
1987:4 to June 1988 <sup>c</sup>	5.1	7.1	7.0	8.5
<i>Quarterly average</i>				
1987: 1 .....	13.2	6.5	6.5	10.5
2 .....	6.6	2.7	4.6	8.6
3 .....	.8	2.8	4.5	7.9
4 .....	3.9	3.9	5.4	10.1
1988: 1 .....	3.8	6.7	7.0	8.4
2 <sup>c</sup> .....	6.1	7.9	7.1	8.3

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

*Behavior of Money and Credit*

From the fourth quarter of 1987 through June 1988, M2 increased at about a 7 percent annual rate, a noticeable increase over its 1987 rate of 4 percent (table 3). The faster growth can be attributed primarily to the lagged reaction of the public's demand for M2 balances to decreases in market interest rates relative to deposit rates that occurred in late 1987 and early 1988. In the second quarter of 1988, however, the "opportunity cost" of holding M2 reversed its downward trend, and growth in M2 moderated toward the end of the period. Also contributing to the May-June slowdown was the runoff of an unusually large, tax-related buildup of transactions balances that inflated both M1 and M2 in April. On balance, M2 velocity is estimated to have declined slightly over the first half of the year, in contrast to its upward movement in

1987 when market interest rates and the opportunity cost of M2 were generally increasing.

A number of the components of M2 contributed to its strengthening in the first half of the year. After declining steadily over the last half of 1987, liquid retail deposits—the sum of other checkable deposits, savings deposits, and money market deposit accounts—registered a solid gain over the first half of 1988, as reductions in market interest rates during the winter combined with the slow adjustment of rates on these deposits to increase their relative attractiveness. Growth in small time deposits also was particularly strong, as was that in M2-type money market mutual fund assets early in the year. Falling market interest rates, coupled with slow adjustment of returns on fund assets, provided money funds with a rate advantage in the first quarter, thereby leading to higher asset growth. Rising market rates of interest and the apparent use of money funds to pay taxes, however, significantly slowed their growth in the second quarter.

M3 growth increased in the first half of 1988 to a 7 percent rate, following a 5½ percent increase in 1987. Credit expansion at banks and thrift institutions, which heavily influences the overall behavior of M3, remained at roughly the same pace as last year, but it was financed to a greater extent over the first half of the year by liabilities included in M3. In particular, inflows to banks from their foreign branches and borrowings by savings and loans from Federal Home Loan Banks, which are not included in M3, dropped off sharply compared with 1987.

M1 grew at a 5 percent rate during the first half of the year, which although below the 6¼ percent rate for all of 1987, was higher than its growth in the second half of last year. The sluggish growth of M1, especially in comparison to that of M2 and M3, owed entirely to weakness

in demand deposits, which have been declining over the past year and a half. In contrast, growth in currency and other checkable deposits was robust.

Domestic nonfinancial debt grew at a rate of 8½ percent rate from the fourth quarter of 1987 to June, according to estimates based on partial data. Debt growth in the first half represented a slowdown from last year's rate of 9½ percent and a substantial decline from the rate of expansion of 13¼ percent in 1985 and 1986. Nonetheless, debt continued to grow faster than nominal GNP. Reflecting the effects of smaller federal deficits during the calendar year, growth in federal debt slowed from last year's pace and remained at a rate well below that recorded over most of the 1980s. Nonfederal debt also expanded at a somewhat slower rate, as the growth of the debt of households and state and local governments declined modestly. In the household sector, a falloff in mortgage borrowing associated with weaker housing expenditures offset a pickup in consumer credit. Business borrowing expanded at roughly the same pace as in 1987, with rising interest rates in the second quarter causing firms to shift more of their borrowing to short-term instruments.

#### *Implementation of Monetary Policy*

In conducting monetary policy, the Federal Reserve directed its operations during the first three months of 1988 at either maintaining or easing slightly the degree of reserve pressure that had prevailed since the October stock market collapse. Thereafter, the System moved in several steps to firm reserve positions.

The early months of 1988 were marked by widespread concern that the economic expansion might be faltering. Data available in January and February pointed toward a weakening in domestic final demand, as evidenced by a substantial buildup of inventories in the fourth

quarter of 1987 and some softening in labor market data. At the same time, inflationary pressures and expectations appeared to have diminished somewhat, and after coming under pressure in late December, the dollar first rebounded and then stabilized against most major currencies.

In these circumstances, the Committee moved in late January to ease slightly the pressure on bank reserve positions. The provision of nonborrowed reserves through open market operations was increased, the level of discount window borrowing declined, and the federal funds rate edged downward. Other market interest rates declined as well; in spite of lower interest rates, the dollar was relatively stable against most major currencies.

The downward trend for most market interest rates came to an end in late February and early March, when incoming information indicated that the economy was considerably stronger than it was earlier thought to be, and in light of emerging pressures on industrial capacity and labor markets, the risks of a pickup in inflation appeared to have risen. In this environment, monetary policy began in late March to become less accommodative. The restraint in policy was aimed at moderating potential inflationary pressures by damping domestic demand in order to facilitate a shift of resources to the external sector. As information pointing to substantial economic strength became available in April and May, and with the monetary aggregates growing at rates near the upper end of their target ranges, the Committee moved again to apply slightly greater pressure on reserve positions. Reflecting both the System's actions and market concerns about inflation, market interest rates moved higher. Since late May, however, long-term interest rates have fallen on balance, despite further increases in short-term

interest rates. The resulting narrowing of the spread between long- and short-term rates apparently reflects some lessening of concerns about inflation, brought about in part by the firmer monetary policy. Long-term yields also have benefited recently from the upward movement of the dollar against most major currencies, as the trade balance has continued to improve. The change in attitude toward the dollar apparently has encouraged investments in relatively high yielding dollar assets.

In the aftermath of the stock market crash last October, the Committee modified the System's procedures by placing greater emphasis on money market conditions and less on bank reserve positions in carrying out day-to-day open market operations. In doing so, it was neither the Committee's intention to alter its operating procedures permanently nor to ignore bank reserve positions completely. Rather, the thrust of the modification was to permit greater flexibility in System operations in light of the volatility and fragility characterizing financial markets at that time. During this period, it was considered important to assure the markets of the System's intention to provide adequate liquidity, and it was feared that significant variation in money market conditions could add to the unusual uncertainties already in the markets.

As markets exhibited signs of increased stability this year, the Committee responded by gradually placing greater emphasis on reserve positions in conducting System operations, allowing money markets to respond more sensitively to changing economic circumstances. The transition back to the pre-October approach was completed in the spring.

#### *Other Financial Developments*

The collapse of equity prices last October heightened public concerns about the volatility of stock prices and the fragility

of financial institutions and markets. These concerns became the subject of studies by a presidential commission, governmental agencies, and the securities industry. Recommendations from these groups and from a follow-up presidential working group focused on ways to avoid excessive stock price volatility and to strengthen the ability of markets and related systems to deal with large price movements. Progress has been made in this regard, with steps having been taken by market participants to address some of the problems revealed by the market break in clearing and settlement systems. Additional steps have been taken to coordinate trading halts triggered by extreme price moves and to strengthen capital positions of specialists and other market makers.

In considering the possibility of future regulatory action in this sphere, it is noteworthy that the stock market break has not been followed by any major aftershocks. In part, this reflects the basic resilience in this period of the economy and financial markets. In addition, it attests to the general adequacy of the current regulatory framework and monetary policy institutions in cushioning financial disturbances, so that they do not spread to the economy as a whole. Thus, while the additional steps initiated by private entities to strengthen market mechanisms certainly are desirable, a major extension of the governmental regulatory apparatus does not seem necessary.

The banking industry also has been the subject of considerable concern, arising from its well-publicized difficulties with energy, agricultural, real estate, and developing country loans. These problems have been highlighted by the many bank closings and the rescue by bank regulators of several large banks. As a result of large banks choosing to make sizable increases in loan-loss reserves,

profits reported by the banking industry as a whole in 1987 were down nearly 80 percent from 1986. Despite these difficulties, some bright spots emerged last year, especially the improved performance of agricultural banks. It is important to note, however, that throughout this period of stress in the industry, the commercial banking system has continued to play its crucial role as a provider of credit to the economy.

The savings and loan industry continues to be under financial stress. Although the majority of savings and loans are healthy and reasonably profitable, the industry as a whole reported enormous losses in 1987 and in the first quarter of 1988. Roughly one-sixth of the institutions are insolvent when evaluated in accordance with generally accepted accounting principles, and their aggregate losses increased in 1987 and in the first quarter of 1988. The prospects for the recovery of the insolvent institutions are not bright, implying that the Federal Savings and Loan Insurance Corporation (FSLIC) will be required either to liquidate them or to assist in their absorption by stronger institutions.

The deterioration of the savings and loan industry has affected the financial condition of FSLIC, whose net worth became more deeply negative in 1987. Congress approved a plan last year providing nearly \$11 billion to recapitalize FSLIC. This action has helped FSLIC liquidate several large and especially troubled savings and loans, but concerns persist in the market that the total available new capital may fall short of that needed for FSLIC to deal fully with the problem institutions.

The difficulties of many individual depository institutions have been associated, in most cases, with specific types of loans or certain regions and countries. However, concerns have been expressed more generally about the financial health

of households and businesses—especially about the ability of these sectors to service their debts if interest rates were to rise sharply or business conditions were to weaken significantly.

With regard to households, the rapid growth of their debt during the current economic expansion has outstripped that of disposable income. The ratio of household sector indebtedness to income is at an all-time high. Recent information also shows a rising level of personal bankruptcies and a relatively high level of delinquencies on certain types of consumer loans.

Although these developments suggest that debt burdens may be difficult for some households to manage, other evidence indicates that most households are able to meet their debt obligations reasonably well. The trend toward longer repayment schedules has held down debt-service payments. The increased use of adjustable-rate mortgages has made the financial positions of many households more vulnerable to increases in interest rates; however, at the same time, deposit deregulation has meant that household interest income is more responsive to changes in rates. Furthermore, for the sector as a whole, assets have risen more rapidly than debt, implying increases in household net worth. Indeed, survey information indicates that many families with consumer debt have substantial amounts of financial assets that could be tapped to meet debt-service obligations in the event that incomes proved to be inadequate.

Like households, businesses have added greatly to their indebtedness in recent years. Many companies have dramatically increased their leverage through debt-financed merger, buyout, and share retirement activity. Reflecting heavier debt loads, the bite that interest payments take out of corporate cash flow is near historically high levels for the

nonfinancial corporate sector as a whole. A downturn in earnings would place serious debt-servicing strains on many individual firms. In addition, heavy reliance on floating-rate loans and short-term debt obligations has rendered many firms vulnerable to a significant rise in borrowing costs. In reflection of this situation, downgradings of corporate debt have continued to exceed upgradings by a large margin.

Firms would not have been able to assume these greater financial exposures were it not for receptive attitudes among lenders and equity investors. Companies engaging in restructurings that have involved the addition of massive amounts of debt to their balance sheets have been rewarded with sizable runups in their share prices; this is reflected in the absence of an uptrend during the 1980s in the market-value based "debt/equity" measure. Moreover, lenders are exacting relatively small risk premiums on debt obligations incurred by firms, as reflected, for example, in the spreads between yields on high-grade corporate bonds and Treasury securities or even those for below-investment-grade "junk" bonds. Nonetheless, our financial history provides numerous reminders of the fragility of this type of situation: last fall, for example, when confidence was jolted by the stock market break, yield spreads widened dramatically, and the availability of new credit to riskier borrowers was sharply curtailed.

### Appendix: The Monetary Base

In recent years, the monetary base has received increased attention as the behavior of other monetary aggregates—especially M1—has diverged from historical patterns. In part, the appeal of the base has resulted from the notion that it may have a reasonably stable relationship with nominal spending. In addition, it is

perceived as being more directly under the control of the Federal Reserve than are the broader aggregates. This appendix reviews the historical and analytical characteristics of the monetary base. It discusses its definition, its relation to income and other economic variables, and its control by the Federal Reserve.

#### *Concepts, Definitions, and Measurement*

The monetary base consists of currency in the hands of the nonbank public and reserves held by depository institutions—both reserves required to be held against deposits and the additional, "excess" reserves that depository institutions choose to hold. Because reserve requirements are substantially higher for transactions deposits (that is, checkable deposits) than for nontransactions deposits, the bulk of required reserves—about three-quarters—is related to transactions deposits. In turn, transactions deposits consist primarily of demand deposits and other checkable deposits, which are the principal components of the narrow monetary aggregate M1. Thus, both through its currency component and its reserves component, the monetary base is closely related to M1. The links between the monetary base and broader measures of money, such as M2 and M3, are much looser because most savings-type instruments in these measures either are not reservable or have a much lower reserve requirement applied to them. Moreover, currency accounts for an even smaller share—on the order of 5 percent—of these aggregates.

Looking at the base as currency and reserves focuses on the monetary liabilities of the Federal Reserve—frequently referred to as the "uses" of the base.<sup>2</sup> Alternatively, the base can be measured from its "sources" in the Federal Reserve

2. Technically, the base also encompasses a relatively small amount of U.S. Treasury liabilities.

balance sheet, the assets held by the System less its nonmonetary liabilities. The two concepts are identical if all components are measured contemporaneously.

There are two publicly available measures of the monetary base. One, corresponding to the uses concept, is constructed by the Board and the other, a sources concept, is produced by the Federal Reserve Bank of St. Louis. Besides the difference in accounting approach, which affects the treatment of vault cash used to meet reserve requirements, the two measures differ in the method of adjustment for changes in reserve requirements and in the method of seasonal adjustment.

The Board measure constructs the base from the currency component of the money stock (currency held by the non-bank public) (76 percent), total reserves (lagged vault cash, up to required reserves, plus reserve deposits at the Federal Reserve banks) (23 percent), and a third component that includes current surplus vault cash held at depository institutions plus service-related balances (1 percent).<sup>3</sup>

The St. Louis measure, consistent with its sources concept, comprises Federal Reserve credit—holdings of U.S. government securities, discounts and advances, Federal Reserve float, and other Federal Reserve assets—plus other sources, including the gold stock, special drawing rights and Treasury currency outstanding. It subtracts several categories of liabilities, namely, Treasury and foreign deposits at the Federal Reserve,

Treasury holdings of coin and currency, and certain miscellaneous items. Implicitly, all vault cash is treated contemporaneously.<sup>4</sup>

The St. Louis and Board measures of the monetary base have moved together over time, though the St. Louis measure generally lies above the Board measure, reflecting differences in techniques for adjustment of breaks caused by changes in reserve requirements. In terms of growth rates, the two series track each other closely.

Growth of the monetary base has been much smoother on average than that of the other monetary aggregates.<sup>5</sup> In large measure, the smooth growth of the base can be attributed to its large currency component, which over long periods of time has expanded in a relatively stable fashion. Between 1959 and 1987, the average quarter-to-quarter fluctuation of growth in currency in circulation was less than one-fifth of the quarterly fluctuation in growth of total reserve balances.

While growth in the base has been relatively smooth, its longer-run pattern has not differed markedly from that of other narrow aggregates. Specifically,

4. There are two other differences between the Board base and the St. Louis base concerning seasonal adjustment and adjustments for changes in reserve requirements. St. Louis seasonally adjusts the whole base directly after adding a reserve adjustment magnitude (RAM) to account for regulatory changes in reserve requirements as well as changes in composition of deposits. For the Board measure, currency, total reserves, and the residual component are seasonally adjusted separately, after applying to the reserves and residual components certain break adjustment factors, and finally the components are summed. The Board's break adjustment method is intended to adjust only for regulatory changes in reserve requirements.

5. This and subsequent mentions of the monetary base refer specifically to the Board measure of the base but, in view of the close relationship between the two measures, should apply nearly as well to the series produced by the Federal Reserve Bank of St. Louis.

3. "Vault cash" included in total reserves is lagged four weeks, which reflects its use to meet reserve requirements. "Surplus vault cash" is bank holdings of currency in excess of required reserves. "Service-related balances" comprise other balances held by depository institutions at the Federal Reserve, including required clearing balances and adjustments to compensate for Federal Reserve float.

the velocity of the monetary base has behaved similarly to M1's velocity, with a pronounced break in the 1980s from its earlier behavior. Between 1960 and 1980, the velocities of the base, M1-A (currency plus demand deposits), and M1 all rose, in part reflecting the effects on money demand of the generally rising trend of interest rates. Fluctuations of base velocity around its trend during the 1960s and 1970s were comparable with those of the other aggregates. And, in the 1980s, velocity of the base and M1 declined both absolutely and relative to the earlier trend as deregulation and falling market interest rates encouraged a large volume of funds to move into transaction deposits.

Statistical methods of relating growth in income to past growth rates in the base produce results that echo this pattern of velocity behavior. When these relationships are estimated using data through 1980, they make substantial errors in predicting nominal GNP in subsequent years, much as do equations involving other aggregates—especially the narrow aggregates. Techniques that allow for a break in behavior in the early 1980s make somewhat smaller but still large errors in the 1980s and leave unanswered questions about the potential for additional shifts in the relationships.

An examination of the demand properties of the base can shed light on the determinants of the behavior of its velocity and the errors made in predicting GNP. The demand for the base is derived from demands for its components, currency and reserves. The demand for reserves, in turn, depends on demands for excess reserves and for reservable deposits—primarily the transactions deposits that are included in M1 but also some that are not in that aggregate, such as interbank and U.S. government deposits and certain time and savings deposits.

Analysis by the Board's staff has found that the demand for the base has substantial interest sensitivity, mainly reflecting the interest sensitivity of demand deposits and other checkable deposits.<sup>6</sup> This interest responsiveness, together with the drop in interest rates during the 1980s, helps to explain the turnaround in base velocity, much as it explains the movements in the velocities of other monetary aggregates—especially M1—in recent years. However, the base probably is less interest sensitive than are the other monetary aggregates, because of the importance of the currency component, which does not respond very much to changes in interest rates. This implies that efforts to control the base to predetermined target ranges could involve very wide swings in interest rates. Whether those fluctuations would be beneficial to the economy depends in part on the stability of the demand relationship. If the demand for the base is relatively stable, the interest rate movements would tend to stabilize GNP in the face of disturbances to spending. But if base demand tends to move unpredictably, the interest rate movements associated with controlling the base would tend to destabilize GNP.

Over long periods of time, the demand for the base appears to be fairly predictable, especially compared with M1-A and M1. Movements in transactions deposits, especially demand deposits, often have been somewhat erratic, tending to loosen the relationships of M1-A and M1 with GNP, but their effects on base demand are muted by the fractional nature of reserve requirements. Another

---

6. An estimated demand equation for the base was derived from the Board staff's standard models of demand for currency and demand for required reserves on transactions accounts in M1 only. Demands for other components of reserves were not explicitly modeled, as the effects of these components on required reserves are relatively small.

factor contributing to the relative stability of the demand for the base is that unpredictable movements in transaction deposits at times have tended to offset unexplained changes in currency, perhaps owing to substitution between currency and demand deposits. However, there is considerable variability in the relationship of the base to income and other variables over periods of a year or less—and evidence suggests that at least over these shorter periods it is no more stable than M2.

In considering the past and prospective degree of stability of demand for the base, attention must be directed to its largest component, currency. Analysts have noted the extraordinarily large volume of dollar currency outstanding relative to measured U.S. economic activity or the number of households. Although available data are inadequate to determine even approximate magnitudes, it seems likely that a substantial part of U.S. currency is being employed in support of activity that is not reflected in U.S. GNP—in particular, activity outside our borders. Especially to the extent this activity and the currency to support it move independently of U.S. GNP, this would tend to reduce the usefulness of the base as an indicator or target.

Not only is it difficult to account fully for the level of currency outstanding, but growth occasionally has been at variance with expectations, despite the relatively stable long-run relationship with measured income. For example, in the past year and a half, growth of currency has been roughly twice as rapid as would be expected on the basis of historical experience, judging by the Board staff's quarterly econometric model, with no obvious explanation for the strength.

#### *Controllability of the Monetary Base*

For the most part, the Federal Reserve historically has supplied the monetary

base to accommodate its demand. This has been a consistent policy with regard to demands for currency. With respect to reserves, the interactions have been more complex. Except in the early 1980s, reactions to deviations of reserves from expectations have been quite indirect. Any increases or decreases in the demand for reserves have been completely accommodated in the short-run. However, over time persistent deviations in money (and implicitly reserves) from objectives have prompted adjustments in monetary policy when those deviations were judged likely to be associated with unwelcome developments in the economy.

Even in the period from late 1979 through late 1982, when the Federal Reserve used nonborrowed reserves as an operating target to achieve goals for money growth over time, total reserves were not closely controlled because borrowed reserves adjusted in response to deviations in money growth from objectives.

Because of the remaining two-day lag between the ends of the reserve computation and reserve maintenance periods, control of total reserves or the monetary base would need to be indirect, working through the effects of changes in interest rates on the demand for the components of the base in the short run. In this respect, control of the base is achieved in the same way as for the broader aggregates. It is likely that the base, or for that matter any of the broader aggregates, could be controlled reasonably well over a span of several quarters—a period that would be meaningful in terms of the effects of monetary policy. However, the degree of interest rate volatility under base targeting could be quite substantial, especially in the short to intermediate run. Changes in the quantity of the base demanded that caused the base to deviate from its target would need to be offset in the short run mainly by changes in



reserves (given the low interest sensitivity of currency demand), which would have multiple effects on the quantity of money. ■

---

## *Part 2*

# *Records, Operations, and Organization*

## *Record of Policy Actions of the Board of Governors*

### **Regulation C (Home Mortgage Disclosure)**

August 3, 1988—Revision and  
Adoption of New Reporting Forms

The Board revised Regulation C to implement recent amendments to the Home Mortgage Disclosure Act and to clarify the regulatory language.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and Kelley.<sup>1</sup>

Early this year, the Congress amended the Home Mortgage Disclosure Act of 1975, expanded its coverage, and made it permanent. The act requires institutions that have more than \$10 million in assets and that operate in a metropolitan statistical area to disclose annually certain detailed information about their home mortgage lending. The recent amendments expanded the coverage of the act to include savings and loan service corporations and mortgage banking subsidiaries of bank and savings and loan holding companies. Accordingly, the Board revised the implementing regulation and the related reporting forms and instructions and clarified the language of the regulation.

The revisions were effective September 19, 1988, except that after January 1, 1989, the provisions governing the definition of loans for home improvement

and home purchase will include loans related to mobile and manufactured homes.

### **Regulation D (Reserve Requirements of Depository Institutions)**

November 29, 1988—Amendments

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

Votes for these actions: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, Kelley, and LaWare.

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 annually to reflect changes in transaction balances nationwide. By the beginning of 1988, this amount was \$40.5 million. Recent growth in such balances warranted an increase of \$1 million. The Board, therefore, amended Regulation D to increase to \$41.5 million the amount of transaction account balances to which the lower reserve requirement applies.

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

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 from \$3.2 million to \$3.4 million in the amount subject to a zero percent reserve requirement, and the Board amended Regulation D accordingly.

The amendments are effective beginning December 20, 1988.

### **Regulation K (International Banking Operations)**

February 3, 1988 – Amendment

The Board amended Regulation K, effective February 24, 1988, to liberalize the conditions under which bank holding companies may make debt-for-equity swaps.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and Kelley. (Governor Angell abstained from voting on the review of general consent limits.)<sup>1</sup>

In August 1987 the Board amended Regulation K to permit U.S. banking organizations to make certain investments abroad using debt-for-equity swaps. (Swaps are useful primarily in a country that has restricted or prohibited foreign creditors from expatriating its currency.) That amendment allowed a U.S. bank holding company to acquire up to 100 percent of the shares of a nonfinancial company in a swap, provided the following conditions were met: (1) the company must be in the process of being transferred from public to private ownership; (2) the company must be located in a country that is heavily indebted; (3) the shares acquired through

the swap must be held by the holding company or a subsidiary and not by the 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.

The Board decided to amend the regulation further to provide additional flexibility in making debt–equity investments. Under the new rules, the investment must be made by the holding company or its subsidiary, and not by the bank. The other conditions are as follows: (1) A U.S. holding company may acquire up to 40 percent of the equity, including voting shares, of a privately owned company. If the organization acquires more than 25 percent, there must be another investor holding a larger block of shares. (2) A holding company that holds more than 20 percent of a company's equity may not finance more than one-half of the company's borrowing needs. (3) The organization may hold the investment for the lesser of 15 years or up to 2 years after the country cancels restrictions on the repatriation of investments. This divestiture period also applies to investments made under the earlier amendment.

The Board also revised its general consent procedures for foreign investments made under debt–equity swaps. Under the regulation's general consent rules, a bank holding company may invest up to \$15 million in a company, or 5 percent of the capital and surplus of the company, whichever is smaller, without first seeking Board approval. For larger investments, a bank must notify the Board of its intentions and may proceed with the acquisition if the Board has not indicated its disapproval within 45 days. A majority of Board members believed that a more liberal general consent provision was appropriate, and they agreed, Governor Angell abstaining, to establish the cutoff for making investments under this amendment without Board approval at \$15

million or 1 percent of the investing organization's equity capital, whichever is greater.

## **Regulation T (Credit by Brokers and Dealers)**

August 10, 1988 – Amendments

The Board amended Regulation T, effective September 15, 1988, to make certain foreign debt securities eligible for margin credit.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and Kelley.<sup>1</sup>

The Board revised the definition in Regulation T of over-the-counter margin bonds to include long-term nonconvertible debt securities issued by foreign governments or supranational entities. The amendment allows brokers and dealers to extend margin credit on long-term debt securities issued or guaranteed as a general obligation by a foreign sovereign, its entities, or a supranational organization, if there is available for the obligation an explicit or implicit rating, in one of the two highest categories, by a nationally recognized statistical rating service.

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

September 6, 1988 – Amendments

The Board amended Regulation Y to implement the Competitive Equality Banking Act of 1987.

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

The Competitive Equality Banking Act, which revised the definition of "bank" in the Bank Holding Company Act to include any institution whose deposits are insured by the Federal Deposit Insurance Corporation, precludes the formation of new FDIC-insured nonbank banks. The act permits a nonbanking company that controlled a nonbank bank on March 5, 1987, to retain it, without being treated as a bank holding company, provided certain conditions are met. Those conditions generally restrict the ability of nonbank banks: to commence new activities or engage in new cross-marketing activities with affiliates after March 5, 1987; to permit overdrafts by or incur overdrafts for affiliates at a Reserve Bank; or to expand their assets by more than 7 percent during any 12-month period after August 10, 1988. The act also prohibits the parent company from acquiring more than 5 percent of an additional bank after the 1987 cutoff date.

## **Regulation CC (Availability of Funds and Collection of Checks)**

May 11, 1988 – Adoption

The Board adopted Regulation CC, effective September 1, 1988, to carry out the requirements of the Expedited Funds Availability Act of 1987.

Votes for this action: Messrs. Greenspan, Johnson, Angell, and Kelley. Votes against this action: Ms. Seger and Mr. Heller.<sup>1</sup>

The act and the regulation impose new requirements for more prompt processing of checks. Banks and other depository institutions now must make funds deposited in transaction accounts available on a specified schedule; disclose their availability schedules to customers; and promptly pay interest on funds deposited in accounts. In general, banks must make

funds available for withdrawal within three business days of deposit, if the check is deposited in a local bank. (A depository bank is determined to be local if it is located in the same Federal Reserve check processing region as the paying bank.) Proceeds from nonlocal checks must be made available within seven business days of deposit. In addition, certain types of checks, such as Treasury checks, state and local government checks, and cashier's checks, must be available for withdrawal the next business day after deposit. Under certain exceptions specified in the regulation, a bank is permitted to place longer holds on a check.

The regulation also includes rules to expedite the collection and return of checks by requiring paying banks to return checks promptly, by authorizing direct returns, and by expanding the requirements governing notices of nonpayment of checks written for amounts above \$2,500. The rules requiring the prompt collection of checks will help reduce the risk that banks might incur when making funds available within the schedules mandated by the regulation.

In addition to rules regarding the availability of funds and the return of checks, the regulation also includes endorsement standards that allow banks to identify more easily the depository banks to which returned checks or notices of nonpayment should be sent.

Governors Seger and Heller opposed adoption of the regulation because they believed it was too burdensome relative to the benefit that consumers would derive from it. Governor Seger was concerned about the regulatory burden on smaller institutions. Governor Heller believed that the burden of the rulemaking was excessive relative to the benefits that consumers would derive. He thought that the benefits would be small and that

some consumers might even be adversely affected by the new rules.

August 10, 1988—Interim rules  
October 19, 1988—Final rules

The Board adopted interim rules for Regulation CC to implement a recent court ruling relating to payable-through checks.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell and Kelley. Vote against this action: Mr. Heller.<sup>1</sup>

The Board amended Regulation CC to adopt the rules in final form.

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

In May the Board adopted Regulation CC, effective September 1, 1988, to implement the Expedited Funds Availability Act. One provision of the regulation had held that a bank check or credit union share draft written on an account at one institution but payable through another institution would be considered local or nonlocal depending on the location of the institution through which the check would be paid. A court decision in July, however, found that that provision was inconsistent with the definition of originating depository institution in the act. The court ruled that the location of the institution on which the check was written—and not the bank through which the check would be paid—should determine whether an item was local or nonlocal.

Because the regulation would become effective shortly after the court's ruling, the Board adopted interim amendments in August to comply with the ruling and at the same time sought public comment

on the amendments. The interim amendments revised several definitions, and also required certain banks and credit unions to amend their disclosure statements. Governor Heller dissented from this action, for the same reason he had dissented when the Board adopted Regulation CC, because he believed the regulatory burden imposed was excessive relative to the benefit consumers would derive.

In October, the Board amended the regulation to adopt the rules in final form, with certain technical revisions. In addition, based on comments received on the interim rules, the Board sought comment on further refinements to the regulation that would ease possible operational difficulties and reduce the risks resulting from the revised rule.

## Policy Statements

### April 20, 1988—The Selection of Securities Dealers and Unsuitable Investment Practices

The Board issued a supervisory policy statement, effective immediately, regarding a bank's selection of securities dealers and the investment practices considered inappropriate for its investment portfolio.

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

The Federal Financial Institutions Examination Council had recommended that the member agencies issue a joint policy statement to advise depository institutions of trading practices that are considered inappropriate when used for the purchase and sale of securities held in an institution's investment portfolio. The statement advises institutions of consid-

erations in selecting a securities dealer and indicates that management should evaluate the condition of securities firms with which they do business. The statement also describes several types of securities with volatile prices and high-risk characteristics that might be unsuitable for an institution's investment portfolio, especially if those securities are held in significant amounts.

### December 16, 1988—Risk-Based Capital Standards and Implementation Guidelines for U.S. Banks and Bank Holding Companies

The Board adopted a new framework for the assessment of capital adequacy and issued guidelines for the application of its standards to U.S. banking organizations.

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

In late 1987, U.S. bank regulators began working with bank supervisors abroad to develop a new framework for assessing bank capital. U.S. regulators and supervisors in eleven other industrialized countries were seeking a uniform capital standard that not only would permit comparisons among banking organizations from different countries but also would be more sensitive to risk factors, including off-balance-sheet risk exposures. After many months of deliberations, the supervisors developed a framework that will permit greater comparability in the measurement and assessment of capital internationally. Also, it will reduce competitive inequities that arise from differences in supervisory treatment among nations.

The new capital framework provides a common definition of the core capital elements that constitute tier I capital, as

well as certain other supplementary capital elements that constitute tier II. In addition, the risks associated with particular types of assets and off-balance-sheet items (which are converted into balance sheet equivalents) are factored into the capital framework by assigning such claims to one of five broad risk categories that have weights ranging from zero to 100 percent. The new standards encourage banking organizations that do business internationally to strengthen their capital positions.

Banking organizations having capital ratios below the minimum established by the new framework are encouraged to strengthen their capital positions as soon as possible. The three U.S. bank regulators expect to begin applying the capital framework in mid-March 1989. The transitional minimum standards for all U.S. banks and bank holding companies will become effective at the end of 1990, and final standards will take effect at the end of 1992.

Governor Seger, who was absent when the standards were adopted, had indicated her opposition to the framework during an earlier discussion of risk-based capital. Governor Seger opposed the standards primarily because of the credit allocation aspects of the risk weights assigned to the various categories of assets and the capital requirements for certain activities. Also, because of the expediency of developing an international standard, she feared that the consequences of assigning those assets to particular risk categories might not have been assessed sufficiently. In addition, she did not think the standards should be applied to bank holding companies.

### **1988 Discount Rates**

The Board approved one change in the basic discount rate during 1988, an increase in August from 6 to 6½ percent.

During the year the Board also voted at four meetings to disapprove requests for increases or decreases submitted by individual Federal Reserve Banks. In April, the Board decided not to renew its temporary, simplified seasonal 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 the related 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 1988, including the votes on those actions, follows this review.

#### **Actions on the Basic Discount Rate**

During the first three months of the year, the Board discussed but took no action on a request, renewed biweekly, from one Federal Reserve Bank to reduce the basic discount rate by ½ percentage point; the proposed reduction was lowered to ¼ percentage point late in the first quarter. Some easing of reserve conditions had been sought through open market operations in late January and early February, but the Board felt that business and financial developments did not warrant an accompanying reduction in the discount rate. Later in the quarter indications of a stronger economic expansion than was anticipated earlier in conjunction with faster growth of the monetary aggregates reinforced the Board's view that the discount rate should not be reduced.

On April 4 the Board turned down the still pending request to reduce the discount rate by ¼ percentage point. This action followed a decision in late March by the Federal Open Market Committee to increase slightly the degree of pressure on reserve positions because of growing



concerns that the expansion might gather excessive and inflationary momentum. During the latter part of April, the Board discussed but took no action on requests from two Federal Reserve Banks calling respectively for an increase and for a decrease of  $\frac{1}{4}$  percentage point in the basic discount rate.

In May and June a growing number of Federal Reserve Banks submitted requests for increases of  $\frac{1}{4}$  or  $\frac{1}{2}$  percentage point in the basic rate. The proposed increases were seen by the Banks as a desirable complement to the gradual tightening of monetary policy that had been implemented through open market operations since late March. On July 5 the Board disapproved pending requests from seven Banks to raise the basic rate by  $\frac{1}{2}$  percentage point. In the Board's judgment, current economic and financial developments, including upward pressures on the dollar in foreign exchange markets, argued on balance against a near-term increase in the discount rate. The Board recognized that prospective developments might call for a higher rate subsequently, but felt that denying rather than taking no action on the pending increases would serve the useful purpose of communicating the Board's current thinking to the Federal Reserve Banks.

On August 9 the Board approved an increase of  $\frac{1}{2}$  percentage point in the basic discount rate to a level of 6 $\frac{1}{2}$  percent. Recent economic statistics, notably on the employment situation in July, suggested a stronger economy than previously appeared to be evolving. In these circumstances the Board concluded that an increase in the discount rate would usefully complement earlier moves to tighten monetary policy through open market operations in order to reduce inflationary pressures. In reaching its decision the Board also took into account the substantial rise in short-term interest

rates that had occurred over the course of recent months and the resulting increase in the spread between such rates and the discount rate. An increase in the discount rate was expected to result in firmer conditions in money markets without widening the spread further.

Subsequently, on September 6 and October 17, the Board disapproved requests from one Federal Reserve Bank to raise the discount rate by a further  $\frac{1}{2}$  percentage point. In the Board's view, the increasing degree of monetary restraint that had been implemented since early spring and some recent indications that the rate of economic growth might be slowing argued against approval of the proposed increase, pending an evaluation of further economic developments.

Toward the end of the year, incoming information suggested that the economic expansion retained considerable momentum and that inflationary pressures remained substantial. Indeed, the risks appeared to have increased that such pressures would intensify in the absence of further monetary tightening. Against this background, the Federal Open Market Committee adjusted its operations toward a greater degree of reserve pressure in late fall and a growing number of Federal Reserve Banks, totaling seven by the second half of December, proposed increases of  $\frac{1}{2}$  percentage point—or in one case a full percentage point—in the basic discount rate.

The Board reviewed but took no action on the proposed increases. In the Board's view, economic and financial developments might warrant a higher discount rate later, but an immediate increase could have unintended repercussions under prevailing conditions in domestic and international financial markets. In particular, it might convey a misleading impression of the extent of the System's policy tightening intentions and generate an undesired degree of upward pressure

on domestic interest rates and on the value of the dollar in foreign exchange markets.

### Termination of Temporary Seasonal Credit Program

On April 4, 1988, the Board decided to discontinue its temporary seasonal credit program. This program was originally approved and implemented in 1985, when financial conditions in the agricultural sector were deteriorating substantially, and renewed for each of the following two years. Its purpose was to make funds available at the discount window to agricultural banks that were experiencing exceptionally strong loan demands in those unusual circumstances. The program was designed 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 their efforts to accommodate their farm borrowers over the planting and production cycle. The Board agreed not to renew the program in light of the improved outlook for the agricultural sector and the relatively small use of the program.

### Structure of Discount Rates

The basic discount rate is the rate charged on loans to depository institutions for short-term adjustment credit. The basic rate also applies to the seasonal credit 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.

A higher, flexible rate may be charged on loans made over extended periods for other than seasonal purposes to depository institutions that are under sustained

liquidity pressure and that are not able to secure similar credit on reasonable terms from other sources. The flexible rate is related to market rates and is adjusted periodically, subject to Board approval. At the discretion of the lending Federal Reserve Bank, the first 30 days of borrowing on extended credit may be at the basic rate, but any further borrowings are charged the higher flexible rate. The highest rate applicable to any credit extended to a depository institution will be charged on exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems, unless the operating problem clearly is beyond the reasonable control of the borrowing institution; under the current rate structure that rate is the flexible rate.

As of December 31, 1988, the structure of discount rates was as follows: a basic rate of 6½ percent for short-term adjustment credit and for credit under the seasonal program, and a flexible rate of 9.55 percent. During 1988 the flexible rate ranged from a low of 7.10 percent early in the year to a high of 9.55 percent at year-end.

### Board Votes

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. Reserve Bank actions on the discount rate include requests 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 and termination of the temporary simplified seasonal credit program. Votes relating to the reestab-

ishment of existing rates or the updating of market-related rates under the extended credit program are not shown. All votes during 1988 were unanimous.

*Votes on the Basic Discount Rate*

*April 4, 1988.* The Board disapproved an action taken by the directors of the Federal Reserve Bank of Dallas on March 24 to reduce the basic discount rate from 6 to 5½ percent.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and Kelley.<sup>1</sup>

*July 5, 1988.* The Board disapproved actions taken on the following dates by the directors of the following Federal Reserve Banks to increase the basic discount rate from 6 to 6½ percent: Philadelphia, Cleveland, Richmond, Chicago, and St. Louis on June 23; Atlanta on June 24; and New York on June 30.

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

*August 9, 1988.* Effective August 9, 1988, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, St. Louis, Minneapolis, Kansas City, and San Francisco to increase the basic discount rate from 6 to 6½ percent.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and Kelley.<sup>1</sup>

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Bank of Chicago, effective August 10, and by the directors of the Federal Reserve Bank of Dallas, effective August 11, 1988.

*September 6, 1988.* The Board disapproved an action taken by the directors of the Federal Reserve Bank of Cleveland on August 25 to increase the basic discount rate from 6½ to 7 percent.

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

*October 17, 1988.* The Board disapproved an action taken by the directors of the Federal Reserve Bank of Cleveland on October 13 to increase the basic discount rate from 6½ to 7 percent.

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

*Vote on the Temporary Seasonal Credit Program*

On April 4, 1988, the Board voted to terminate the temporary, simplified seasonal credit program for small and medium-size banks that lend to agricultural borrowers.

Votes for this action: Messrs. Greenspan and Johnson, Ms. Seger, and Messrs. Angell, Heller, and Kelley.<sup>1</sup> ■

## *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 1988, 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 1988 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 1988. 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, 1988**

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to

carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than \$6.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;<sup>1</sup>

(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 condi-

1. Pursuant to an action taken by the Committee at its meeting on Dec. 15-16, 1987, the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities was set at \$9.0 billion for the period through the close of business on Feb. 10, 1988, at which time the limit reverted to \$6.0 billion.

tions imposed on purchases and sales of securities in paragraph 1(c), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

## Domestic Policy Directive

### In Effect January 1, 1988<sup>2</sup>

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 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

2. Adopted by the Committee at its meeting on Dec. 15-16, 1987.

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 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.

At the conclusion of a telephone meeting on January 5, 1988, 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.

## **Authorization for Foreign Currency Operations**

### **In Effect January 1, 1988**

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 \$12.0 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 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 member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager for 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, 1988

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.

**Meeting Held on  
February 9–10, 1988**

## Domestic Policy Directive

The information reviewed at this meeting indicated that economic activity continued to expand rapidly in the fourth quarter, although gains in output appeared to have moderated around year-end. Over the quarter as a whole, manufacturing output recorded a sizable further increase, supported by continued strong demands for exports. Domestic final sales

weakened, however, with consumption outlays and business fixed investment declining, and much of the rise in production apparently went into inventories. The rate of inflation was held down late in the year by declines in energy prices, while wage trends showed little change.

Industrial production rose considerably over the fourth quarter, but the increase slowed in November and moderated further in December. Output of consumer goods, which changed little in both months, was held down by reductions in automobile assemblies. Also, output of business equipment edged lower after substantial growth over the summer and early autumn. Nonfarm payroll employment grew at a brisk pace in the fourth quarter, but slowed substantially in January. In manufacturing, employment gains moderated in January as sizable increases in a few industries were partly offset by layoffs elsewhere. In contrast to the payroll survey, total employment as measured by the household survey was up sharply in January, bringing the rise over the past four months into line with the advance in payroll employment. The growth in the labor force about matched the rise in household employment in January, and the civilian unemployment rate was unchanged at 5.8 percent.

Consumer spending remained sluggish in recent months. Excluding motor vehicles, real outlays on goods and services were essentially unchanged during the last three months of 1987. Sales of new automobiles improved after incentives were reintroduced in mid-November, but dealer inventories remained high. With consumer spending weak and growth in disposable income stronger in the fourth quarter, the saving rate rose considerably to 4.9 percent.

Housing starts fell to an annual rate of 1.37 million units in December, reflecting a sharp drop in the multifamily sector

after a surge in November and some decline in the single-family area. Sales of new and existing homes also decreased in late 1987. For the fourth quarter as a whole, total starts were down appreciably from their averages in the previous two quarters.

Business fixed investment fell somewhat in the fourth quarter, after an exceptionally large rise in the previous quarter. Spending on information-processing equipment, which earlier had grown rapidly, appeared to slow, and business purchases of motor vehicles declined. At the same time, expenditures for industrial equipment continued to expand as did spending for nonresidential construction, including sizable increases in outlays for office structures and other commercial buildings. New orders for nondefense capital goods, excluding aircraft, were little changed in the fourth quarter, after appreciable gains earlier in the year, while new building commitments continued to increase.

Inventory investment rose strongly in October and November. The increase was concentrated in the trade sector, particularly at automobile dealers and merchant wholesalers. Stocks at non-auto retailers also continued to expand at a faster rate than sales, especially at general merchandise, apparel, and furniture stores. In contrast, manufacturers' inventories remained low relative to shipments.

Increases in consumer prices moderated in late 1987, reflecting a decline in retail energy prices in response to earlier decreases in crude oil prices. The consumer price index was up only slightly in December, when prices of consumer goods also were held down by extensive markdowns on holiday merchandise and by the latest round of incentives for automobile sales. At the producer level, prices of finished goods fell somewhat in late 1987. Hourly compensation in the

private nonfarm sector increased at a moderate pace over recent months, little changed from earlier trends.

The nominal deficit in U.S. merchandise trade was estimated to have increased slightly over October and November from the average rate in the third quarter, but in real terms the trade deficit as measured in the GNP accounts appeared to have narrowed further. Nonagricultural exports rose somewhat over the first two months of the quarter, but agricultural exports fell slightly. Non-oil imports rose considerably in the October–November period from the third-quarter pace, with the increases widespread. Oil imports, however, fell somewhat as both price and volume declined. The increases in prices of exports and of non-oil imports accelerated in the fourth quarter to rates experienced in the first two quarters of 1987, reversing the slower increases in the third quarter. Recent indicators of economic performance in major foreign industrial nations were mixed, after strong growth of real GNP in most of those countries in the third quarter of 1987. Data continued to suggest relatively vigorous growth in Japan, the United Kingdom, and Canada. In contrast, expansion appeared to have slowed during the fourth quarter in Germany, France, and Italy.

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies increased about 3 percent over the period since the December meeting. The dollar rose about 1½ percent in terms of the yen and about 4 percent in terms of the mark during the intermeeting period. Early in the period, the dollar fell sharply owing to heightened concerns about prospects for adjustment of U.S. external imbalances and reports that G-7 authorities no longer supported the Louvre accord. The G-7 authorities released a statement in late December reaffirming the objectives and

economic policy commitments of the Louvre accord, and the dollar retraced its decline in early January when heavy intervention by central banks associated with the G-7 statement became particularly visible. The dollar strengthened further in mid-January following the release of better-than-expected data for the U.S. trade balance in November.

At its meeting on December 15–16, 1987, and its meeting via telephone conference on January 5, 1988, the Committee adopted directives that called for maintaining the existing degree of pressure on reserve positions. In December, the Committee recognized that still sensitive conditions in financial markets and uncertainties in the economic outlook might continue to require a special degree of flexibility in the conduct of open market operations. In early January, the Committee agreed that the passing of time and of year-end pressures in the money market should permit further progress toward restoring a normal approach to open market operations. At the same time the members recognized that some flexibility might continue to be needed in the conduct of operations. At both meetings, the Committee decided that, taking account of conditions in financial markets, somewhat lesser or somewhat greater reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in the foreign exchange markets, as well as the behavior of the monetary aggregates. The intermeeting range for the federal funds rate was left unchanged at 4 to 8 percent.

Over the course of the intermeeting period and especially after early January, the conduct of open market operations involved placing more emphasis on reserve positions and correspondingly less on influencing money market conditions on a day-to-day basis. Even so,

adjustments in the provision of reserves were made on a number of occasions during the intermeeting period in light of unusual developments affecting reserve and money market conditions. Those developments included heavy borrowing over the four-day New Year's weekend and sizable borrowing subsequently stemming from a data processing problem at a large bank. In the ensuing reserve maintenance period, demands for discount credit were very limited. In late January and early February, with incoming data suggesting some weakening in the economic expansion and in the context of a more stable dollar in foreign exchange markets, some easing was sought in the degree of pressure on reserve positions. Thus far in the current maintenance period, borrowing had remained relatively low. Total reserves contracted in December, reflecting continued weakness in transactions deposits, but rebounded strongly in January as most categories of reservable deposits grew rapidly and excess reserves also increased.

The federal funds rate averaged 6.82 percent over the three complete reserve maintenance periods since the December meeting; in recent days, the rate moved down toward 6½ percent. Year-end pressures in the money market were much milder than most market participants had expected, partly because of a greatly reduced need for funds compared with that a year earlier, more planning in advance by banks and others, and a relatively generous provision of reserves. With the easing of concerns about year-end pressures, rates on private money market instruments fell sharply in late December. Yields on Treasury securities of all maturities and on longer-term debt of private borrowers changed little on balance over the first several weeks of the intermeeting period. More recently, such rates declined as the dollar tended to

stabilize and economic data were viewed as pointing to a softer economy, more subdued inflation, and easier monetary policy. Early in February, banks lowered their prime rate. Broad indexes of stock prices increased somewhat on balance since mid-December, though price fluctuations were relatively large on occasion.

Preliminary data showed that money growth rebounded strongly in January after the marked weakening in November and December. For 1987 as a whole, M2 expanded at a rate well below the 5½ percent lower boundary of the target range that the Committee had established for the year. M3 growth was at the lower end of its range. M1 grew sharply in January, after declining in late 1987. Demand deposits were particularly weak in late 1987, possibly reflecting in part incentives to adjust compensating balances downward before year-end, but other checkable deposits also fell in November and December without a corresponding increase in other M2 deposits. The strengthening of money growth in January was spread widely over various components of the monetary aggregates and appeared to be related in part to the general decline in interest rates since mid-October.<sup>1</sup>

---

1. These growth rates and all subsequent data on the monetary aggregates reflect annual benchmarks and seasonal factors as published on February 11, 1988.

The monetary aggregates are defined as follows: M1 comprises demand deposits at commercial banks and thrift institutions, currency in circulation, travelers checks of nonbank issuers, negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts at banks and thrift institutions, and credit union share draft accounts. M2 contains M1 and savings and small-denomination time deposits (including money market deposit accounts (MMDAs) at all depository institutions, overnight repurchase agreements (RPs) at commercial banks, overnight Eurodollars held at foreign branches of U.S. banks by U.S. residents other than

The staff projection for economic activity continued to suggest relatively sluggish growth in output in the first half of 1988 and a pickup later in the year. This pattern primarily reflected variations in the growth of inventories. A sharp slowing in the pace of investment in nonfarm inventories, notably automobile inventories, was expected early in the year following the buildup in the fourth quarter. Final domestic demand was projected to expand sluggishly in 1988, given an erosion in the growth of real income associated in part with higher import prices and a moderately restraining fiscal policy. Over 1988 as a whole, the primary impetus to growth was anticipated to come from further strong demand for U.S. exports. Prices were projected to rise at a moderate rate during the year. Prices of nonpetroleum imports were believed likely to increase substantially, but the price of imported petroleum was assumed to rise only slowly. Nominal gains in compensation were expected to pick up, as wage demands responded to increases in consumer prices. With unemployment rates remaining near current levels, however, labor market conditions were not expected to put much additional pressure on wage rates, especially in light of uncertainties about the economic outlook and continuing efforts by businesses to improve competitiveness.

In the Committee's discussion, members emphasized that the economic outlook was subject to a great deal of uncertainty under prevailing circumstances. They noted that it was especially

difficult to evaluate the outlook for an economy that appeared to be in transition from a consumer-driven to an export-driven expansion. Another area of uncertainty related to the decline in equity prices. The latter did not appear to have had a substantial impact on consumer or business spending to date, judging from currently available data, but more repercussions might be felt later. In addition, financial markets, including the foreign exchanges, were still relatively sensitive, and many financial institutions had been weakened by serious debt repayment difficulties among their domestic and foreign borrowers. Several members commented that the staff projection remained a reasonable expectation but that the risks of a different outcome were substantial. Others saw somewhat greater or somewhat lesser economic growth as more likely for the year ahead. The members generally agreed, however, that the major risks to the economy over the longer run appeared to be in the direction of more inflation.

In conformance 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 1987 to the fourth quarter of 1988, the forecasts for growth of real GNP had a central tendency of 2 to 2½ percent and a full range of ½ to 3 percent. Forecasts of nominal GNP centered on growth rates of 5¼ to 6 percent and ranged from 4 to 6½ percent. Estimates of the civilian rate of unemployment in the fourth quarter of 1988 were concentrated in a range of 5¾ to 6 percent with a full range of 5½ to 6¾ percent. With regard to the rate of inflation, as indexed by the GNP

---

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.

deflator, the projections centered on rates of  $3\frac{1}{4}$  to  $3\frac{3}{4}$  percent and had an overall range of  $2\frac{1}{2}$  to 4 percent for the year. In making these forecasts, the members took account of the Committee's objectives for monetary growth in 1988. They 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 their assessment of specific developments bearing on the economic outlook, members gave considerable attention to the recent buildup of inventories and the related possibility of some correction that would tend to depress overall growth in business activity during the first half of the year. Several believed that the adjustment in inventories might be relatively limited and economic growth in the first half somewhat stronger than projected by the staff, especially in light of the strength of orders for capital goods on the books of manufacturing firms. Others anticipated a sharper inventory correction but one that would probably be over by mid-year. The outlook for the second half was particularly uncertain, and views differed regarding the likelihood and potential strength of a rebound. Conditions in financial markets would have an important influence on business conditions and any major new disturbances in those markets could have a negative effect on both consumer and business spending. Some members could see few signs in the domestic economy that pointed to a resurgence in business activity later in the year. Other members viewed the prospects as more promising, and some did not rule out the possibility that the expansion might in fact tend to be more vigorous than was desirable in a period when increasing domestic production needed to be diverted to export markets. All of the members agreed that the rate of economic expansion over the next several

quarters would depend to a substantial extent on the rate of improvement in the nation's balance of trade.

In the discussion of the outlook for trade, a number of members observed that sizable further gains in exports were a reasonable expectation, but the rate of increase would probably diminish from the very rapid pace in recent quarters. Among the factors tending to inhibit export growth, they cited the possibility that expansion in major industrial nations, as a group, might be relatively limited. On balance, while the extent of the improvement in trade was uncertain and might well prove to be relatively slow and uneven, most members saw favorable prospects for continuing gains of appreciable magnitude over the year ahead.

Turning to the outlook for inflation, the members generally agreed that the risks over time were in the direction of greater inflation. They emphasized that relatively rapid growth in overall demands, including that for exports, could trigger inflationary pressures in a period when the utilization of productive resources was already relatively high and comparatively little leeway appeared to exist for growth in excess of the moderate pace projected by most members. The recent behavior of broad price indexes did not suggest any acceleration in the overall rate of inflation, but several members saw evidence in local economies that price pressures might be intensifying. Business contacts were reporting that some firms were successful in selective efforts to pass through rising costs by raising product prices. And, in one view, the behavior of key commodity prices raised concern about more inflation. Some members also indicated that rising import prices were tending to put upward pressure on competing products that were manufactured domestically. In general, increases in wages remained moderate,

but members expressed concern that, given the reduced level of unemployment, rising prices would tend to be translated into higher wages at some point. It was noted that the key to avoiding both more inflation or a recession in a period of major adjustments in the trade balance would be the difficult task of maintaining restrained growth in domestic demands over an extended period.

Against that background the Committee at this meeting completed the review, begun at the meeting in December, of the ranges for growth in the monetary and debt aggregates in 1988; those ranges had been established on a tentative basis in July 1987 in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act). The tentative ranges included growth of 5 to 8 percent for both M2 and M3 for the period from the fourth quarter of 1987 to the fourth quarter of 1988. A monitoring range of 8 to 11 percent had been set on a provisional basis for growth of total domestic non-financial debt in 1988. With regard to M1, the Committee had decided in July not to set a tentative range for 1988 but to reappraise at this meeting the issues relating to the establishment and use of such a target.

All of the members favored some reduction in the ranges for growth of M2 and M3 in 1988. Such a reduction would help to focus attention on the need for relatively restrained expansion in domestic demand to accommodate the adjustment in the nation's external accounts and would underscore the Committee's commitment to achieving reasonable price stability over time. However, given their differing assessments of the risks to the business expansion and of the prospective relationship of monetary growth to satisfactory economic performance, members expressed some divergence of views with

regard to how much the ranges should be reduced. Several indicated a preference for confirming the ranges for 1988 that the Committee had established on a tentative basis in July. Those ranges involved reductions of  $\frac{1}{2}$  percentage point from 1987. Others favored lower ranges with midpoints that were reduced by a full percentage point. The latter included a proposal, which received considerable support, for wider ranges of 4 to 8 percent for both M2 and M3. The members noted that monetary expansion in 1988 at rates around the midpoints of the ranges under consideration, which they generally viewed as a reasonable expectation, would represent some acceleration from the relatively modest expansion in 1987, especially in the case of M2.

Further discussion focused on the desirability of widening the ranges for growth of the broader aggregates to 4 to 8 percent. Such a range was deemed to be warranted by the experience of recent years when more marked variability had emerged in the relationship between monetary expansion and ultimate policy objectives such as prices and output. That variability stemmed from a number of sources, but prominent among them was the course of interest rates; a level of rates consistent with satisfactory economic performance would depend on the underlying strength of demands in the economy and on emerging price pressures. In that context, an uncertain outlook for the economy and inflation suggested to several members the need for somewhat wider ranges than had been used in the past. A range of 4 percentage points would provide more room for appropriate policy responses to unanticipated economic and financial developments and would encompass more fully the possible outcomes for monetary growth that might prove consistent with acceptable economic performance in

1988. Some members expressed reservations about the desirability of wider ranges. They acknowledged that ranges of 4 percentage points might reflect more adequately the various uncertainties that were involved, but they were concerned that widening the ranges could be viewed as a further retreat from effective monetary targeting. Moreover, the narrower ranges imposed a desirable discipline by requiring a more prompt reappraisal of policy as their limits were approached or exceeded.

The members also considered proposals for using a different base than the actual fourth quarter level of the aggregates as the starting point for the 1988 ranges. In support of this view, some members argued that the depressed levels of the aggregates in late 1987, which may have reflected in part some special factors, together with the reduced ranges under consideration implied a quite substantial lowering of the Committee's objectives for monetary growth. Several members were opposed to a change in the Committee's procedures, especially on an ad hoc basis. A number expressed their willingness to consider at a later time proposals for a regularized procedure that would take account of overshoots or of shortfalls in the previous year. Others believed that it would be preferable to adjust the new ranges themselves each year, rather than the base, if the Committee concluded that it was desirable to compensate for excessive or inadequate monetary growth in the previous year.

No member supported the reestablishment of a target range for M1 in 1988, but a few favored the use of a monitoring range for this aggregate. The behavior of M1 had become highly sensitive to changes in interest rates, among other factors, in recent years, as reflected in sharp swings in its velocity. It remained particularly difficult to interpret the

relationship between growth in M1 and the performance of the economy. In light of its unpredictable behavior, a narrow range for M1 could easily trigger an inappropriate response of monetary policy to unexpected developments in the economy. On the other hand, a range wide enough to reasonably encompass possible acceptable growth in M1 over the year would be of little use in guiding the conduct of monetary policy or in communicating the Committee's policy intentions to the public.

The members anticipated some further slowing in the growth of nonfinancial debt in 1988, following a marked slowdown in 1987, but the rate of growth this year appeared likely to remain well above that of nominal GNP. A key factor bearing on the outlook for debt expansion was the expectation of some reduction in government borrowing. However, as in the case of the monetary aggregates, considerable uncertainty surrounded the prospects for debt growth in 1988 and Committee members endorsed a proposal to widen the monitoring range for total domestic nonfinancial debt to 7 to 11 percent, a reduction of 1 percentage point from the lower limit of the 1987 range.

At the conclusion of the Committee's consideration of the ranges for 1988, all of the members indicated that they could support ranges of 4 to 8 percent for growth in both M2 and M3 for the year. No range was established for M1 for the year, while the monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, the ranges would be reviewed at midyear, or sooner if deemed necessary. It was understood that in carrying out policy the Committee would continue to judge the behavior of the monetary aggregates against the background of developments in the economy and financial markets,



including attention to the sources and extent of price pressures in the economy, the performance of the dollar in foreign exchange markets, and other indicators of the impact of monetary policy.

The following paragraphs relating to the 1988 ranges were approved for the domestic policy directive:

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 this meeting established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee again decided not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, 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.

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

In the Committee's discussion of policy implementation for the period immediately ahead, all of the members indicated that they favored or could accept a directive that called for maintaining the slightly reduced degree of pressure on reserve positions that had been sought recently. While some members expressed reservations about that easing, a few indicated a preference for easing marginally further. Members commented during the discussion that policy imple-

mentation faced the special challenge of balancing the risks of a potentially softer economy over the nearer term while also remaining positioned to achieve the Committee's anti-inflationary objectives over the longer run. Accordingly, despite shadings of opinion, the members were in broad agreement that any substantial change in policy, in either direction, was not warranted under prevailing economic and financial conditions. A tightening move would not be appropriate at a time when the expansion was showing some signs of slackening, and against this background such a policy course might well have a disruptive impact on financial markets, which remained somewhat fragile. On the other side, policy should not overreact to recent indications of a more sluggish business expansion because any policy easing now would tend to have its major impact later in the year when, in the view of many members, a stronger economic expansion was likely to emerge. Moreover, while the dollar had tended to stabilize recently in the foreign exchange markets, members were concerned that appreciable further easing, especially if it was seen as leading to a lower discount rate, could have highly adverse repercussions on the dollar. It might also have unsettling effects on financial markets more generally if it was not viewed by market participants as warranted by substantial new evidence of a weaker economy. The slight easing that had already been undertaken did not appear to put significant downward pressure on the dollar and it provided greater assurance that the expected strengthening of the business expansion would in fact materialize later in the year.

In the course of the Committee's discussion, members referred to the rebound in the growth of M2 and M3 in January, but they noted that the stronger growth needed to be viewed in relation to the

weakness in late 1987. According to a staff analysis prepared for this meeting, expansion in M2 and M3 could be expected to strengthen a little over the balance of the first quarter from the average pace in December and January, assuming unchanged conditions of reserve availability. More generally, somewhat faster growth was projected in the current quarter than had occurred in the second half of 1987, as increased demands for money balances in response to the decline in interest rates since mid-October more than offset the expected effects of slower income growth. The growth in M1 might also strengthen over the first quarter, but the near-term behavior of this aggregate remained subject to a high degree of uncertainty.

During this meeting further consideration was given to the Committee's operating procedures. In keeping with the Committee's decision in early January, continuing progress had been made toward restoring the Committee's previous focus on reserve positions in the day-to-day implementation of policy. At this meeting the members expressed differing views about whether that process should now be completed. Several felt that the approach originally adopted at a time of crisis in financial markets was no longer warranted, even in attenuated form, and that the previous approach to reserve management provided a better basis for guiding the conduct of monetary policy because it allowed greater scope for changes in supply and demand forces to be reflected in the money market. On the other hand, a majority of the members preferred to retain for now a directive that called for some flexibility in the approach to open market operations. These members emphasized that financial market conditions still exhibited some degree of fragility and, against the background of substantial uncertainty in the economic outlook, unanticipated

developments might well continue to warrant occasional departures from the focus on reserve objectives for the purpose of moderating temporary fluctuations in money market conditions. A number of these members also commented on the need for flexibility because a relatively normal or predictable relationship between the provision of reserves and money market conditions had not yet emerged.

The members expressed some shadings of opinion with regard to possible adjustments in policy during the intermeeting period. A majority felt that there should be no presumptions about the likely direction of any such adjustments, especially in light of the consensus at this meeting for maintaining reserve conditions that were consistent with the slight easing that had been sought since late January. Some members believed, however, that policy implementation should be especially alert to developments that might point to somewhat easier reserve conditions, particularly because of the risks that they saw of a weaker economy than was currently projected. In the view of some members, further easing might also be appropriate if monetary growth fell appreciably short of current expectations. Several members cautioned that any decision to ease should take careful account of the potential impact on the dollar in foreign exchange markets. While the dollar had tended to stabilize recently, it could be vulnerable to a further decline.

At the conclusion of the Committee's discussion, all of the members indicated their acceptance of a directive that called for maintaining the slightly easier degree of reserve pressure that had been sought recently. With regard to the Committee's operating procedures, a majority endorsed the view that some flexibility might continue to be needed in the conduct of open market operations in

light of the still somewhat unsettled conditions in financial markets, the uncertainties in the relationship between reserve and money market conditions, and the substantial risks of unanticipated economic and financial developments. 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 given to the behavior of the monetary aggregates. The reserve conditions contemplated by the Committee were expected to be consistent with growth in both M2 and M3 over the four-month period from November through March at annual rates of about 6 to 7 percent. 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 not to indicate any expectation regarding its growth over the months ahead. The members agreed that the intermeeting range for the federal funds rate, which provides one 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 indicated that economic activity continued to expand rapidly in the fourth quarter but that the advance reflected a build-up in inventories as domestic final demands weakened. The growth in output appeared to have slowed around year-end. Total nonfarm payroll employment rose much less in January than on average over the previous three months; the manufacturing sector also recorded reduced employment growth in January. The civilian unemployment rate, at 5.8 percent in

January, was unchanged from December. Growth in industrial production moderated further in December. Retail sales picked up in December, buoyed by improved auto sales, but remained below levels reached during the summer. Indicators of business capital spending were mixed late in the year. Housing starts fell markedly in December, and were down somewhat on balance in the fourth quarter from the average pace in the second and third quarters. The nominal U.S. merchandise trade deficit declined substantially in November. For October and November combined, the deficit rose slightly from the average rate in the third quarter, but in real terms the deficit was estimated to have narrowed further. The rise in consumer prices slowed and producer prices fell in late 1987, reflecting declines in energy prices; wage trends have shown little change in recent months.

Most interest rates were down substantially on balance since the Committee's meeting in mid-December. In the Treasury securities market, long-term yields fell considerably more than short-term rates. Broad indexes of stock prices rose somewhat on balance over the intermeeting period in still relatively volatile trading. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined further in the second half of December but recovered after the turn of the year and has increased moderately on balance since the December meeting.

Growth of M2 and M3 strengthened substantially in January after slowing over November and December. For 1987 as a whole, expansion of M2 fell considerably below the lower end of the range established by the Committee for the year, while growth of M3 was at the lower end of its range. Growth of M1 surged in January following two months of declines. For the year 1987, M1 growth was marginally below that of nominal GNP, and expansion in total domestic nonfinancial debt was at the midpoint of 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 at this meeting established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter

of 1988. The monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee again decided not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, 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.

In the implementation of policy for the immediate future, the Committee seeks to maintain the slightly reduced degree of pressure on reserve positions sought in recent days. The Committee agrees that the current more normal approach to open market operations remains appropriate; 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 both M2 and M3 over the period from November through March at annual rates of about 6 to 7 percent. 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, and Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

## Meeting Held on March 29, 1988

### 1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity was

continuing to expand in the current quarter, although the rate of growth was down somewhat from the rapid pace in the fourth quarter. The moderation reflected a considerable slowing in the pace of inventory investment. However, domestic final sales seemed to have picked up sharply in the first quarter; business capital expenditures apparently increased substantially and consumer spending also strengthened, buoyed by higher sales of motor vehicles. The rate of inflation had remained relatively restrained over the course of recent months and wage trends had shown little change.

Growth in industrial production moderated in January and February from a rapid pace in late 1987. After a surge in the second half of 1987, the output of materials edged down. Also, auto assemblies and the production of consumer home goods dropped below their late 1987 levels, apparently reflecting in part an effort to trim or to moderate the growth in inventories. In contrast, the production of business equipment remained quite strong, with gains in nearly all categories. Capacity utilization rates were at relatively high levels in a number of industries. Gains in total nonfarm payroll employment continued strong over the January-February period, led by the service and retail trade sectors. In manufacturing, employment gains were smaller in January and February than during the second half of 1987. The unemployment rate edged down to 5.7 percent in February, its lowest level since mid-1979.

Increased demand for motor vehicles produced a rebound in consumer spending early in the year. That demand appeared to be bolstered by sales incentives programs, strong income growth, and rising consumer confidence. Excluding motor vehicles, nominal retail sales were essentially flat since November,

and the saving rate was well above its average for the year preceding the break in the stock market.

Housing activity picked up in February but still was slightly below its fourth-quarter pace. While sales of new and existing homes continued to decline in January, housing starts rose to an annual rate of 1.49 million units in February, with growth stronger in the single-family sector than in the multifamily area.

Available information suggested that business fixed investment was increasing rapidly since late last year, led by large gains in equipment spending. Data on shipments indicated a surge in spending on information-processing equipment. Increases in other equipment categories were smaller but were widespread. Spending on nonresidential structures was relatively weak in early 1988. Inventory investment apparently slowed in the first quarter, reflecting the strength in sales of motor vehicles combined with cutbacks in their production.

The nominal U.S. merchandise trade deficit in January was significantly below the fourth-quarter average, although essentially unchanged from December. Non-oil imports and nonagricultural exports both fell noticeably from their December levels. The current account deficit had narrowed in the fourth quarter, but the improvement was more than accounted for by a sharp increase in capital gains stemming from the depreciation of the dollar and the related revaluation in the book value of direct U.S. investments abroad denominated in foreign currencies. On average, economic growth in major foreign industrial countries continued strong in the fourth quarter and early this year, though it slowed somewhat from the rapid third-quarter pace. Growth was particularly robust in Canada and Japan.

Increases in consumer prices remained relatively moderate in early 1988, reflect-

ing the impact of declining energy prices and a relatively small rise in food prices. At the producer level, prices of finished goods fell slightly in February after fluctuating irregularly in other recent months, largely because of swings in food prices. Commodity prices registered mixed changes during the first quarter. The index of hourly earnings was unchanged in February after increasing in January, and on balance it rose roughly in line with the pace in 1987.

At its meeting on February 9-10, 1988, the Committee had adopted a directive that called for maintaining the slightly reduced degree of pressure on reserve positions that had been sought since late January. These reserve conditions were expected to be consistent with growth in both M2 and M3 at annual rates of about 6 to 7 percent over the period from November through March. With regard to operating procedures, the Committee had agreed that the more normal approach to operations implemented especially since the year-end, which emphasized the provision of reserves rather than money market conditions, remained generally appropriate. Nonetheless, it was understood that some flexibility might continue to be needed in the conduct of operations in light of the still somewhat unsettled conditions in financial markets, the uncertainties in the relationship between reserve and money market conditions, and the substantial risks of unanticipated economic and financial developments. Taking account of conditions in financial markets, the members had decided that somewhat less or somewhat more reserve restraint would be acceptable, depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, and the behavior of the monetary aggregates. The intermeeting range for the federal funds rate had

been left unchanged at 4 to 8 percent.

As contemplated at the February meeting, primary emphasis was placed on achieving reserve objectives during the intermeeting period, although slightly greater than normal attention continued to be given to developments in the money market. In the three reserve maintenance periods ending March 23, adjustment plus seasonal borrowing averaged \$238 million. Growth in M2 and M3 remained relatively robust in February and apparently also in March following a rebound in January. Since November both aggregates had expanded at an annual rate of about 7 percent. Growth in M1 slowed considerably over the intermeeting period from a very rapid pace in January. With transaction deposits expanding at a relatively sluggish pace on balance and excess reserves declining, total reserves advanced at a modest rate during the intermeeting period.

The federal funds rate averaged 6.59 percent for the three full reserve maintenance periods since the February meeting, close to the rate prevailing around the time of that meeting but below the average in January. Most other interest rates rose somewhat on balance during the intermeeting period. The largest increases were in bond markets and they appeared to have been prompted by evidence of more strength in the economy than had been anticipated. Broad indexes of stock prices rose somewhat over the period, but price swings remained sizable on occasion.

Through most of the period since the February meeting the dollar fluctuated in a relatively narrow range. However, it came under downward pressure late in the period following reports suggesting stronger than anticipated growth in U.S. domestic demand that raised questions about the pace of adjustment in the U.S. trade balance. Over the intermeeting period the dollar declined 2 1/4 percent on

a weighted-average basis in relation to the other G-10 currencies. The net decline was largely accounted for by a 4 percent depreciation in terms of the pound and 2 percent in terms of the Canadian dollar and the yen, while the mark and other EMS currencies remained little changed in relation to the dollar.

The staff projection prepared for today's meeting suggested more strength in business activity this year than had been forecast earlier. The faster growth was expected to be associated with little change in the unemployment rate from current levels. And while the projection for 1989 now indicated a somewhat reduced rate of growth, higher levels of capacity utilization over the projection period as a whole were associated with marginally higher rates of inflation by late 1988 and for the year 1989. A key adjustment in the forecast was stronger investment spending. The staff continued to anticipate that the external sector would make a substantial positive contribution to business activity in 1988 and 1989.

In the Committee's discussion of the economic situation and outlook, the members generally agreed that the information available since the February meeting pointed to a stronger expansion in business activity than they had anticipated earlier. Unfortunately, recent developments in the view of several members also increased the risks of more pressures on productive resources and more inflation. A number of members noted that the revised staff forecast was in line with their own projections, and some also indicated that any deviations were likely to be in the direction of somewhat faster expansion and even higher rates of inflation. A number of other members did not disagree that the risks had shifted and that concerns about a recession had receded, but they also referred to areas of weakness in the economy that implied the

potential for relatively moderate growth without adding to price pressures.

In the course of the Committee's discussion, members referred to high or improving levels of business activity in many parts of the country, albeit from depressed levels in some areas or sectors of the economy. Manufacturing was exhibiting particular strength across the nation. Despite some increasing pressures on manufacturing capacity, business executives generally appeared to remain cautious in their plans for new production facilities, apparently reflecting their uncertainties about the outlook for sales growth in both domestic and export markets. However, some businesses were reported to be in the process of reappraising their capacity needs, and with demands for business equipment relatively strong, a number of members concluded that appreciable further growth was likely in overall business-fixed investment. The members differed to some extent in their views on the outlook for consumer spending and business inventory accumulation, but they generally expected at least moderate growth in total domestic final demands.

In the view of some members any strengthening in domestic demand could well give rise to pressures on resources as net exports continued to expand. The outlook for trade remained subject to considerable uncertainty, but further improvement in the trade balance was nonetheless a reasonable prospect. That prospect was supported by reports from businesses of their increased ability to compete internationally. A number of members again commented that long-run adjustment in the trade balance would require a period of relatively moderate growth in domestic purchases as more production was directed to export markets.

Turning to the outlook for inflation, some members reported that an increas-

ing number of business contacts were expressing concern about the prospects for prices and wages. On the positive side, while some deterioration seemed to have occurred recently, inflationary expectations appeared to have diminished on balance since the stock market crash in October. Moreover, aggregate measures of prices and wages had not yet shown any sustained tendency to accelerate. This could indicate that some leeway remained in the economy before a more serious inflation problem emerged. Inflation developments did not depend solely on rates of capacity use but on the overall inflationary and financial climate and on expectations about policy responses to inflation. In particular, responses to rising capacity constraints might be reduced or delayed in light of the downturn in inflation since the early 1980s. Nonetheless, most members agreed that the risks of more inflation stemming from increased pressures on capacity had increased and represented a key challenge for policymakers. In a still limited number of manufacturing industries, relatively high capacity utilization rates were being reflected in sizable price increases for some metals and other business products, increasing lead times in filling certain orders, and some precautionary ordering in anticipation of future needs. While there was little evidence thus far that the added price pressures extended to finished products or that overall business buying and inventory patterns were being significantly affected, the economy might well be near the point where faster growth in business activity would induce a higher rate of inflation, and in the view of several members, there was a potential for a sharp escalation in prices. Members were particularly concerned that any tendency for greater price pressures to become imbedded in more rapid wage increases would make achievement of the ultimate

objective of price stability considerably more difficult.

In further comments some members noted that an assessment of the economic outlook was complicated by the continuing risks associated with the troubled status of a number of financial institutions and the still somewhat unsettled conditions in financial markets, as evidenced in part by occasionally sharp movements in stock prices. Some members believed that speculative attitudes had intensified recently as reflected for example in increases in corporate merger, acquisition, and commercial construction activities that typically involved heavy use of debt financing. Such a development was surprising so soon after the October 1987 disturbances in financial markets, and still growing debt burdens served to increase the vulnerability of the economy to adverse developments. Some members also expressed considerable concern about the outlook for the dollar, which had been under downward pressure in the foreign exchange markets. A sizable further decline in the dollar, while it might have favorable implications for the U.S. trade balance, would tend to raise domestic prices and could adversely affect the nation's ability to continue to finance a massive trade deficit, with disruptive effects on domestic financial markets and the domestic economy.

At its meeting in February the Committee had agreed on policy objectives that called for monetary growth ranges of 4 to 8 percent for both M2 and M3 for the period from the fourth quarter of 1987 to the fourth quarter of 1988. The associated range for growth in total domestic nonfinancial debt was set at 7 to 11 percent. The Committee decided not to establish a numerical target for M1 growth; instead, the appropriateness of changes in M1 would be evaluated during the year in the light of the behavior of M1 velocity, developments in the economy and finan-

cial markets, and the nature of emerging price pressures.

In the Committee's discussion of policy implementation for the intermeeting period ahead, nearly all the members favored some increase in the degree of pressure on reserve positions. Most indicated a preference for only a slight move toward restraint, at least at this time, but a few urged somewhat greater tightening. Several commented that a stronger economic outlook in the context of already high capacity utilization rates in a number of industries required timely action to help prevent the business expansion from gathering excessive and unsustainable momentum that would lead to higher inflation. A policy response under emerging circumstances would also serve to confirm the System's commitment to achieving price stability over time and might help to avert an aggravation of inflationary expectations. Moreover, action at this time might preclude the need for more substantial tightening later.

While they favored a slight increase in reserve pressures, a number of members stressed that monetary policy should not overreact to recent developments. The firming should proceed with caution in light of the prevailing uncertainties in the economic outlook and the current absence of evidence in broad measures of prices and wages that rates of inflation were already rising. Other factors cited in favor of a cautious approach included the persisting problems or incomplete recovery in some sectors of the economy and areas of the country, the still sensitive conditions in financial markets, and the troubled status of many financial institutions. In the view of one member, underlying demands in the economy were not likely to be sufficiently robust to pose a threat of greater inflation, and so prospective economic and financial conditions did not warrant any tightening of reserve conditions.



In the course of the Committee's discussion, some members noted that growth of the broader monetary aggregates had remained fairly rapid in February and March. According to a staff analysis, the reserve conditions favored by most members were likely to be associated with some slowing in the expansion of those aggregates, assuming a typically sluggish adjustment of offering rates on retail deposits to changes in short-term market rates. Even so, the analysis suggested that for the year through June growth of both M2 and M3 would still be appreciably above the midpoints of the Committee's ranges for 1988. Some members observed that the near-term outlook for monetary growth was subject to more uncertainty than usual because the impact of new tax laws on mid-April tax payments and related deposit balances could not be fully anticipated. Some concern was expressed regarding the inflationary potential of the recent rates of growth in the broader monetary aggregates, and one member commented that under prevailing circumstances significantly stronger than expected expansion in those aggregates should be resisted, especially expansion that brought the cumulative growth of M2 and M3 to levels above the Committee's ranges by midyear.

During this meeting the Committee reviewed its operating procedures at some length, including the relative merits of focusing primarily on money market conditions or on a specified degree of reserve pressure in the day-to-day conduct of monetary policy. The considerable emphasis on stabilizing money market conditions in the period after the October collapse of the stock market had given way increasingly to the earlier concentration on achieving reserve position objectives, especially since the year-end. Nonetheless, in keeping with the Committee's instructions as reaffirmed at the February meeting, open market oper-

ations had continued to be conducted with some degree of flexibility that involved occasional departures from a normal focus on targeting reserve positions and slightly greater than usual attention to money market conditions. In today's discussion a few members indicated that they favored paying greater attention to money market conditions in the normal course of conducting open market operations. It was noted in support of this view that money market interest rates were a key variable for transmitting monetary policy to financial markets and the economy, and that the variability in those rates that sometimes accompanied the pursuit of a given degree of pressure on reserve positions injected an unneeded element of uncertainty in the decisions of market participants. However, most members were in favor of either retaining the existing emphasis on reserve pressures or completing the process of reinstating the previous approach to reserve management. Short-run variability in money market interest rates was not seen as detracting from the functioning of the market or the implementation of policy since market participants were well aware of the System's procedures, and such fluctuations could reflect important shifts in market expectations or underlying conditions of supply and demand for reserves and credit. The shifts would be masked if the Federal Reserve were to focus more closely on money market conditions in its day-to-day conduct of open market operations. Even so, a majority of the members felt that the uncertain economic outlook and still sensitive conditions in financial markets warranted some continuing flexibility in the conduct of open market operations.

In the Committee's consideration of possible adjustments in policy implementation during the intermeeting period, some members felt that the risks of more

inflation argued for giving particular attention to developments that might call for somewhat tighter reserve conditions. A majority of the members believed, however, that there should be no presumption about the likely direction of intermeeting adjustments, if any, in the implementation of policy. While these members generally agreed that the economic risks were in the direction of more inflation, they preferred not to weight the directive toward possible further tightening in light of the firming that was already contemplated at this meeting and the considerable uncertainties that they saw in the economic and financial outlook. One member proposed placing more emphasis on the behavior of the monetary aggregates as a factor that might trigger some firming during the intermeeting period, but other members preferred the current emphasis, partly because any surge in money growth over the weeks ahead might reflect temporary developments related to mid-April tax payments. Some consideration was given during the discussion to an upward adjustment in the intermeeting range for the federal funds rate, especially since federal funds could trade well into the upper half of the Committee's range following the decision made at today's meeting. However, the members concluded that increasing the range under current circumstances could be misread as implying a greater move toward restraint than the Committee intended.

At the conclusion of the Committee's discussion, all but one of the members indicated their acceptance of a directive that called for a slight increase in the degree of pressure on reserve positions. With regard to the Committee's operating procedures, a majority continued to endorse the view that some flexibility might be desirable in the day-to-day conduct of open market operations in light of the still somewhat unsettled

conditions in financial markets and the uncertainties surrounding the economic outlook. Taking account of conditions in financial markets, the members indicated that somewhat greater or somewhat lesser 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, and the behavior of the monetary aggregates. The reserve conditions contemplated by the Committee were expected to be consistent with growth in both M2 and M3 over the period from March through June at annual rates of about 6 to 7 percent. As at previous meetings, the Committee decided not to indicate any expectation regarding the growth of M1 over the months ahead. The members agreed that the intermeeting range for the federal funds rate, which provides one 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 some moderation in the expansion of economic activity in the current quarter from the rapid pace in the fourth quarter; the continuing expansion has been supported by a sharp pickup in domestic final sales while the accumulation of inventories appears to have slowed. Total nonfarm payroll employment rose substantially over the first two months of the year, although employment growth slowed somewhat in the manufacturing sector. The civilian unemployment rate fell slightly to 5.7 percent in February. Growth in industrial production moderated in early 1988 from a brisk pace during the second half of 1987. Consumer spending strengthened in January and February, buoyed by higher sales of motor vehicles. Indicators of business capital spending pointed to substantial gains in the first quarter. Housing starts rebounded in

February but were still somewhat below the reduced fourth-quarter average. The nominal U.S. merchandise trade deficit changed little in January and was significantly below the fourth-quarter average. In recent months the rise in consumer and producer prices has been relatively modest on balance, reflecting developments in food and energy prices, and wage trends have shown little change.

Most interest rates were up somewhat on balance since the Committee's meeting in February, with the largest increases concentrated in bond markets. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies fluctuated in a relatively narrow range over most of the intermeeting period, but declined somewhat in recent days.

After strengthening in January, growth of M2 and M3 remained relatively robust in February and in the first part of March. Thus far this year expansion of these two aggregates appears to have been in the upper portion of the ranges established by the Committee for 1988. M1 has grown moderately on balance since the fourth quarter. Expansion in total domestic nonfinancial debt appears to be continuing at a pace close to that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 meeting in February established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee decided in February not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, 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.

In the implementation of policy for the immediate future, the Committee seeks to increase slightly the degree of pressure on

reserve positions. The Committee agrees that the current more normal approach to open market operations remains appropriate; 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 greater reserve restraint or somewhat lesser 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 March through June at annual rates of about 6 to 7 percent. 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, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, and Parry. Vote against this action: Ms. Seger.

Ms. Seger dissented because she did not believe that economic and financial developments warranted any tightening of reserve conditions. She did not see a significant risk of more inflationary pressures on productive resources stemming from prospective demands in domestic and export markets. She remained concerned about the downside risks in the economy, the fragility in financial markets, especially the stock market, and the weakened condition of many depository institutions.

## 2. Authorization for Domestic Open Market Operations

The Committee approved a temporary increase of \$4 billion, to a level of \$10 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. The increase was effective for the intermeeting period starting March 30, 1988, and ending with the close of business on May 17, 1988.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, and Parry and Ms. Seger. 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 probably would not be sufficient to accommodate desirable increases in System Account holdings of securities during the intermeeting period. Those increases would supply reserves to help offset very large reserve drains stemming mainly from a short-term rise in Treasury balances at the Federal Reserve Banks associated with mid-April tax payments.

## **Meeting Held on May 17, 1988**

### **Domestic Policy Directive**

The information reviewed at this meeting suggested continuing strength in the economic expansion, supported by strong sales in both domestic and export markets, and relatively high utilization levels of labor and capital resources. In this setting, consumer and producer prices have risen more rapidly recently. In addition, labor costs increased substantially in the first quarter.

Nonfarm payroll employment continued to increase in April, though at a more moderate pace than in other recent months. The rise included sizable growth in the manufacturing sector and was accompanied by a sharp increase in the average workweek. Employment as mea-

sured by the household survey was up very sharply in April, and the civilian unemployment rate declined 0.2 percentage point to a level of 5.4 percent; that level was down appreciably since the start of the year and was the lowest since 1974.

Growth in industrial production picked up considerably in April from a reduced pace earlier in the year. Auto assemblies posted large gains, and the output of business equipment remained exceptionally strong. Capacity utilization rates in manufacturing and mining and in the production of industrial materials increased appreciably in April and on balance have risen substantially over the past several quarters to relatively high levels.

Consumer spending for durables and services was strong in the first quarter. Retail sales, as revised, showed substantial gains in February and March but fell in April. Auto sales declined somewhat in April, apparently reflecting reduced sales incentives, but household spending on other durables and on services remained strong. Outlays on nondurable goods continued sluggish.

A surge in business fixed investment during the first quarter reflected large gains in spending on information-processing and other equipment. New orders for nondefense capital goods softened recently, but order backlogs were still high and suggested that output would remain at an advanced level in the current quarter. Spending on structures declined in the first quarter, and forward commitments for nonresidential building were essentially flat in nominal terms. While inventories of motor vehicles declined during the first quarter, non-auto inventory investment remained close to the high rate of the fourth quarter. Sales of new and existing homes increased late in the first quarter. After showing weakness early in the year,

housing starts picked up to a 1.55 million annual rate in March, a level marginally above that in the fourth quarter but still appreciably below that in earlier quarters.

The U.S. merchandise trade deficit declined substantially in both nominal and real terms in the first quarter. Exports reached a record level; oil imports fell, but non-oil imports continued to expand. Indicators of economic activity in the major foreign industrial countries during the first months of 1988 showed continued strength in Japan and, on balance, in Europe as well.

The consumer price index increased substantially in March, despite a limited rise in retail food prices and flat retail energy prices. At the producer level, prices of finished goods rose rapidly in March and April, largely reflecting increases in the food and energy sectors. Prices of intermediate goods advanced considerably further in both months, continuing their uptrend of the past year and a half that has coincided with increased capacity utilization rates. Commodity prices strengthened recently after registering mixed changes in the first quarter. Broad measures of labor costs indicated a substantial advance in the first quarter, in part because of a rise in payroll taxes.

Dollar exchange rates moved within a narrow range during most of the intermeeting period, with uncertainties regarding U.S. trade and price performance apparently offset by indications of U.S. monetary tightening; also, weakness at the time of the release of the February trade data was met by concerted central bank intervention. On a weighted-average basis, the dollar appreciated slightly on balance in relation to the other G-10 currencies until late in the period; it strengthened with respect to the mark and weakened slightly with respect to the pound and the yen. The dollar then

appreciated about 1 percent on the morning of the May 17 meeting in response to news of the improved U.S. trade deficit in March.

At its meeting in February the Committee agreed on policy objectives that called for monetary growth ranges of 4 to 8 percent for both M2 and M3 for the period from the fourth quarter of 1987 to the fourth quarter of 1988. The associated range for growth in total domestic nonfinancial debt was set at 7 to 11 percent. The Committee decided not to establish a numerical target for M1 growth; instead, the appropriateness of changes in M1 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.

At its previous meeting on March 29, the Committee adopted a directive calling for a slight increase in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth in both M2 and M3 at annual rates of about 6 to 7 percent over the period from March through June. Taking account of conditions in financial markets, the members agreed that somewhat greater or somewhat lesser reserve restraint would be acceptable, depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, and the behavior of the monetary aggregates. The intermeeting range for the federal funds rate was left unchanged at 4 to 8 percent.

Some slight firming of reserve conditions was implemented immediately after the March meeting. In the two reserve maintenance periods ending April 20, adjustment plus seasonal borrowing rose to an average of about \$330 million; in the subsequent period ending May 4, borrowing averaged about \$440 million, reflecting the impact of a tax-related

bulge in Treasury deposits at the Federal Reserve Banks that affected reserve market conditions and complicated the management of reserves. More recently, open market operations were adjusted toward the implementation of further slight firming in reserve conditions in relation to what had been sought earlier in the period. This action was taken in light of information that indicated considerable strength in the economy and a related increase in concerns about the potential for greater inflation. Growth of M2 and M3 for the year to date was at rates in the upper portions of the Committee's ranges for 1988. Monetary growth was boosted in April by a temporary buildup in transaction balances associated with very large tax payments by individuals. Although preliminary data for early May indicated substantial weakness of money growth, the cumulative expansion of the broad aggregates remained relatively high in their annual ranges. Total and nonborrowed reserves rose at rapid rates in April in conjunction with the increase in required reserves against transaction deposits.

The firming of reserve conditions was reflected in a rise in the federal funds rate from around 6½ percent at the time of the March meeting to around 7 percent most recently. Other short-term rates also rose about ½ percentage point over the intermeeting period, while yields on Treasury and corporate bonds increased somewhat less. Banks raised their prime lending rate from 8½ to 9 percent during the first half of May. Broad indexes of stock prices changed little on balance over the period.

The staff projection reviewed at this meeting suggested that the economy had considerable underlying strength, reflecting both an improving trade balance and continuing momentum in domestic demands. With unemployment already a little lower, and capacity utilization a

little higher, than had been anticipated, the risks of higher rates of price and wage inflation had increased. The actual course of the economy would depend in part on how these developments affected financial markets. Pressures in those markets could restrain domestic final demands. Relatively sluggish growth in such demands, along with indications of overstocking in the retail sector, would encourage a reduced rate of inventory investment. Growth in business fixed investment was projected to slow substantially, and federal purchases, in constant dollar terms, were expected to be weak. Under such circumstances, while prices and wages might rise somewhat more rapidly in the quarters ahead, reflecting the effects of the lower dollar on market prices and reduced margins of unutilized production resources, the extent and duration of any pickup of inflation might be limited.

In the Committee's discussion of the outlook for economic activity and prices, the members focused on the strong performance of the economy in recent months, and, in the context of diminishing margins of unused labor and other production resources, they expressed considerable concern about the potential for higher rates of inflation in the year ahead. Members referred to widespread evidence of strength in the manufacturing sector and to indications that many firms were producing at very high levels of capacity use. Manufacturing was continuing to benefit from the nation's improved ability to compete internationally as a result of the depreciated dollar, and strength in manufacturing was feeding through to other related sectors of the economy. On the negative side, members referred to indications that inventories were higher than desired in some industries, notably at the retail level, and some saw a relatively weak outlook for construc-

tion, both residential and nonresidential. Weaknesses in the financial sectors of the economy and relatively heavy debt burdens also increased the downside risks in the economy. But, on balance, while some slowing from the current rate of expansion was a reasonable expectation, the risks were on the side of faster-than-desired growth and more inflationary pressures. Some members observed that in these circumstances fiscal restraint, especially if supplemented by measures to reduce the inflationary consequences of many government programs, could greatly facilitate the effort to control inflation while encouraging sustained economic expansion.

Turning to the outlook for inflation, members reported rising costs of materials and other manufacturing inputs. With profit margins under more pressure, numerous firms were looking for opportunities to pass on rising costs, and there were reports of some increase in successful efforts by businesses to raise prices, especially on crude and intermediate producer goods. However, while many specific instances of sizable price increases could be cited, broad measures of prices, including commodity prices as a group, did not indicate at this point that a significant worsening had occurred in the overall rate of inflation. Likewise, while reports of shortages of qualified labor were multiplying and business resistance to higher wages seemed to be diminishing in some areas, the members did not currently detect any appreciable acceleration in wage rate increases. Nonetheless, several expressed concern that, unless the expansion in overall demands were to slow markedly from the recent pace, which exceeded the trend growth of potential output, a substantially higher rate of price and wage inflation could not be avoided in the relatively near future. Others were less ready to conclude that

an inflationary surge might be imminent, but they believed that the situation needed careful watching.

In the Committee's discussion of policy for the intermeeting period ahead, the members generally agreed that some further tightening of reserve conditions was needed to counter the risks of rising inflationary pressures in the economy. A failure to act in timely fashion not only would be inconsistent with the Committee's commitment to achieving price stability over time but would in fact compound the difficulties of accomplishing that objective. Views differed, however, regarding the desirable extent of such firming and the appropriate timing for its implementation. A majority favored only a slight move toward more restraint, at least pending an evaluation of further developments, and most of these members preferred to delay the tightening action for a short period. Other members felt that current and potential pressures on prices and wages argued more urgently for a prompt move to somewhat greater restraint.

The members who favored only slight further firming, whether immediately or after a short delay, saw a considerable risk that an appreciable further tightening would be unexpected so soon after the most recent firming and might well have an exaggerated impact on financial markets. Among other effects, it might give rise to anticipations of an increase in the discount rate, and foster unwarranted expectations about the System's intentions. Some members also stressed the adverse impact that any marked weakening of financial markets could have on troubled depository institutions. In these circumstances, marginal further tightening in the near term would provide an appropriate balance between the need to curb the emergence of excessive demand pressures in the economy and the risks of further restraint for financial markets and

depository institutions. A few members also expressed the view that the two firming actions since late March, taken together, already represented a significant move to greater restraint and more time was needed to appraise their impact on the economy before any substantial further tightening was implemented.

Members who favored moving promptly to a somewhat greater degree of restraint gave more emphasis to the risks of more inflation as demand pressures encountered labor and capacity constraints in many industries. In this view the System's recent firming actions were helpful, but they did not go far enough toward restraining the growth in total demands to a noninflationary pace. These members recognized that appreciable further firming could have some adverse impact on financial markets in the short run and on the condition of many already weakened depository institutions. However, a prompt and somewhat stronger response to inflationary developments at this point would have a favorable effect on inflationary expectations, and over time also on long-term debt markets, and would reduce the need for greater and more disruptive tightening actions later. Some of these members indicated that a relatively modest move now, or in the very near future, and a readiness to tighten further later during the intermeeting period would constitute an acceptable compromise, given concerns about the risks of unwarranted reactions in the financial markets.

During the discussion members referred to a staff analysis prepared for this meeting that concluded that expansion of the monetary aggregates, especially M1 and M2, was likely to moderate substantially from the pace in April. The projected slowing reflected in part a reversal of the tax-related buildup in transaction accounts during April, which was already occurring, and the impact of increased

opportunity costs of holding money balances in response to the rise in market interest rates. While M2 and M3 currently appeared to be growing at rates that were consistent with the Committee's expectations for the second quarter, their cumulative growth thus far this year was at rates in the upper part of the Committee's ranges. One member stressed that any tendency for monetary growth to exceed the ranges should be firmly resisted under prevailing circumstances. Another commented that reduced growth, which brought the expansion for the year to around the middle of the Committee's ranges, would be a desirable outcome.

With regard to adjustments in the degree of reserve pressure during the intermeeting period, the slight firming after a short interval following today's meeting that was favored by a majority of the members would be implemented unless economic and financial conditions in the period ahead were to differ markedly from current expectations. Should unanticipated developments of that sort occur, the Chairman would call for a special consultation of the Committee. On the question of any subsequent adjustment in policy, a majority believed that policy implementation should remain especially alert to incoming information that might call for further firming. Given the recent tightening of reserve conditions and the presumption that at least marginally firmer reserve conditions would be implemented in the intermeeting period, the members decided to raise the intermeeting range for the federal funds rate by 1 percentage point to 5 to 9 percent. With such an increase the average trading level expected for the federal funds rate in the period ahead would be aligned somewhat more symmetrically around the middle of the range.

In further discussion most of the members indicated that they now favored dropping from the directive the special



reference to sensitive conditions in financial markets and the related reference to the need for flexibility in the conduct of open market operations. Members noted that these references, while helpful in describing the Committee's approach to operations for an extended period following the October disturbances in financial markets, no longer served a clarifying purpose in communicating the Committee's intentions. While still somewhat volatile, market conditions were now closer to those prevailing prior to the October break in the stock market, and the Committee anticipated that the earlier approach to open market operations generally would be followed. A few members felt, however, that still quite sensitive conditions in financial markets continued to warrant more than the usual amount of flexibility in the conduct of open market operations.

In advance of the discussion of long-term monetary growth ranges at its next meeting, the Committee considered the role that the monetary base might play in monetary policy. One proposal was to set fairly wide limits on quarterly fluctuations in the monetary base, but to adjust policy promptly if the limits were breached. The Committee also discussed whether a range for the base comparable to the existing ranges for M2 and M3 and nonfinancial debt might usefully supplement the current ranges. Most members expressed reservations about the reliability of the base as a guide to or restraint on policy, given their questions about the behavior of currency and reserves relative to income. However, there was sentiment for a continuing review of possible monetary indicators of future pricetrends.

At the conclusion of the Committee's discussion, all but two of the members indicated that they favored or could accept a directive that called initially for maintaining the current degree of pressure on reserve positions. Some slight

firming would be implemented after a short interval following today's meeting, assuming that economic and financial conditions remained reasonably consistent with current expectations. In particular, and in keeping with the Committee's usual approach to policy, the conduct of open market operations would take account of conditions in financial markets, the strength of the business expansion, indications of inflation, the performance of the dollar in foreign exchange markets, and the behavior of the monetary aggregates. Later in the intermeeting period, some added reserve restraint would be acceptable, or some slight lessening of reserve pressure might be acceptable, depending on ongoing economic and financial developments. The contemplated reserve conditions were likely to be associated with slower monetary growth, but given their relatively rapid expansion in April, M2 and M3 were still expected to grow at the rates of 6 to 7 percent established in late March for the period from March to June. The members agreed that the intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be raised by 1 percentage point 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 continuing strong expansion in economic activity and rising levels of resource utilization. In April, total nonfarm payroll employment rose further; the increase included sizable growth in the manufacturing sector. The civilian unemployment rate fell to 5.4 percent, down appreciably from its level at the start of the year. Growth in industrial production picked up considerably in April from a reduced pace earlier in the year. Retail sales fell appreciably last month but estimates of sales in February and March were revised

substantially higher. Indicators of business capital spending point to substantial gains thus far this year, notably for equipment. The nominal U.S. merchandise trade deficit in the first quarter was substantially smaller than that for the fourth quarter. Consumer and producer prices have risen more rapidly recently following a period of relatively modest increases. Broad measures of labor costs indicate a substantial advance in the first quarter, in part because of a rise in payroll taxes.

Interest rates have risen somewhat since the Committee's meeting on March 29. The trade-weighted foreign exchange value of the dollar in terms of other G-10 currencies had increased slightly on balance over the intermeeting period prior to May 17 and jumped following release of the March trade data.

M1 and M2 grew rapidly in April, owing in part to a buildup in transaction balances associated with tax payments, while M3 expanded at a slower pace than in previous months. Through April, expansion of M2 and M3 was in the upper portion of the ranges established by the Committee for 1988. Expansion in total domestic nonfinancial debt appears to be continuing at a pace close to that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 meeting in February established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee decided in February not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, 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.

In the initial implementation of policy, the Committee seeks to maintain the existing

degree of pressure on reserve positions. Taking account of conditions in financial markets, the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, and the behavior of the monetary aggregates, the Committee expects that a slight increase in the degree of pressure on reserve positions would be appropriate in the weeks ahead. Depending on further developments in these factors, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, also be acceptable later in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from March through June at annual rates of about 6 to 7 percent. 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, Black, Forrestal, Heller, Johnson, and Kelley and Ms. Seger. Votes against this action: Messrs. Hoskins and Parry.

Messrs. Hoskins and Parry dissented because they favored a prompt move to a greater degree of reserve restraint. In their view the risks were considerable that price and wage inflation would accelerate from rates that were already too high. A more substantial firming was needed to moderate underlying pressures and to foster reasonable progress toward price stability. In the absence of such a move at this time, even greater tightening might well be required later, with attendant costs to financial markets and the economy. Mr. Hoskins noted that the M2 and M3 aggregates were near the upper bound of their target ranges. He also referred to the strengthening of business activity abroad, which had implications, potentially, for more widespread price pressures, and to the desirability of increasing the credibility, and thus the

effectiveness, of monetary policy through timely, anti-inflationary measures. He emphasized that monetary policy should be directed toward a steady reduction of inflation and not toward meeting shorter-term business cycle goals. Mr. Parry noted that the two tightening actions in recent weeks were of insufficient magnitude to have much effect on the economy in the context of strengthened prospects for growth and already tight labor markets.

## **Meeting Held on June 29–30, 1988**

### **Domestic Policy Directive**

The information reviewed at this meeting suggested that economic activity was continuing to expand at a relatively vigorous pace, though apparently not quite as rapidly as earlier this year. Growth in output was being sustained by considerable strength in manufacturing; the latter appeared to reflect in part a continuing improvement in the nation's trade balance as well as ongoing expansion in domestic demands. Various measures of prices and wages suggested some intensification of inflation in recent months.

Growth in nonfarm payroll employment moderated somewhat in April and May, particularly in construction, trade, and services. However, manufacturing employment and the average workweek showed continued strength. In May, household employment fell sharply and reversed a large gain in April. The civilian unemployment rate rose from 5.4 percent in April to 5.6 percent in May, but it remained slightly below the first-quarter average.

Industrial production increased considerably in April and May. Assemblies of motor vehicles and the production of capital goods rose substantially in both

months. The output of materials also strengthened over the two months, but that of non-auto consumer goods edged down. There were widespread increases in capacity utilization rates in April and May. Those rates have risen to high levels in primary processing industries.

After increasing appreciably in the first quarter, retail sales were little changed on balance over April and May. Sales of durable goods edged down from recent advanced levels, while spending on nondurable goods extended the sluggish pattern in evidence over the previous two quarters. Housing starts fell to an annual rate of 1.38 million units in May, down from a rate of approximately 1½ million units over the preceding three months. Despite the decline, data on building permits and home sales suggested that the pace of housing activity was little changed.

Business fixed investment also appeared to have leveled off at a high rate recently. Outlays for structures increased in April, particularly in the industrial sector, but new commitments for nonresidential construction were trending down. While new orders for nondefense capital goods showed little change in April and May, the latest survey data implied further gains in capital spending over the second half of 1988. Nonfarm inventory investment in April remained close to its first-quarter pace. The buildup in stocks continued to be sizable in manufacturing and wholesale trade and was concentrated in industries experiencing strong domestic and foreign demand. At the retail level, non-auto inventory investment slowed sharply in April, while inventories of automotive products rose somewhat after declining substantially in the first quarter.

The U.S. merchandise trade deficit narrowed in April on a seasonally adjusted basis, essentially reflecting a decline in imports across a wide range of

commodity categories. Exports fell slightly in April after a large increase in March. Real economic activity expanded strongly during the first quarter in most of the major foreign industrial countries, but available indicators pointed to some slowing in the second quarter, while inflation remained subdued.

Over April and May, the consumer price index rose at about the average pace of the first quarter, despite a sizable advance in retail food and energy prices. At the producer level, prices of finished goods continued to increase in May at the quickened pace of the previous two months. Prices of a broad range of commodities, particularly agricultural goods, increased sharply in the past few weeks, in part because of the effects of the drought. The rise in average hourly earnings of private nonfarm workers picked up significantly in April and May.

The dollar firmed considerably in foreign exchange markets from late May through mid-June, and it subsequently appreciated further in the days leading up to the Committee meeting. In relation to other G-10 currencies, the dollar finished the period on average about 6 percent above its level at the time of the previous Committee meeting on May 17. Continuing improvement in the U.S. trade balance and perceptions that inflationary pressures would be resisted with tighter monetary policy helped to strengthen the dollar.

At its previous meeting in May, the Committee adopted a directive that called initially for maintaining the existing degree of pressure on reserve positions. The Committee agreed that some slight firming would be implemented after a short interval following this meeting, assuming that economic and financial conditions did not diverge significantly from the members' expectations. In particular, the conduct of open market operations would take account of condi-

tions in financial markets, the strength of the business expansion, indications of inflation, the performance of the dollar in foreign exchange markets, and the behavior of the monetary aggregates. Later in the intermeeting period, some added reserve restraint would be acceptable, or some slight lessening of reserve pressure might be acceptable, depending on ongoing economic and financial developments. The contemplated reserve conditions were expected to be associated with growth in M2 and M3 at annual rates of 6 to 7 percent over the period from March to June. The members agreed that the intermeeting range for the federal funds rate should be raised by 1 percentage point to a range of 5 to 9 percent.

In accordance with the Committee's instructions, open market operations were directed toward a slight increase in the degree of reserve pressure starting in the latter part of May. In the two reserve maintenance periods ending June 15, adjustment plus seasonal borrowing rose to an average of \$530 million. That average included a bulge over the Memorial Day holiday in late May. The implementation of firmer reserve conditions, interacting with market expectations of a tighter monetary policy and some seasonal pressures in the money market, contributed to an increase in the federal funds rate from about 7 percent at the time of the May meeting to around 7½ to 7½ percent by mid-June. Subsequently, a marginal further increase was sought in the degree of reserve restraint. This further adjustment in open market operations was made in the context of a flow of economic information that suggested a continuing risk of greater inflation and a directive that called for evaluating new economic data with a greater readiness to tighten than to ease. Adjustment plus seasonal borrowing averaged about \$520 million in the reserve maintenance period ending June 29. Federal funds traded

mostly around 7½ percent during this period but rose to around 8 percent late in the month with the approach of the quarterly statement date.

Most other short-term interest rates rose by ¼ to ⅓ percentage point during the intermeeting period. In contrast, bond yields declined by about the same amount over the interval. Demands for long-term debt instruments appeared to be buoyed by improved prospects for the dollar and by signs that the economic expansion might be moderating toward a more sustainable pace in the context of perceptions that monetary policy was being tightened in a timely manner. Broad indexes of stock prices increased appreciably on balance over the period since mid-May.

Growth of M2 and M3 slowed substantially in May, and M1 was about unchanged. This weaker performance reflected mainly a runoff of tax-related balances. Based on partial data through midmonth, growth of the monetary aggregates appeared to have rebounded in June, though it remained below that registered earlier in the year as increases in market interest rates in recent months apparently began to damp demands for money. Expansion in total domestic nonfinancial debt thus far this year was estimated to have moderated somewhat from the pace in 1987.

The staff projection prepared for this meeting suggested that the economy would expand at a more moderate pace in the quarters immediately ahead. Growth in output would be held down by the effects of the drought on agricultural output, a decline in automobile production, and a more restrained pace of nonfarm inventory accumulation than was thought to have occurred in recent months. Over the longer run, the course of the economy would depend to an important extent on developments in financial markets. To the degree that

demands were strong, in a context of an anti-inflation monetary policy, this would show through in pressures in those markets tending to restrain domestic spending. The staff projection continued to anticipate a sluggish pace of consumer spending, substantially slower growth in business fixed investment, and subdued housing activity; it also assumed a mildly restrictive fiscal policy. As in earlier projections, improvement in the trade balance was expected to contribute substantially to continuing growth in overall economic activity. Prices and wages were expected to rise somewhat more rapidly in the quarters ahead because of the continuing effects of the dollar's depreciation on prices of non-oil imports and of reduced margins of unutilized production resources. Increases in food prices as a consequence of drought conditions were also expected to contribute to inflationary pressures over the quarters immediately ahead.

In the Committee's discussion of the economic situation and outlook, the members generally agreed that some moderation in the rate of economic expansion was a reasonable expectation for the next several quarters. Indeed, although the specific rate of economic growth that would foster achievement of the Committee's price stability goal could not be anticipated with any degree of precision, the members generally agreed that a considerably slower rate of expansion than appeared to have occurred in the first half of 1988 would probably be needed, given already high utilization rates of labor and capital resources. Views differed, however, with regard to the likely extent of the slowing that might already be under way. Many members expressed concern that, in the absence of tighter fiscal and monetary policies, the momentum of the economy pointed to faster growth than would be consistent with the Committee's objective

of containing inflationary pressures over time. Some other members gave more emphasis to recent data that seemed to point to more moderate economic growth. They noted that the higher interest and exchange rates and the slower monetary growth that had accompanied the tightening of monetary policy over the spring would be restraining demands over coming quarters, and they saw a lesser risk of a significant pickup in inflation. In the view of these members, inflation remained a major concern, but additional information was needed to assess whether the economy was on a course that would lead to an intensification of price pressures.

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 prepared specific projections of growth in real and nominal GNP, the rate of unemployment, and changes in the overall price level. With regard to rates of expansion in real GNP, the projections had a central tendency of 2¾ to 3 percent for 1988 as a whole, implying a considerable slowing over the second half of the year; for the year 1989 the central tendency of the projections was 2 to 2½ percent or close to that implied for the second half of this year. Projections of growth in nominal GNP centered on rates of 5¾ to 6¾ percent for 1988 and 5 to 7 percent for 1989. The projected rates of civilian unemployment had a central tendency of 5¼ to 5¾ percent for the fourth quarter of 1988 and 5½ to 6 percent for the fourth quarter of 1989. With respect to the rate of inflation, as indexed by the GNP deflator, the projections centered on rates of 3 to 3¾ percent for 1988 and 3 to 4½ percent for 1989. The somewhat higher midpoint of the central tendency for 1989 overstated

the anticipated pickup in inflation for technical reasons, including a shift in the composition of output that had produced an unusually low increase in the deflator for the first quarter of 1988. In making these projections the members took account of the Committee's objectives for monetary growth established at this meeting and assumed that the fiscal policy understandings reached by the Congress and the administration in late 1987 would be fully implemented. The members also assumed that fluctuations in the exchange value of the dollar would not be of sufficient magnitude to affect economic growth and inflation materially in the period through the end of 1989.

In their review of developments bearing on the prospects for the economy, the members generally agreed that the outlook for consumer and business spending pointed to slower growth in domestic final demands over the next several quarters, but they continued to anticipate that further improvement in the nation's trade balance would provide a major impetus to sustained moderate expansion in overall economic activity. There was uncertainty about strength of demands in the economy from both domestic and foreign sources. Some recent data on consumption and investment seemed to suggest that demands were moderating a bit in the second quarter; moreover, the rise in interest rates would be damping domestic demands over coming quarters, and the higher dollar, if it persisted, could restrain the pace of external adjustment. In addition, money stock growth, taking 1987 and the first half of 1988 together, had been much less rapid than in previous years, and this suggested some restraint in the economy. On the other hand, the economy seemed to have a good deal of momentum and it was far from clear whether the slowing, if any, would be sufficient to relieve growing pressures on resources. Consumption

seemed sluggish, but restrained consumer spending was needed to allow production resources to be shifted to sectors that competed in international markets. Reports from the Federal Reserve Districts suggested that the improved international competitiveness of domestic producers continued to boost manufacturing activity and that capital spending to expand and modernize industry would likely continue fairly robust, if below the extraordinary pace of the first quarter. Economic activity abroad had been somewhat stronger than expected, and if that pattern continued it would tend to boost demands on U.S. exporters.

An important uncertainty in the economic outlook, at least in the view of some members, was the prospective performance of inventories. A somewhat reduced rate of inventory accumulation was desirable to prevent an excess buildup in relation to sales, but a surge in inventory investment could not be ruled out. Such a development would contribute to demand pressures and would threaten the sustainability of the expansion. Members also noted that the drought was having an adverse impact on agriculture in several parts of the country, but its ultimate effects on the economy were difficult to predict. A timely improvement in moisture conditions might yet limit that impact for many producers. In areas unaffected by the drought, agricultural producers were benefiting from higher prices of agricultural commodities.

During the Committee's discussion, the members focused a great deal of attention on the outlook for prices and wages. Specific developments, such as rising import prices and the impact of the drought on agricultural prices, were contributing to inflationary pressures. However, of more fundamental concern to members was the possibility that aggregate demand pressures in the econ-

omy might prove excessive in relation to available labor and capital resources, especially given the high levels of resource utilization already prevailing. By some measures, prices had risen somewhat more rapidly in recent months, although any associated worsening of inflationary expectations, at least as reflected in certain key financial markets, appeared to have been muted, perhaps by favorable reactions to the System's tightening moves. With regard to wages, some members commented that recent wage data, on the whole, had an upward tilt. Reports from different parts of the country suggested that labor market conditions were relatively taut in many, but not all, areas, but there were few reports of substantial acceleration in rates of wage increases. Many business executives were expressing concern, however, about their continuing ability to restrain demands for higher wages. For the moment, priority in labor negotiations continued to be placed on job security issues, and many business executives, facing domestic and foreign competition, continued to emphasize measures to increase productivity and hold down unit labor costs.

Against the background of the Committee's views regarding the economic outlook and in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee at this meeting reviewed the ranges for growth in the monetary and debt aggregates that it had established in February for 1988 and decided on tentative ranges for growth in those measures in 1989. The 1988 ranges included growth of 4 to 8 percent for both M2 and M3 for the period from the fourth quarter of 1987 to the fourth quarter of 1988. A monitoring range of 7 to 11 percent had been set for growth in total domestic nonfinancial debt in 1988. For the year to date,

cumulative expansion of M2 and M3 had been in the upper portion of the ranges established by the Committee, while expansion in nonfinancial debt had been around the middle of its range. With regard to M1, the Committee had decided in February not to set a numerical target for 1988 but to appraise the behavior of this monetary measure in terms of its velocity and against the background of developments in the economy and financial markets and the nature of emerging price pressures.

In the Committee's review of the ranges that had been set for 1988, all of the members found acceptable a proposal to retain the current ranges. The Committee took account of a staff analysis that indicated that a moderation in the growth of M2 over the second half of 1988, bringing M2 expansion to around the middle of the Committee's range for the year, was consistent with the slower growth of income that was both expected and desirable. The slower M2 growth also would reflect the impact of the rise in market interest rates in recent months in association with an expectation that depository institutions characteristically would not adjust offering rates fully on their interest-bearing deposits or would do so only after a considerable delay. Growth of M3 was projected to exceed that of M2 during the remainder of 1988, reflecting needs to finance fairly robust credit growth at depository institutions. Nonetheless, the growth of M3 was projected to remain well within the Committee's range for the year. Growth in total domestic nonfinancial debt was expected to remain near the middle of its range and thus still appreciably above the projected expansion in nominal GNP, in part because of a widened corporate financing gap.

With regard to the ranges in 1989, the members generally agreed that achievement of sustained economic expansion

and concurrent progress toward price stability would require that the ranges continue to be ratcheted down over time. However, views differed as to how much, if any, of this reduction should be scheduled at this time for 1989—especially in light of the uncertainty at mid-1988 as to what economic and financial conditions would prevail in 1989. With deposit rate deregulation, the aggregates had become more interest sensitive, and it had become increasingly difficult to anticipate very far in advance what rates of monetary growth would be appropriate. Many members favored a reduction of a full percentage point in the M2 range. They viewed such a reduction as necessary to constrain income growth in a period when underlying inflation pressures could remain strong and velocity could be increasing. Most other members favored a smaller reduction, or no reduction, in the money growth ranges. Some anticipated that the expansion in business activity as 1989 began might well be slower than most members currently anticipated. Interest rates might also be lower, thereby tending to damp velocity. Because of uncertainty about the outlook, there was a risk that a part, or all, of any current reductions might have to be reversed when the ranges were reexamined in February, with adverse effects in terms of the public's perception of the System's anti-inflation resolve. In the view of these members, the ranges could be adjusted downward in February, when the outlook for 1989 would be in clearer focus. On the other hand, one member felt that a reduction of more than 1 percentage point in the M2 range probably would be needed if progress was to be made in lowering the rate of inflation in 1989. Despite their differing preferences and in recognition of the possibility of revisions next February in these tentative ranges, all but one member indicated they could accept a reduction of a full percentage



point in the M2 range. This would communicate the System's intention to restrain any tendency for inflation to accelerate next year and, indeed, to move over time toward price stability. In light of the uncertainties, the Committee decided to retain the 4-point width for all the aggregates in 1989. Consideration would be given to narrowing the ranges to 3 percentage points when they were reviewed in February.

The tentative range for M3 was reduced by  $\frac{1}{2}$  percentage point and left somewhat higher than that for M2. Growth in M3 had shown a tendency to exceed M2 growth over time and that pattern was expected to continue. The range for M3 had been set above that for M2 in a number of earlier years. The monitoring range for expansion in total domestic nonfinancial debt also was lowered on a tentative basis by  $\frac{1}{2}$  percentage point from the range for 1988. In the economic environment projected for 1989, growth in nonfinancial debt was believed likely to slow a bit from the already reduced pace now expected for all of 1988. Even so, with business loan demands expected to remain relatively strong, growth in nonfinancial debt would probably continue to exceed that of nominal GNP by a considerable margin.

The Committee again decided not to set a specific range for M1 for 1988 or 1989. The velocity of M1 had exhibited sharp swings in recent years. The latter were in part the result of the increased sensitivity of M1 to fluctuations in market interest rates since the deregulation of deposit rate ceilings. The Committee concluded that the prospective relationships between M1 and aggregate measures of economic performance remained too uncertain to justify reliance on this monetary aggregate as a guide for monetary policy, at least insofar as could be judged at this point for next year. Similarly, after Committee consideration

most members preferred not to make use of another narrow monetary measure, the monetary base, in guiding monetary policy. In recent years, the base had varied less in relation to economic activity and prices than had M1, but its velocity had nonetheless fluctuated substantially, and sometimes unpredictably, from year to year.

At the conclusion of this discussion, the Committee approved for inclusion in the domestic policy directive the following paragraphs relating to its objectives for the broader aggregates and nonfinancial debt in 1988 and the role of M1:

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 reaffirmed at this meeting the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, and Parry and Ms. Seger. Votes against this action: None.

The following paragraph relating to the ranges for 1989 was approved for inclusion in the domestic policy directive:

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and

3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth in total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrester, Heller, Hoskins, Johnson, Kelley, and Parry. Vote against this action: Ms. Seger.

Ms. Seger dissented because she preferred to retain—at least for now—this year's ranges of 4 to 8 percent for growth in both M2 and M3 for 1989. The economic outlook for next year remained highly uncertain at this point, and she was concerned about reducing the ranges so far in advance and incurring the risk of having to reverse that decision next February. Such a reversal would create unnecessary uncertainty about the conduct of monetary policy. She recognized that further reductions in the M2 and M3 ranges might well be needed over time to bring inflation under control, and she would be prepared to lower those ranges early next year if economic conditions and prospects appeared to warrant such an action at that time.

In the course of the Committee's discussion of policy implementation for the period immediately ahead, considerable emphasis was given by some members to the desirability of avoiding any impression of a reversal in what was widely perceived as the thrust of policy in recent months toward a gradual increase in the degree of restraint. Several observed that the tightening actions of recent months had had a salutary effect on financial markets, and, as evidenced in part by the performance of the bond markets, on inflation expectations. The Committee did not contemplate any easing of policy in the current economic environment, and some members were concerned that maintaining the degree of reserve pres-

sure sought recently might well be interpreted as a move to an easier policy once the effects of seasonal pressures on money market interest rates subsided. In present circumstances such a development could have an exaggerated effect on inflationary attitudes and thus on the effectiveness of monetary policy. A slight increase in reserve pressure would help to maintain the general thrust of policy and its perception by the markets; some further tightening could be assessed as new data, especially pertaining to inflation pressures, became available. Other members preferred a somewhat greater degree of firming immediately. They were concerned that there were substantial risks that the tightening actions to date might not be sufficient to limit the expansion to a noninflationary pace, and some felt that an increase in the discount rate might helpfully complement open market operations at this juncture.

Some members favored steady reserve conditions. They gave more emphasis to the anticipated lagged effects of earlier policy tightening actions, and most of these members also interpreted recent information as indicative of some slowing in the business expansion. They also were concerned that any firming, however slight, would add to existing upward pressures on the dollar. The rise in the dollar already suggested monetary restraint in the United States, and further upward movements might work against needed adjustment of external imbalances. Some firming might well be needed at some point and should be reflected in a directive that indicated a greater willingness to tighten than to ease in response to new data. However, economic and monetary indicators in this view did not point to the need for any tightening at this time.

According to a staff analysis prepared for this meeting, the implementation of unchanged or slightly firmer reserve conditions was likely to be associated

with some slowing in the growth of M1 and M2 during the months ahead, largely reflecting the impact on deposit growth of more attractive yields on short-term market instruments stemming from the recent rise in market rates. Growth in M3 might be better maintained as banks and thrift institutions continued to finance still sizable expansion in credit demands through issuance of managed liabilities. In these circumstances, cumulative growth in both M2 and M3 through September would be expected to remain in the upper halves of the Committee's 1988 ranges, albeit with M2 declining toward the midpoint of its range.

With regard to possible changes in the degree of reserve pressure during the intermeeting period, all of the members agreed that operations should be adjusted more readily toward further tightening than toward some easing. However, those who preferred no change in the degree of reserve restraint, at least for now, also thought that the directive should incorporate such a presumption only if there were no immediate tightening. The relatively long span between meetings and the importance of the forthcoming data to an assessment of the evolving economic and price outlook, might well require consideration of intermeeting adjustments in the stance of open market operations in coming weeks. In addition, developments in financial markets, especially the foreign exchange market, could have an important effect on the timing of policy actions in the near term, and such developments would need to be reviewed carefully. The members generally endorsed a suggestion to give particular weight to incoming information bearing on the outlook for inflation during the intermeeting period, though the usual attention should also continue to be given to the strength of the economic expansion, conditions in domestic and foreign exchange markets, and

the growth of the monetary aggregates.

At the conclusion of the Committee's discussion, a majority of the members indicated that they preferred or could accept a directive that called for a slight increase in the degree of pressure on reserve positions. The members indicated that somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange and domestic financial markets, and the behavior of the monetary aggregates. The reserve conditions contemplated by the Committee were expected to be consistent with growth in M2 and M3 at annual rates of about 5½ and 7 percent respectively over the three-month period from June through September. In keeping with its decision on the longer-run ranges, the Committee decided not to indicate any expectations regarding the growth of M1 over the months immediately ahead. The members agreed that the intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 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 that economic activity has continued to expand at a fairly vigorous pace. Growth in total nonfarm payroll employment moderated somewhat in April and May. The civilian unemployment rate rose to 5.6 percent in May, a level just below its average in the first quarter. Industrial production advanced considerably in April and May. Retail sales were little changed on balance over the two months after rising appreciably in the first quarter. Available data indicate that business capital spending has remained at the high level

reached in the first quarter. Housing starts fell sharply in May, but other indicators suggested little change in the pace of recent housing activity. The nominal U.S. merchandise trade deficit declined substantially in April, as imports dropped sharply and exports were essentially unchanged. Most measures indicate that prices and wages have risen somewhat more rapidly in recent months. Prices of a broad range of commodities, particularly agricultural goods, have increased sharply in the past few weeks.

Short-term interest rates have risen since the Committee's meeting on May 17, while bond yields have moved lower. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies appreciated considerably over the intermeeting period.

Expansion of M2 and M3 slowed considerably in May and M1 was about unchanged, but data available for June suggested some pickup in monetary growth. From a fourth-quarter base, M2 and M3 have grown at rates in the upper portion of the ranges established by the Committee for 1988. Expansion in total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 reaffirmed at this meeting the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth in total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also

decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to increase slightly the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange and domestic financial markets, and the behavior of the monetary aggregates, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from June through September at annual rates of about 5½ and 7 percent, respectively. 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 the paragraph on short-term policy implementation: Messrs. Greenspan, Corrigan, Black, Forrestal, Heller, Hoskins, Johnson, and Parry.  
 Votes against: Messrs. Angell and Kelley and Ms. Seger.

Messrs. Angell and Kelley and Ms. Seger dissented because they preferred to direct policy toward maintaining unchanged conditions of reserve availability. They did not rule out the possible need for some firming later during the intermeeting period, subject to a review of developments by the Committee.

Mr. Angell indicated that he supported a continued slowing in the growth of the monetary aggregates that was directed toward price level stability over time. In his view, while longer-run developments in prices remained somewhat uncertain, recent information

from exchange rate and commodity markets, as well as the monetary aggregates, called for a pause in the process of continuous tightening in order to gain additional insight regarding the effects of previous actions. In addition, the dollar had been under substantial upward pressure, which had prompted central bank intervention. He felt that the exchange rate objectives implied in dollar sales would be frustrated by the double sterilization of reserves implied by monetary tightening. He wanted to call attention to the cross purposes of these actions.

Mr. Kelley noted that he had supported firming actions over the past several months, but he could not concur with a decision to increase reserve pressure further at this time. The economy, for the most part, was behaving satisfactorily, with evidence that the rate of growth in real activity might be decelerating. He recognized and shared the concern that inflation had the potential to accelerate. However, there was insufficient evidence at this time to justify further tightening that might foster undue slowing in economic growth. He would be prepared to support appropriate firming action later should adequate evidence of increased inflationary pressures emerge, taking into account overall economic activity.

Ms. Seger emphasized that some current business indicators already pointed to a slower economic expansion. Moreover, the full impact of the firming of policy in recent months had not yet materialized. In the circumstances and also taking into account the strength of the dollar and the absence of broad indications of significant acceleration in the rate of inflation, she believed that a further increase in the degree of reserve restraint represented an unwarranted risk at this time to satisfactory economic performance.

## Meeting Held on August 16, 1988

### Domestic Policy Directive

The information reviewed at this meeting suggested that the economy was continuing to expand at a vigorous pace, with manufacturing activity exhibiting particular strength. Some measures of price inflation pointed to a pickup from recent trends, and data on wages and total compensation indicated that labor costs were rising more rapidly.

Total nonfarm payroll employment increased sharply further in June and July. The rise included continuing rapid expansion in the manufacturing sector, and it was accompanied by an appreciable increase in the workweek of production workers. After declining considerably in June, the civilian unemployment rate edged up to 5.4 percent in July but remained slightly below its average level for the second quarter.

Industrial production rose strongly in July after a sizable advance during the second quarter. Production gains were widespread but were especially pronounced for business equipment. Capital utilization rates in manufacturing rose further in June and July and were at relatively high levels in primary processing industries.

Retail sales increased moderately further in July, and revised data indicated somewhat higher retail sales in the second quarter than had been estimated earlier. Overall consumer spending in constant dollar terms increased at about the same moderate pace in the second quarter as it had on average in the previous three quarters; outlays for services and durable goods posted strong gains in the quarter, while spending for nondurable goods declined.

Business fixed investment was now indicated to have increased substantially

further in the second quarter. Spending for business equipment registered another sharp rise, paced by continued large gains in outlays for computing equipment. An upturn in expenditures for nonresidential construction offset about half of the drop in the previous quarter. With outlays for consumer durables and business equipment relatively robust, the accumulation of nonfarm business inventories slowed markedly in the second quarter. Housing starts were unchanged in the quarter from their pace in the first quarter.

The U.S. merchandise trade deficit declined considerably in the second quarter to its lowest level in three years. Exports of both agricultural and nonagricultural goods rose substantially while non-oil imports fell after increasing steadily since early 1985. Economic activity appeared to have slowed in most of the major foreign industrial countries in the second quarter. The rate of inflation had increased in some of those countries in recent months, but it was still relatively low.

Producer prices of finished goods, which had increased at an accelerated pace in the second quarter, rose appreciably further in July. The advance in July included a substantial rise in prices of consumer goods excluding food and energy. The consumer price index, available for June, continued to suggest little change in the rate of consumer price inflation as declines in energy prices tended to offset some acceleration in food and other prices. The prices of some basic commodities had softened recently, in part because of the appreciation of the dollar in foreign exchange markets. Increases in most measures of labor costs had picked up over the past several months, with the acceleration occurring in most broad industry and occupational groupings.

In the foreign exchange markets, the dollar rose somewhat further over the

period since the Committee meeting on June 29–30. In relation to other G-10 currencies, the dollar was up about 2½ percent on average over the intermeeting period. Indications of continuing improvement in the U.S. trade balance and of some tightening in U.S. monetary conditions contributed to the strength of the dollar, but the rise in its exchange value may have been tempered by perceptions that it would be resisted by official actions.

At its meeting in late June, the Committee adopted a directive calling for a slight increase in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about 5½ percent and 7 percent respectively over the period from June to September. The members agreed 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 and domestic financial markets, and the behavior of the monetary aggregates. The intermeeting range for the federal funds rate was left unchanged at 5 to 9 percent.

Some slight firming of reserve conditions was implemented immediately after the June meeting. In the reserve maintenance period ending in mid-July, adjustment plus seasonal borrowings jumped to an average of \$1.3 billion, reflecting a surge in borrowings over the extended July 4 weekend and another bulge associated with an unanticipated large upward revision in required reserves late in that maintenance period. In the two reserve maintenance periods that followed, borrowings averaged close to \$600 million, somewhat above the level prior to the June meeting. Over much of the intermeeting period, federal funds traded

primarily in a range of  $7\frac{3}{4}$  percent to 7½ percent. In addition to the firming of reserve conditions, market expectations of further near-term monetary restraint in response to the strength of incoming economic data seemed to contribute to the rise in the federal funds rate from its average level in June. On August 9, the discount rate was increased from 6 percent to  $6\frac{1}{2}$  percent and at the time of this meeting federal funds were trading around  $8\frac{1}{4}$  percent.

Against the background of continuing strength in the economy, related concerns about inflation, and the firming of monetary policy, most other interest rates rose  $\frac{1}{2}$  to  $\frac{3}{4}$  percentage point over the intermeeting period; however, increases in yields on corporate and municipal bonds were more limited, reflecting reduced supplies of new issues. Mortgage rates rose marginally during the period. Banks raised their prime lending rate from 9 to  $9\frac{1}{2}$  percent in mid-July and subsequently to 10 percent in the first part of August. Broad indexes of stock prices were down around 5 percent over the intermeeting period.

Growth of the broader monetary aggregates, especially M2, slowed in July to rates somewhat below the Committee's expectations for the third quarter as a whole. The weakness in M2 was concentrated in its volatile overnight RP and Eurodollar components. Growth of retail deposits in M2 remained considerably less than in the first few months of the year and apparently was damped by the rise since early spring of market interest rates and related opportunity costs of holding such deposits. M1 continued to expand rapidly in July, with strength especially evident in other checkable deposits. Reflecting a surge in total reserves, the growth of the monetary base accelerated in July.

In the light of recent economic developments, the staff projection prepared

for this meeting was revised to incorporate notably faster real growth in the current quarter than had been anticipated earlier. Nevertheless, the rate of expansion was still projected to moderate considerably on balance over the next several quarters. The effects of the drought were expected to depress measured GNP growth in the second half of the year, but those effects would be reversed in the first part of 1989. Growth of final demand was projected to moderate somewhat over the year ahead. To the extent that the current momentum in final demand tended to be sustained but was not accommodated by monetary policy, pressures would be generated in financial markets that would restrain domestic spending. The staff projection continued to anticipate relatively sluggish growth of consumer spending, much slower expansion of business fixed investment, and subdued housing activity. The strengthening of the dollar since late spring might inhibit the improvement in the nation's trade balance to some extent in 1989, but continuing progress in reducing the trade deficit was still expected to provide a key impetus to sustained economic expansion. The rate of inflation was projected by the staff to increase somewhat over the next several quarters, to an important extent because of the effects of reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, a number of members gave considerable emphasis to indications of ongoing strength in the economic expansion and to the implications of such growth for inflation in the context of relatively full utilization of labor and capital resources. Some commented that the surprises in the incoming economic information over the course of recent weeks—indeed for the year 1988 to date—had tended to be on

the side of greater than projected strength. Other members gave more weight to the possibility that monetary tightening over previous months—reflected in reduced growth of the monetary aggregates, higher interest and exchange rates, and flat commodity prices—might already have fostered a significant slowing of the expansion and restraint on inflation. The members generally anticipated at least some moderation in the expansion from the recent pace and viewed slower growth as a desirable development in terms of accommodating long-run anti-inflation objectives, but they differed as to what degree of policy restraint might be needed to achieve a sustainable and noninflationary rate of economic expansion.

In their assessment of prospective developments in key sectors of the economy, a number of members focused on business fixed investment and business inventory accumulation as areas of particular uncertainty. Growth in business capital spending was expected to slow substantially from its rapid pace earlier this year, but a number of members believed that the risks of a different outcome were in the direction of unanticipated strength, particularly in light of exceptionally high rates of capacity utilization in many industries. Tending to support that view were a growing number of reports from business contacts of plans to expand or modernize production facilities. Business inventories currently appeared to be at generally acceptable levels, as evidenced by inventory-to-sales ratios, lead times on deliveries, and reports from many business firms around the country. Nonetheless, a surge in inventory accumulation could not be ruled out at this stage of the cyclical expansion. Under prevailing economic conditions, such a development might well add to inflationary demand pressures and could threaten the sustainability of the business expansion itself.

Views with respect to the outlook for consumer spending differed to some extent, but the members generally anticipated relatively limited growth over the next several quarters. One factor cited was the impact of higher interest rates, whose restraining effects on consumer spending might be reflected more quickly than earlier because of the increased use of variable rates on consumer and mortgage loans. Some members commented that relatively slow growth of consumer expenditures would be desirable not only to curb potentially inflationary expansion of overall final demand but to facilitate the allocation of more production resources to export markets. The rise in mortgage interest rates was expected to damp housing activity, and one member emphasized that this effect might be quite substantial.

With regard to the prospects for foreign trade, the members still expected net exports to continue to improve, but the extent of that improvement might be less than previously anticipated, given the appreciation of the dollar in recent months. Indeed, some business contacts competing in international markets or preparing to enter such markets were already expressing concern about the potentially negative impact that the rise in the dollar would have on their sales.

Turning to the outlook for inflation, members noted with particular concern that labor compensation costs were rising at a faster rate this year. Several commented on increasing shortages of workers in their local and regional markets and on more numerous reports of higher wages to attract or retain workers. However, wage inflation did not appear to be worsening in many areas, including some where available workers were reported to be in increasingly short supply. With regard to price developments, recent statistical indicators presented a mixed picture. Producer prices of finished goods



were rising more rapidly, and there were reports from some parts of the country that business firms were succeeding to a greater extent than earlier in their efforts to pass on rising costs or to raise profit margins. On the other hand, sensitive commodity prices, particularly for industrial materials, had been fairly steady and a firmer dollar should relieve some of the pressure on import prices. On balance, however, most of the members thought that the risks were on the side of greater inflation over the quarters ahead.

At its meeting in late June, the Committee reviewed the basic policy objectives that it had set for growth of the monetary and debt aggregates in 1988 and established tentative objectives for expansion of those aggregates in 1989. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the Committee reaffirmed the ranges of 4 to 8 percent established in February for growth of both M2 and M3. The monitoring range for expansion of total domestic nonfinancial debt was left unchanged at 7 to 11 percent for 1988. On a cumulative basis through July, M2 and M3 grew at annual rates a little above the midpoints of their annual ranges. Expansion of total domestic nonfinancial debt appeared to have moderated to a pace marginally below the midpoint of its range. For 1989 the Committee agreed on tentative reductions to ranges of 3 to 7 percent for M2 and  $3\frac{1}{2}$  to  $7\frac{1}{2}$  percent for M3. The monitoring range for growth of total domestic nonfinancial debt was reduced to  $6\frac{1}{2}$  to  $10\frac{1}{2}$  percent for 1989. It was understood that all the ranges for next year were provisional and that they would be reviewed in February 1989 in the light of intervening developments. With respect to M1, the Committee reaffirmed in June its earlier decision not to set a specific target for growth in 1988 and also decided not to establish a tentative range for 1989.

During the Committee's discussion of policy for the intermeeting period ahead, nearly all the members indicated that they preferred or could support a directive to maintain unchanged conditions of reserve availability. In assessing the desirability of such a policy, members noted that the discount rate had been raised only recently and, to date, financial markets did not appear to have adjusted fully to the increase. In the circumstances, several members expressed concern that further tightening at this time through open market operations might have unintended and unsettling effects on financial markets. Moreover, under prevailing circumstances, further firming might well foster some added strengthening of the dollar in foreign exchange markets with undesirable repercussions over time on progress in improving the nation's foreign trade position. One member also noted that further tightening so soon after the increase in the discount rate would add to pressures for firmer monetary policies abroad and thereby heighten the risks of an upward ratcheting of interest rates in financial markets around the world.

While the members generally agreed on the desirability of a steady policy for the near term, many thought that some further firming was likely to be needed, perhaps relatively soon. These members saw substantial risks that inflationary pressures would intensify in the absence of further fiscal and monetary restraint. The economy had considerable momentum, and there already were indications that cost pressures and some prices were increasing more rapidly. In light of their concerns, these members favored a directive that would permit operations during the intermeeting period to be adjusted more readily toward further tightening if incoming information tended to confirm the potential that they saw for increasing inflationary pressures. While most of

these members did not rule out the possibility of some easing, one proposed a directive that did not envisage any move in that direction during the intermeeting period.

Other members, while they could accept a directive that indicated a greater willingness to tighten than to ease reserve conditions, were less certain of the potential need for further monetary restraint, especially in the near term. These members emphasized that, when taken together, the tightening actions over the past several months represented, in their judgment, a major policy move whose restraining impact was not yet fully reflected in the economy. In this view, time was needed to observe the effects of the earlier policy actions and thus to reduce the risk that monetary policy inadvertently might become too restrictive. Also, a cautious approach to further tightening might be appropriate in light of the fragilities that had developed in the economy, including the vulnerability of many financial intermediaries and the exposure of many business and household borrowers and of some foreign debtor countries to rising interest rates. Other members, while not disagreeing that debtor problems were a matter of serious concern, nevertheless felt that primary emphasis needed to be placed on curbing any tendency for inflation to gather momentum; such a development, if allowed to proceed, would lead to even higher interest rates and more severe damage to exposed, interest-sensitive borrowers, both in the United States and abroad.

In the discussion of factors that might trigger future monetary policy actions, a number of members felt that the behavior of the monetary aggregates should be given more weight, although only a few favored giving primary emphasis to these measures. According to a staff analysis prepared for this meeting, growth of both

M2 and M3 was likely to be appreciably slower in the current quarter than had been anticipated at the time of the previous meeting, given the rise in interest rates that had occurred over the intermeeting period. Assuming no further increase in interest rates, the cumulative expansion of M2 through September might be around the midpoint of the Committee's range for the year while that of M3 might be only marginally above the midpoint of its range. Growth of M1 also was expected to slow substantially from its relatively rapid rates of expansion in June and July. Members who wanted to give the monetary aggregates greater attention expressed satisfaction that monetary growth appeared to have slowed to a pace deemed more consistent with progress in reducing inflationary pressures and a sustainable expansion in economic activity over time. They also observed that the behavior of M2 had resumed a more predictable pattern over the past several quarters in relation to aggregate measures of economic performance. However, several members expressed the reservation that more time was needed to assess the ongoing reliability of M2 as a guide for the conduct of monetary policy. A number commented that the major focus in policy implementation should continue to be on incoming indications of inflationary pressures in the economy.

In light of the increase that had occurred in the federal funds rate, including the recent rise following the advance in the discount rate, the members accepted a proposal to raise the intermeeting range for the federal funds rate by 1 percentage point to a range of 6 to 10 percent. The upward adjustment in the range was intended to align its midpoint more closely with the current average level of the federal funds rate. The range for the federal funds rate provides one mechanism for initiating consultation of the

Committee when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all but one member indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve positions. The members decided that somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 3½ percent and 5½ percent respectively over the three-month period from June to September. The intermeeting range for the federal funds rate was raised by 1 percentage point to a range of 6 to 10 percent.

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

The information reviewed at this meeting suggests that economic activity has continued to expand at a vigorous pace. Total nonfarm payroll employment grew sharply further in June and July. The civilian unemployment rate in July, at 5.4 percent, was slightly below its average level in the second quarter. Industrial production advanced considerably further in July. Growth in retail sales remained moderate last month. Business capital spending has continued to grow rapidly. Some measures of prices indicate a pickup from recent trends and labor costs have risen more rapidly in recent months.

Most interest rates have increased appreciably since the Committee's meeting on June 29-30. On August 9 the Federal Reserve Board approved an increase in the discount rate from 6 to 6½ percent.

The nominal U.S. merchandise trade deficit fell in the second quarter as exports continued

to rise and non-oil imports declined. Over the intermeeting period, the trade-weighted foreign exchange value of the dollar appreciated somewhat further in terms of the other G-10 currencies.

Expansion of M2 and to a lesser extent M3 slowed in July but growth of M1 remained relatively strong. From a fourth-quarter base through July, M2 and M3 have grown at rates somewhat above the midpoints of the ranges established by the Committee for 1988. Expansion in total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth in total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial

markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from June through September at annual rates of about 3½ and 5½ percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Johnson, LaWare, and Parry and Ms. Seger. Vote against this action: Mr. Hoskins. Absent and not voting: Mr. Kelley.

President Hoskins dissented because he preferred a policy that would give less emphasis to near-term business conditions and exchange rate considerations and greater emphasis to the longer-term objective of price stability. He viewed the current rate of inflation as too high relative to that objective and believed that the strength of final demand and associated pressures on costs in the economy suggested that inflation may be heading higher. In the circumstances, he thought further monetary restraint would be more consistent with the Committee's long-run price stability objective and would increase market confidence in the eventual achievement of that objective.

## Meeting Held on September 20, 1988

### Domestic Policy Directive

The information reviewed at this meeting suggested that the expansion of economic activity might be moderating from the vigorous pace experienced earlier in the year. Information on output and spending in the third quarter was still fragmentary,

but recent statistics, including data on labor market activity, pointed on balance to some slowing in the rate of economic growth. Measures of price and wage inflation showed little change from recent trends, apart from the continuing upward impetus to food prices stemming from the drought.

Total nonfarm payroll employment rose more slowly in July and August, but gains in overall employment remained sizable. After four months of strong increases, manufacturing employment fell slightly although some industries with strong domestic and export sales recorded further increases. The civilian unemployment rate edged up in July and rose somewhat further to 5.6 percent in August, returning to its average level of the first half of the year.

Industrial production advanced somewhat further in August after a sharp increase in July. Production gains were recorded for most categories although they generally were smaller than those in July. Total industrial capacity utilization was little changed in August. Utilization rates remained at relatively high levels in primary processing industries but slipped in manufacturing as a whole after four months of increases.

Total retail sales were little changed on balance in July and August. Outlays for durable goods declined in both months, partly because of some slowing in unit sales of new automobiles. Sales of non-durable goods increased at a sluggish pace.

Recent information on business capital spending suggested some moderation from the very rapid growth in earlier months of the year. Real outlays for equipment continued to expand in July but at a pace well below that of the first half of the year as shipments of office and computing equipment fell. Nonresidential construction activity apparently edged higher in July despite further contraction

in oil drilling and in spending on industrial and commercial structures other than office buildings. Inventory investment in the manufacturing and wholesale sectors in July evidently remained at about the moderate second-quarter pace. Housing starts rose in July, as multifamily construction rebounded from a reduced June level, but single-family starts remained close to the average pace of the first half of the year. Sales of new and existing homes retreated from their June pace, which had been the highest in more than a year.

The nominal U.S. merchandise trade deficit fell appreciably further in July from a considerably reduced second-quarter rate and was the lowest monthly deficit since March 1985. Virtually all of the improvement in July was due to a reduction in imports. The total value of exports was little changed from the June level as a sharp reduction in exports of automotive products about offset small increases in most other major categories. Economic activity in major foreign industrial countries slackened in the second quarter, but expansion appeared to have resumed in the current quarter.

Producer prices of finished goods, propelled by further substantial increases in refinery prices for gasoline, registered another large advance in August. At the level of crude materials, producer food prices were up sharply for the fourth straight month, reflecting the continuing effects of the drought. Consumer prices, available for July, advanced at about the second-quarter pace. Consumer food prices surged again; and energy prices rose further, mainly because of higher gasoline prices. Excluding food and energy items, consumer prices increased at about the average pace of the preceding 12 months.

In the foreign exchange markets, the trade-weighted value of the dollar changed little on balance over the period

since the Committee meeting on August 16. Following that meeting, the dollar remained under upward pressure until late in the month when increases in European official lending rates arrested its climb. Following the softer U.S. employment report for August, the dollar moved lower in early September, but it subsequently firmed in response to the publication of the July merchandise trade figures.

At its meeting in mid-August, the Committee adopted a directive calling for no change in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about  $3\frac{1}{2}$  and  $5\frac{1}{2}$  percent respectively over the period from June through September. The members agreed 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, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.

Reserve conditions remained essentially unchanged over the period since the August meeting. Adjustment plus seasonal borrowing averaged just below \$600 million for the two reserve maintenance periods completed since the meeting, and federal funds primarily traded near the  $8\frac{1}{8}$  percent level prevailing at the time of the meeting. In light of some indications of more moderate economic expansion, most other market interest rates declined  $\frac{1}{4}$  to  $\frac{3}{8}$  percentage point over the intermeeting period. Broad indexes of stock prices were up 1 to 3 percent.

Growth of the broader monetary aggregates slowed again in August. The slower expansion of M2 was concentrated in its liquid deposit components and probably continued to reflect the rise since early

spring of market interest rates and related opportunity costs of holding such deposits. Growth of M1 fell sharply in August, as total transaction deposits declined slightly. Reflecting a contraction in total reserves, growth of the monetary base slowed markedly in August.

The staff projection prepared for this meeting incorporated somewhat slower growth of economic activity in the current quarter than had been projected earlier, largely reflecting the recent softening in the data on employment. The rate of expansion through the end of 1989 was expected to remain on balance below the pace in recent quarters, with the drought likely to contribute to an uneven quarterly pattern of growth. To the extent that monetary policy did not accommodate any tendency for growth in final demand to be sustained at a pace that threatened more inflation, pressures would be generated in financial markets that would restrain domestic spending. The staff continued to project relatively limited growth of consumer spending, considerably reduced expansion of business fixed investment, and sluggish housing activity. The foreign sector was still expected to make a major contribution to domestic economic growth, even though progress in reducing the trade deficit was thought likely to be slower than in recent quarters. The staff also anticipated some continuing cost pressures over the next several quarters, reflecting the effects of rising import prices and especially of reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, members noted that the recent indications of some moderation in the rate of economic growth tended to reinforce their expectations of a reduced rate of economic expansion through next year. The members welcomed the signs of somewhat slower economic growth, given the risks

of higher inflation. A number were concerned that the apparent slowing might prove to be only a temporary pause in a generally strong expansion or to be inadequate to avert an intensification of inflationary pressures without further monetary restraint. Others, while noting the still tentative nature of the incoming data, interpreted recent developments in financial markets as well as the real economy as suggesting a greater likelihood that policy had tightened sufficiently to put the economy on a desirable course toward moderate growth that would prove compatible over time with the achievement of the Committee's anti-inflationary objectives.

In the Committee's discussion of factors bearing on the economic outlook, a number of members emphasized that, on the whole, indicators of economic activity continued to suggest appreciable momentum in the expansion. Recent growth of payroll employment, while below the average pace of the first half of the year, was still substantial. Capital spending exhibited few signs of weakening following a period of rapid expansion, and sizable profits augured for continuing growth. Likewise, new orders, notably for exports, were holding up well, and some greater inventory investment was seen as a reasonable prospect, given current low inventory-to-sales ratios. A number of members also referred to continuing evidence of a high level of business activity in many parts of the country. Indeed, in some areas and industries, growth was being constrained by a limited availability of labor and other production resources. At the same time, members noted that economic performance remained uneven across the country, depending on the mix of local industries, and a few signs of moderation could be observed even in areas that were characterized by strong local economies. Retail sales were lackluster in a number

of areas, and the drought was having a mixed impact on agriculture. The drought's adverse effects in some parts of the country contrasted with income gains in other areas where producers experiencing more normal crop yields were benefiting from higher prices. On balance, local conditions appeared consistent with expectations of somewhat slower growth in domestic demand.

Members continued to anticipate further improvement in the nation's trade balance over the next several quarters. That view was bolstered by local reports of strength in export demands for a wide variety of products and indications of gains in domestic market shares by firms in the United States. The prospective improvement in net exports was not likely to be as strong as in recent quarters, however, reflecting the lagged effects of the rise in the exchange value of the dollar over the course of recent months.

With regard to the outlook for inflation, members generally emphasized that the risks remained on the side of an intensification of inflationary demand pressures. Some favorable developments that had tended to dampen inflation, such as declining oil prices and a rising dollar, might well be reversed. More fundamentally, given current utilization rates of labor and other production resources, the economy was probably near the point where expansion at a rate somewhat above the economy's trend growth potential could result in greater pressures on wages and prices. Other members saw less risk of more inflation, particularly in the context of what they viewed as the moderating growth of the economy and the appreciable tightening of monetary policy over the past several months. Consistent with this view, some noted that inflationary expectations appeared to have eased as evidenced, for example, by the performance of long-term debt markets and the behavior of the dollar in

foreign exchange markets. Moreover, industrial commodity prices had been relatively stable for an extended period. Reports from contacts around the nation did not suggest much change recently in local price and wage developments. Capacity constraints and labor shortages in some industries and areas continued to be a source of inflationary pressures, but there were few reports of outsized increases in prices or wages. Indeed, some members noted that prices had tended to level out or to rise more slowly in a number of industries and indications of faster increases in wages were limited.

At its meeting in late June the Committee reviewed the basic policy objectives that it had set for growth of the monetary and debt aggregates in 1988, and it established tentative objectives for expansion of those aggregates in 1989. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the Committee reaffirmed the ranges of 4 to 8 percent set in February for growth of both M2 and M3. The monitoring range for expansion of total domestic nonfinancial debt in 1988 was left unchanged from its February specification of 7 to 11 percent. On a cumulative basis through August, M2 had grown at an annual rate slightly above, and M3 at a rate more noticeably above, the midpoints of their annual ranges. Expansion of total domestic nonfinancial debt appeared to have moderated to a pace marginally below the midpoint of its range. For 1989 the Committee agreed on tentative reductions to ranges of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The monitoring range for growth of total domestic nonfinancial debt was lowered to 6½ to 10½ percent for 1989. It was understood that all the ranges for next year were provisional and that they would be reviewed in February 1989 in the light of intervening developments. With respect to M1, the Committee reaffirmed in

June its earlier decision not to set a specific target for growth in 1988 and it also decided not to establish a tentative range for 1989.

In the Committee's discussion of policy implementation for the weeks immediately ahead, all of the members agreed on a proposal calling for an unchanged policy stance pending an evaluation of further economic developments. Those who perceived the risks in the economic outlook as still decidedly on the side of continued strong demand and greater inflationary pressures saw enough uncertainties in the current economic situation to warrant a pause in the policy firming process. Others were less persuaded that inflationary pressures would intensify, especially given the degree of policy restraint that already had been implemented over the past several months. It was noted that additional firming at this time could have undesirable repercussions on the dollar in foreign exchange markets and on the financial condition of many already troubled depository institutions. Some members expressed concern that a marked weakening in the economy, which would become a greater risk if policy were tightened further, would disrupt the urgent task of reducing the federal budget deficit.

In their consideration of a desirable policy for the near term, the members took account of a staff analysis, which suggested that monetary expansion was likely to remain relatively damped in coming months. This outlook assumed a continuing lagged adjustment of offering rates on retail deposits to earlier increases in market interest rates.

With regard to possible adjustments in the degree of reserve pressure during the intermeeting period, all of the members indicated that the balance of risks in the economy was such that they favored or could accept a directive that would more readily accommodate a move toward

firming than an adjustment toward easing in the weeks ahead. Some commented that near-term developments were not likely to call for a policy change in this period, while others saw a greater likelihood that intermeeting developments would point to the desirability of some firming. The potential need for some easing was viewed as remote.

At the conclusion of the Committee's discussion, all of the members approved a directive that called for maintaining the current degree of pressure on reserve positions. The members decided that somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, over the intermeeting period, depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of about 3 percent and 5 percent respectively over the four-month period from August to December. The members agreed that the intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 6 to 10 percent.

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

The information reviewed at this meeting suggests that the expansion in economic activity may be moderating from the vigorous pace earlier in the year. Total nonfarm payroll employment grew more slowly in July and August, though the increases in the two months were still sizable. The civilian unemployment rate rose to 5.6 percent in August. Industrial production advanced slightly fur-



ther in August after a sharp increase in July. Retail sales were flat in July and August. Recent indicators of business capital spending suggest some moderation from the especially rapid growth in earlier months of the year. Preliminary data for the nominal U.S. merchandise trade deficit in July showed some further reduction from the improved second-quarter rate. The latest information on prices suggests little if any change from recent trends.

Most interest rates have declined somewhat since the Committee meeting on August 16. Over the intermeeting period, the trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies was about unchanged on balance.

Expansion of M2 and M3 moderated further in August. For the year through August, M2 has grown at a rate slightly above, and M3 at a rate more noticeably above, the midpoints of the ranges established by the Committee for 1988. M1 was unchanged in August after registering relatively strong growth in June and July. Expansion of total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth of total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth of total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated

in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from August through December at annual rates of about 3 and 5 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, and Parry and Ms. Seger. Votes against this action: None.

## Meeting Held on November 1, 1988

### 1. Domestic Policy Directive

The information reviewed at this meeting indicated that the expansion in economic activity had moderated from the vigorous pace evident earlier in the year. Private domestic final demand grew at an appreciably slower pace in the third quarter than in the first half of the year; and other recent statistics, including data on labor market activity, also suggested some slowing in the rate of economic expansion. Information on wage and price developments gave no clear evidence on balance of any change in underlying inflation trends.

Total nonfarm payroll employment increased considerably in the third quarter, but the gains were less than those registered in the first half. In August and September, hiring in all major sectors except government moderated, and employment in manufacturing declined. Despite this broad-based slowing in the growth of private payrolls, the civilian unemployment rate fell to 5.4 percent in September and has remained in a narrow range around 5½ percent since early spring.

Industrial production increased only slightly on balance in August and September after a strong surge earlier in the summer. Output of business equipment continued to advance fairly rapidly while production of consumer goods was sluggish. Total industrial capacity utilization declined slightly in September but was still more than ½ percent above the relatively high second-quarter level.

Overall consumer spending in constant dollar terms increased substantially on average in the third quarter, as outlays for services and nondurable goods strengthened while purchases of durables were little changed. However, retail sales weakened in August and September, owing partly to reduced sales of motor vehicles.

Indicators of business capital spending in the third quarter suggested a considerably reduced rate of expansion compared with the first half of the year. Growth of real outlays for business equipment slowed sharply, as investment in information-processing equipment decelerated. Nonresidential construction activity was weak in the first two months of the quarter, with oil drilling and expenditures on commercial and industrial structures other than office buildings contracting further. Inventory investment in the manufacturing and wholesale sectors picked up in July and August, but stocks accumulated about in line with the growth

of sales. Retail inventories, reflecting little further change in stocks at auto dealers after a sharp rise in the second quarter, increased much less rapidly. Housing construction had been flat in recent months; the third-quarter pace of starts of single-family homes was unchanged from that of the previous quarter while multifamily starts edged down.

Preliminary data for the nominal U.S. merchandise trade deficit in August showed a larger deficit than in July. However, the average for July and August was slightly lower than the second-quarter rate as exports increased more than imports. Most of the rise in exports was in nonagricultural goods, particularly capital goods and consumer durables; increased imports of consumer goods and food outweighed a slight reduction in the value of purchases of imported oil. Economic activity in the major foreign industrial economies appeared to have rebounded somewhat in the third quarter, following a pronounced slackening in the second quarter.

Reflecting a decline in gasoline prices at the refinery level, producer prices of finished goods registered a smaller advance in September than in August; however, for the third quarter as a whole, these prices rose more rapidly than during the first half of the year. At the crude materials level, producer food prices continued to rise sharply. Consumer prices increased at a somewhat slower rate in September as declines in energy prices outweighed the passthrough to the retail level of higher wholesale food prices. Excluding food and energy items, consumer prices on a year-over-year basis continued to rise at about the 4½ percent annual rate evident since late 1987. Most measures of labor costs indicated some slowing in the rate of increase over the summer months, after a sharp upward movement in the second half of 1987 and early 1988.

In the foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies had declined from its high level of last summer by the time of the previous Committee meeting on September 20. Following the meeting, the dollar initially fluctuated in a narrow range but later declined appreciably in response to indications of more moderate U.S. economic growth and to information suggesting a slower U.S. external adjustment than the markets had anticipated earlier.

At its meeting on September 20, the Committee adopted a directive calling for no change in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about 3 and 5 percent respectively over the period from August to December. The members agreed 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, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.

Adjustment plus seasonal borrowing fluctuated over a sizable range during the intermeeting period, averaging about \$630 million in the two complete reserve maintenance periods since the September meeting. The federal funds rate rose somewhat, with funds trading around 8 1/4 percent and sometimes higher over most of the intermeeting period. Most other short-term interest rates edged higher, perhaps reflecting the firmer federal funds rate as well as increased supplies of Treasury bills and CDs. Interest rates in long-term debt markets declined a little further as indications of more moderate economic expansion and weak energy prices apparently reduced concerns about inflation and buoyed expectations that

money market conditions would not be tightened substantially further. Lower bond yields apparently contributed to higher equity prices; some broad indexes of stock prices had risen about 3 percent since the September meeting.

Expansion of M2 slowed further in September, and preliminary data suggested that growth remained quite weak in October as earlier increases in market interest rates and opportunity costs continued to damp demands for liquid deposit components. By contrast, after slow growth in August and September, M3 appeared to have strengthened somewhat in October, in association with a resumption in growth of bank credit. After registering relatively strong expansion in June and July, M1 had increased only slightly on balance in recent months, with total transactions deposits falling marginally.

The staff projection prepared for this meeting suggested that growth of the nonfarm sector of the economy in the current quarter might be near the reduced pace of the third quarter and that expansion in 1989 was likely to remain, on balance, well below the pace of the first half of 1988. The effects of the drought would continue to be reflected in an uneven quarterly pattern of growth of GNP, notably through the first half of next year. To the extent that expansion of final demand at a pace that could foster higher inflation was not accommodated by monetary policy, pressures would be generated in financial markets that would restrain domestic spending. The staff projection, which assumed a slightly restrictive fiscal policy, continued to indicate relatively sluggish growth of consumer spending, sharply reduced expansion of business fixed investment from the pace in the first half of 1988, and restrained housing activity. As in earlier projections, the external sector was expected to contribute importantly to

domestic economic growth. The staff now anticipated some marginal easing in aggregate price increases in 1989, in large part because recent declines in crude oil prices portended lower energy prices more generally. However, any decline in inflation would be limited, largely because of continuing pressures stemming from still strong demands pressing against reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, members welcomed the apparent moderation in the expansion of economic activity toward a pace that might prove to be more sustainable and consistent with progress over time toward price stability. Continuing expansion, but at a more moderate pace than that experienced in the first half of 1988, was viewed as a reasonable expectation, partly in light of the monetary policy tightening that already had been implemented this year. There was no evidence of emerging imbalances in key sectors of the economy that might bring the expansion to an end, although the outlook remained clouded by the nation's outsized trade and federal budget deficits and the financial problems or debt exposure of a number of depository institutions and business firms. In the view of many of the members, the risks of deviations from current expectations continued to be in the direction of greater inflationary pressures. Other members, while concerned about the potential for inflation, felt that the economy already appeared to be on a track consistent with no pickup in inflation and perhaps some improvement next year.

In the course of the Committee's discussion, members noted that despite signs of some slowing in recent months, the expansion in business activity retained appreciable momentum as evidenced, for example, by order backlogs, ongoing

strength in business capital spending, and noteworthy improvement in the agricultural sector. Further improvement in the nation's trade balance also appeared likely, and while the gains might be more limited than in recent quarters, they would help to sustain domestic manufacturing activity. Consumer spending might be supported to some extent by gains in real incomes stemming from reduced energy prices. By most measures, business inventories appeared to be relatively lean and, assuming continued moderate growth in overall final demand, further inventory accumulation might provide a modest fillip to the expansion over the year ahead. On the other hand, members also took note of the relatively sluggish performance of retail sales recently, notably of durable goods, and the continuing weakness of construction activity, including housing. A review of local business conditions continued to indicate an uneven pattern of regional activity, but on balance local developments tended to confirm broader indications of further, though reduced, growth in overall business activity.

With regard to the outlook for inflation, a critical issue in the view of many members was whether overall demand conditions in the economy would be consistent with containing or reducing inflation. A number of members expressed concern that underlying pressures on resources remained strong and that the possibility of greater inflation constituted the major current threat to sustained economic expansion. One observed that the uncertainties in the outlook for inflation were compounded by the prospect that, with production resources at or close to full capacity, even small differences in demand pressures could have a disproportionate effect on the actual rate of inflation next year. However, some members commented that, on the whole, price and wage

developments were more favorable than might have been anticipated at current rates of capacity utilization. Recent reports from around the nation suggested that inflation was not worsening in regional markets, including parts of the country where business activity remained relatively robust. Indeed, there were indications that prices of some business products previously in short supply now were showing some tendency to level off, and there was little or no evidence of faster increases in wages. Moreover, recent developments in financial markets suggested some lessening of inflationary expectations, although the latter remained volatile.

At its meeting in late June, the Committee reviewed the basic policy objectives that it had set for growth of the monetary and debt aggregates in 1988, and it established tentative objectives for expansion of those aggregates in 1989. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the Committee reaffirmed the ranges of 4 to 8 percent set in February for growth of both M2 and M3. The monitoring range for expansion of total domestic nonfinancial debt in 1988 was left unchanged from its February specification of 7 to 11 percent. For the year to date, M2 had grown at an annual rate somewhat below, and M3 at a rate somewhat above, the midpoints of their annual ranges. Expansion of total domestic nonfinancial debt appeared to have moderated to a pace marginally below the midpoint of its range. For 1989 the Committee agreed on tentative reductions to ranges of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The monitoring range for growth of total domestic nonfinancial debt was lowered to 6½ to 10½ percent for 1989. It was understood that all the ranges for next year were provisional and that they would be reviewed in February 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed in June its earlier decision not to set a specific target for growth in 1988 and it also decided not to establish a tentative range for 1989.

In the Committee's discussion of policy implementation for the period immediately ahead, the members generally agreed that the current relatively balanced performance of the economy and the uncertainties surrounding the outlook argued for an unchanged policy at this point. Some commented that the apparent strength of underlying inflationary pressures might require further monetary restraint later, but for now they favored or could accept a steady policy course. Other members were more persuaded that, in the context of the recent evidence of slower economic growth, monetary policy already appeared to be on a course that would promote progress in reducing inflation. From the perspective of the growth of the monetary aggregates and reserve as well as interest rate developments, monetary policy had been fairly restrictive for some months and further restraint needed to be approached with some caution. At the same time, members stressed the continuing need to sustain the System's commitment to its long-run objective of controlling inflation, including the desirability of making clear that the current rate of inflation was unacceptable.

In the course of the Committee's discussion, the members took account of a staff analysis that concluded that the maintenance of unchanged reserve conditions was likely to be associated with relatively slow monetary growth over the balance of the year. Some pickup in the growth of M2 and M3 was anticipated from the very sluggish performance of September and October, but further adjustments of asset portfolios to previous increases in interest rates and opportunity costs were likely to limit the rise.

In addition, reductions in compensating balances in response to earlier increases in market interest rates were expected to be more pronounced late in the year, though such adjustments would have their major impact on M1 growth. Concurrently, expansion of M3 and, to a lesser degree, M2 might be buttressed to some extent as banks undertook to secure funds to underwrite a perhaps substantial portion of the initial cash needed to finance the recent surge in merger and buyout activities. Although members observed that any easing of reserve conditions to stimulate monetary growth would not be desirable at this point, some indicated that they would become increasingly concerned if very weak monetary growth were to persist in the context of sluggish expansion in economic activity.

With regard to possible adjustments in the degree of reserve pressure in the intermeeting period, a majority of the members believed that operations should be adjusted more readily toward further tightening than toward any easing. Some indicated that they viewed the incorporation of such an understanding as a key element of an acceptable directive, given their assessment of the inflationary risks in the economic outlook. Most of the other members indicated that they could accept such a directive, although they were less inclined than they had been previously to bias it toward further restraint; in this view, the direction of any potential adjustment in policy implementation was less certain than earlier, given the recent performance of the economy and behavior of the monetary aggregates. One member felt that the risks of some further weakness in the economy were sufficiently strong that a continued bias toward possible tightening during the intermeeting period was not acceptable.

At the conclusion of the Committee's discussion, all but one member indicated

that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve conditions and that provided for remaining especially alert to potential developments that might require some firming during the intermeeting period. Accordingly, somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 2½ percent and 6 percent respectively over the three-month period from September to December. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 6 to 10 percent.

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

The information reviewed at this meeting indicates that the expansion in economic activity has moderated from the vigorous pace earlier in the year. Total nonfarm payroll employment grew considerably in the third quarter but the gains were less than those registered in the first half of the year and employment in manufacturing declined in August and September. The civilian unemployment rate fell to 5.4 percent in September, remaining in the narrow range that has prevailed since early spring. Industrial production advanced only slightly on balance in August and September after a sharp increase in July, while housing construction has been flat in recent months. Consumer spending increased substantially on average in the third quarter but apparently slowed in recent months. Indicators of business capital spend-

ing suggest considerably slower expansion in the third quarter, following very rapid growth in the first half of the year. Preliminary data for the nominal U.S. merchandise trade deficit in August showed a greater deficit than in July, but the average for July–August was slightly less than the second-quarter rate. The latest information on prices and wages suggests little if any change from recent trends.

Interest rates in long-term debt markets have declined a little further since the Committee meeting on September 20, while rates in short-term markets have edged higher. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined appreciably over the intermeeting period from the high level of last summer.

Expansion of M2 has slowed considerably in recent months; growth of M3 moderated in August and September but appears to have strengthened somewhat in October. Thus far this year, M2 has grown at a rate somewhat below, and M3 at a rate somewhat above, the midpoint of the ranges established by the Committee for 1988. M1 has increased only slightly on balance in recent months after registering relatively strong growth in June and July. Expansion of total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth of total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth of total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to

establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 2½ and 6 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, and Parry. Vote against this action: Ms. Seger.

Ms. Seger indicated that while an unchanged policy was acceptable to her at this point, she did not want to bias the directive toward potential tightening. In her view current indications of slower economic growth and the lagged effects of earlier policy tightening actions pointed to relatively slow expansion and reduced inflationary pressures over the year ahead. In these circumstances, she would not want to react more promptly or vigorously to indications of greater strength or price pressures in the economy, which might well prove to be temporary, than to evidence of a weakening economy.

In the period following the Committee meeting on November 1, it became

increasingly evident in the implementation of policy that depository institutions had reduced their demands on the discount window; in this period, a significantly lower level of adjustment plus seasonal borrowing was being associated with a slightly higher federal funds rate than had been anticipated at the time of the meeting. To take account of this change in behavior, but also in light of recent information suggesting that the economic expansion retained considerable strength, the Manager for Domestic Operations adjusted the reserve paths to incorporate a lower level of borrowing, with the expectation that federal funds would continue to trade in the slightly higher range that had prevailed recently. This adjustment in open market operations was discussed with the Committee on November 22, 1988. The members agreed that the factors relating to the apparent change in the relationship between borrowing and the federal funds rate, and the broader implications for the conduct of open market operations, would be reviewed further at the December meeting.

## 2. Authorization for Domestic Open Market Operations

Effective November 2, 1988, the Committee approved a temporary increase of \$4 billion, to \$10 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities that is specified in paragraph 1(a) of the Authorization for Domestic Open Market Operations. The increase was effective for the intermeeting period ending with the close of business on December 14, 1988.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller,

Hoskins, Johnson, Kelley, LaWare, and Parry and Ms. Seger. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the usual leeway of \$6 billion for changes in System Account holdings would probably not be sufficient over the intermeeting period because of seasonal increases in currency in circulation and in required reserves.

## 3. Change in Terms of Certain Members to Calendar-Year Basis

The Committee amended its "Rules of Organization" to advance from March 1 to January 1 of each year the start of the terms of office of the Federal Reserve Bank presidents who serve one-year terms as Committee members or alternate members. The change will be effective starting with the calendar year 1990. Because the Committee's objectives for monetary growth are established on a calendar-year basis, the Committee believed that it would be appropriate to have all the members responsible for carrying out those objectives during the year participate in the vote to establish them at the start of the year. The Committee emphasized that this change was essentially procedural in nature, given the continuity of its decisionmaking process. The Full Employment and Balanced Growth Act of 1978 requires that the Committee's monetary growth objectives for the calendar year be transmitted to the Congress by February 20 of each year.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, and Parry and Ms. Seger. Votes against this action: None.



## **Meeting Held on December 13-14, 1988**

### **Domestic Policy Directive**

Information on employment and production reviewed at this meeting suggested that, apart from the direct effects of the drought, economic activity had continued to expand at a vigorous pace although some measures of demand, available on a less current basis, still indicated more moderate growth. Recent price data showed a fairly stable inflation rate, partly because of the favorable effects of earlier oil price declines, while labor cost measures continued to indicate some acceleration from a year earlier.

Total nonfarm payroll employment rose sharply in October and November. Following declines in late summer, gains in manufacturing employment were large in both months, with particularly sizable increases recorded in the machinery, electrical equipment, and lumber industries. Employment in service industries picked up significantly in November from the reduced pace of expansion in previous months. The civilian unemployment rate edged up to 5.4 percent in November but remained in the lower part of the narrow range that had prevailed since early spring.

Industrial production advanced considerably further in October and November after a strong third quarter. Output of consumer goods continued to increase, on balance, at a fairly vigorous pace, and production of materials posted another solid gain in November. Output of business equipment also increased in November, but revised data indicated that such growth had moderated appreciably in recent months. Total industrial capacity utilization edged up further in November, and the operating rate in manufacturing reached its highest level since July 1979.

Growth of overall consumer spending had moderated somewhat in recent months. Spending for nondurables had been sluggish in September and October, while outlays for durable goods had declined, mainly because of reduced purchases of cars. On the other hand, preliminary data for total retail sales in November indicated a strong advance following a large, upward-revised increase in October.

Indicators of business capital spending suggested a substantially slower rate of expansion in October than earlier in the year. Shipments of nondefense capital goods were little changed, reflecting a fairly broad-based deceleration. Nonresidential construction edged down a little further, as petroleum drilling fell again and expenditures on commercial structures other than office buildings declined. Inventory investment in the manufacturing and wholesale sectors in the third quarter remained about in line with the growth of sales. In the retail sector, a buildup in inventories in the third quarter largely reflected additions to stocks by auto dealers; the expansion of nonauto stocks remained broadly in line with sales. Housing starts strengthened in October after changing little on balance over the previous several months.

Excluding food and energy, producer prices of finished goods were unchanged in October after a sizable increase in September. At the consumer level, retail food prices eased in October and energy prices were little changed, but prices of other goods and services increased faster on balance than in preceding months. On a year-over-year basis, consumer prices continued to rise at about the 4½ percent annual rate evident since late 1987. The limited data available for labor costs in the fourth quarter suggested that increases in these costs continued to exceed those of a year earlier.

Preliminary data for the nominal U.S. merchandise trade deficit in October showed a slightly smaller deficit than in September. The value of total imports fell, with declines recorded in capital goods, consumer goods, and oil. Exports also declined in October owing to lower agricultural sales abroad. Boosted by higher aircraft shipments, nonagricultural exports were unchanged from their September level. Economic activity accelerated or remained strong in most of the major foreign industrial countries in the third quarter but appeared to have slowed somewhat in the fourth quarter.

In the foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies had declined about  $2\frac{1}{2}$  percent on balance over the period since the Committee meeting on November 1, bringing it to a level 8 percent below its peak of last August. Following a brief respite in the week before the U.S. elections, the dollar was under downward pressure over most of the intermeeting period. However, the dollar firmed somewhat near the end of the period, as prospects were seen to be increasing for further reductions in the federal deficit and a tightening of monetary policy.

At its meeting on November 1, the Committee adopted a directive calling for no immediate change in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about  $2\frac{1}{2}$  and 6 percent respectively over the period from September to December. The members agreed 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, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.

In the course of implementing policy following the November meeting, it became increasingly evident that a slightly higher federal funds rate than that anticipated at the time of the meeting was associated with a substantially lower volume of adjustment plus seasonal borrowing; for reasons that remained unclear, depository institutions exhibited a reduced willingness to come to the discount window. To take account of this change in borrowing behavior, and against a backdrop of recent information suggesting that the economic expansion retained considerable vigor and potential for price pressures, the Manager for Domestic Operations adjusted the reserve paths on November 22 to incorporate a lower level of borrowings, with the expectation that federal funds would continue trading in the slightly higher range that had prevailed recently. Over the intermeeting period, the federal funds rate rose nearly  $\frac{1}{4}$  percentage point to around  $8\frac{1}{2}$  percent. Other short-term market interest rates generally advanced by more than the federal funds rate over the intermeeting period, as expectations of a tighter monetary policy were stimulated by higher world oil prices, renewed weakness of the dollar, and the release of strong domestic economic data. The prime rate was increased 50 basis points. Rates in long-term debt markets also rose on balance, although by appreciably less than short-term rates. Stock prices fell over the first half of the intermeeting period, but most indexes rebounded subsequently to nearly their values at the time of the November 1 meeting.

Growth of the broader monetary aggregates strengthened in November from the relatively sluggish rates of expansion recorded in previous months, especially for M2. The acceleration in M2 reflected strong expansion in its liquid retail components. M3 growth picked up somewhat less, as bank credit growth and

associated funding needs remained moderate. On average in October and November, growth of M2 had been somewhat faster, and that of M3 slightly faster, than the Committee expected at the time of the previous meeting. With demand deposits running off again, M1, which had increased only slightly on balance since midsummer, was virtually unchanged in November.

The staff projection prepared for this meeting suggested that, after adjustment for the effects of the drought, economic growth in the current quarter might be near the vigorous pace of the third quarter but that expansion in 1989 was likely to moderate on balance. However, to the extent that expansion of final demand at a pace that could foster higher inflation was not accommodated by monetary policy, pressures would be generated in financial markets that would tend to restrain domestic spending. The staff continued to project some slowing in the growth of consumer spending, sharply reduced expansion of business fixed investment, and sluggish housing activity. Foreign trade was expected to make an important contribution to growth in domestic output, despite some damping effects from the dollar appreciation that had occurred earlier in 1988 and somewhat slower growth abroad. The staff also anticipated some continuing cost pressures over the next several quarters, especially owing to reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, the members focused on indications of continuing strength in the economic expansion. While some signs of prospective slowing in the expansion remained in evidence, recent data on employment and production suggested that the economy retained considerable momentum. A number of members commented that

business activity had remained more robust than had seemed likely earlier, and many expressed concern that continued expansion at a relatively rapid pace raised the risk that inflation would intensify, given already high rates of capacity utilization in many industries and tight labor markets in many parts of the country. On balance, while somewhat more moderate growth continued to be viewed as a reasonable expectation for 1989, most members interpreted recent developments as suggesting that, in the absence of some added policy restraint, any moderation in the expansion might well prove to be insufficient to forestall a pickup in inflation, much less to permit progress to be made in reducing inflation over time. At the same time, some members cautioned that the risk of a recession stemming from a substantial tightening of policy should not be overlooked; in addition to job and output losses, a recession could impede progress in bringing the federal budget into balance and could have severe repercussions on the viability of highly leveraged borrowers and many depository institutions.

In their review of developments bearing on the economic outlook, members took account of indications that overall domestic demands were being well maintained, including some recent strength in retail sales, and that exports remained on a clear uptrend. High levels of activity continued to characterize business conditions in many areas. Manufacturing was benefiting from growing export markets and the substitution of domestic products for higher-priced imports; moreover, many domestic producers had not yet exploited potential markets abroad. There were indications of some softening in business fixed investment, including a moderation of growth in outlays for equipment and reduced construction activity in a number of areas, notably those most affected by weak energy

markets and previous overbuilding. Nonetheless, business contacts suggested that overall investment spending would continue to benefit from ongoing efforts in many industries to modernize or expand production facilities. With regard to housing construction, members reported somewhat depressed conditions in a number of areas, but the latest statistics for the nation as a whole were on the firm side of recent trends.

In the course of the Committee's discussion, members gave a good deal of attention to the outlook for inflation. On the positive side, inflationary expectations did not appear to be worsening, as evidenced for example by the stability of long-term bond markets, and strong competitive pressures were encouraging business firms to persist in their efforts to hold down costs. Such competition continued to make it difficult for many businesses to pass on increasing costs through higher prices and tended to harden business resistance to demands for higher wages. With regard to labor costs, reports from local areas suggested that non wage components were rising at a faster rate than wages but that large increases in the latter still were infrequent despite some shortages of labor.

While the members saw no clear evidence in current aggregate measures of prices that the overall rate of inflation was worsening, key indicators of labor compensation suggested some uptrend and many members commented that the risks were in the direction of greater inflation, given the apparent growth of the economy at a pace above its long-run potential together with the relatively full employment of production resources. These risks would be heightened if the dollar were to decline significantly from current levels. Commodity prices appeared to have leveled off, but they showed little sign of reversing earlier increases, which themselves might not

yet have been passed through fully to consumer prices. Of particular concern was the prospect that, in the absence of a timely move to restraint, greater inflation would become embedded in the economy, especially in the labor-cost structure. A new wage-price spiral would then be very difficult to avoid and the critical task of bringing inflation under control would be prolonged and much more disruptive. A worsening of inflationary pressures and inflation expectations, if unchecked, eventually would foster higher interest rates and would lead to growing imbalances and distortions in the economy and almost certainly to a downturn at some point in overall economic activity.

At its meeting in late June, the Committee reviewed its basic policy objectives for growth of the monetary and debt aggregates in 1988 and established tentative objectives for expansion of those aggregates in 1989. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the Committee reaffirmed the ranges of 4 to 8 percent that it had set in February for growth of both M2 and M3. The monitoring range for expansion of total domestic nonfinancial debt in 1988 was left unchanged from its February specification of 7 to 11 percent. For the year through November, M2 grew at an annual rate a little below, and M3 at a rate a little above, the midpoint of their annual ranges. Expansion of total domestic nonfinancial debt appeared to have moderated to a pace somewhat below the midpoint of its range. For 1989 the Committee agreed in June on tentative reductions to ranges of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The monitoring range for growth of total domestic nonfinancial debt was lowered to 6½ to 10½ percent for 1989. It was understood that all the ranges for next year were provisional and that they would be reviewed in February 1989 in the light

of intervening developments. With respect to M1, the Committee reaffirmed in June its earlier decision not to set a specific target for growth in 1988, and it also decided not to establish a tentative range for 1989.

In the Committee's discussion of policy for the near term, nearly all the members supported a proposal that called for an immediate increase in the degree of reserve pressure to be followed by some further tightening at the start of 1989 unless incoming evidence on the behavior of prices, the performance of the economy, or conditions in financial markets differed greatly from current expectations. The appropriate degree of reserve restraint also would be reevaluated in the event of an increase in the discount rate. While the members recognized that the degree of monetary restraint could be overdone, they generally felt that the risks of a downturn stemming from the limited tightening under consideration were extremely small and needed to be accepted in light of what they perceived as the much greater threat of a recession if inflation were allowed to intensify. Expressing a differing view, one member commented that further restraint was undesirable in light of that member's expectation that economic growth over the next several quarters was likely to be at a pace consistent with progress against inflation.

While all but one member agreed on the need for some further monetary restraint, views differed to some extent with regard to the appropriate degree and timing of such restraint. A number of members indicated a preference for a stronger immediate move to greater restraint, given their perception of the urgency of countering inflation expectations and inflationary pressures in the economy. Other members did not disagree that inflation was a serious problem, but they preferred a more gradual

approach to further restraint in order to minimize potential market disturbances, especially around the year-end, and to facilitate adjustments to rising interest rates. It also was suggested that more marked tightening at this time could have the unintended effect of fostering an escalation of interest rates in world markets, with especially undesirable effects on many less developed debtor nations.

In the discussion of adjustments in the provision of reserves through open market operations, many members commented on how a possible increase in the discount rate might interact with such operations. Several favored the implementation of a tighter policy through the discount rate in order to signal more clearly than through a gradual tightening of reserve conditions the System's ongoing commitment to an anti-inflationary policy. Other members expressed concern that, under immediately prevailing circumstances, an increase in the discount rate might have exaggerated repercussions on domestic and international financial markets. The Committee concluded that in the event of an increase in the discount rate during the intermeeting period the members would need to consult regarding the implications for the conduct of open market operations.

In the course of the Committee's discussion, the members took account of a staff analysis, which suggested that monetary growth was likely to remain relatively restrained in the months immediately ahead, especially if reserve conditions were tightened. An increase in the degree of reserve restraint in line with that contemplated by the Committee would reduce growth of M2 somewhat from its recent pace, assuming a typically delayed adjustment in deposit rates to rising short-term market interest rates, while growth of M3 would continue at a somewhat higher rate than that of M2.

Several members observed that restrained monetary growth would continue to be desirable, and some expressed concern that in the absence of some tightening of reserve conditions such growth might accelerate, with inflationary implications under foreseeable economic conditions. On the other hand, in light of the limited growth in the monetary base and reserves in the past several months, some other members cautioned that sharp additional restraint on reserve provision could have an undesirably restraining effect on monetary growth and the economy.

With regard to the proposed move toward further monetary restraint shortly after the year-end, it was understood that such firming would be implemented unless emerging economic and financial conditions were to differ markedly from current expectations. Should unanticipated developments of that kind occur or should the Board of Governors approve an increase in the discount rate during the intermeeting period, the Chairman would call for a special consultation of the Committee. On the question of any additional adjustment in policy, the members generally agreed that policy implementation should remain especially alert to incoming information that might call for further firming beyond that already contemplated. In light of the tightening of reserve conditions after today's meeting and the presumption that some further monetary restraint would be implemented later during the intermeeting period, the members decided to raise the intermeeting range for the federal funds rate by 1 percentage point to 7 to 11 percent. With such an increase, federal funds would be expected to trade at rates averaging closer to the middle of the range. That range provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded.

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 immediate firming of reserve conditions, with some further tightening to be implemented at the start of 1989, assuming that economic and financial conditions remained reasonably consistent with current expectations. In keeping with the Committee's usual approach to policy, the conduct of open market operations would be subject to further adjustment during the intermeeting period based on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. Depending on such developments, some added reserve restraint would be acceptable, or some slight lessening of reserve pressure might be acceptable. The reserve conditions contemplated at this meeting were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 6½ percent respectively over the four-month period from November 1988 to March 1989.

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

The information reviewed at this meeting suggests that, apart from the direct effects of the drought, economic activity has continued to expand at a vigorous pace. Total nonfarm payroll employment rose sharply in October and November, with sizable increases indicated in manufacturing after declines in late summer. The civilian unemployment rate, at 5.4 percent in November, remained in the lower part of the range that has prevailed since early spring. Industrial production advanced considerably in October and November. Housing starts turned up in October after changing little on balance over the previous several months. Growth in consumer spending has been somewhat more moderate

in recent months, and indicators of business capital spending suggest a substantially slower rate of expansion than earlier in the year. The nominal U.S. merchandise trade deficit narrowed further in the third quarter. Preliminary data for October indicate a small decline from the revised deficit for September. The latest information on prices and wages suggests little if any change from recent trends.

Interest rates have risen since the Committee meeting on November 1, with appreciable increases occurring in short-term markets. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined significantly further on balance over the intermeeting period.

Expansion of M2 and M3 strengthened in November from relatively slow rates of growth in previous months, especially in the case of M2. Thus far this year, M2 has grown at a rate a little below, and M3 at a rate a little above, the midpoint of the ranges established by the Committee for 1988. M1 has increased only slightly on balance over the past several months, bringing growth so far this year to 4 percent. Expansion of total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987 and around the midpoint of the Committee's monitoring range for 1988.

The Federal Open Market Committee seeks monetary and financial conditions that will foster 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 meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth of total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3½ to 7½ percent for M3. The Committee set the associated monitoring range for growth of total domestic nonfinancial debt at 6½ to 10½ percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to

establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to increase somewhat the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from November through March at annual rates of about 3 and 6½ percent, respectively. 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 7 to 11 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, and Parry. Vote against this action: Ms. Seger.

Ms. Seger dissented because she viewed current business indicators as already pointing on balance to slower economic expansion, and in the circumstances she did not feel that any added monetary restraint was needed to foster economic conditions consistent with progress in reducing inflationary pressures. In the context of already restrained monetary growth, she was concerned that a further increase in the degree of reserve pressure would pose unnecessary risks to interest-sensitive sectors of the economy and ultimately to the sustainability of the expansion itself. She expressed particular concern that the higher interest rates implied by greater monetary

restraint would aggravate the condition of financially troubled thrift institutions.

At this meeting the Committee reviewed its current procedure for implementing open market operations against the background of a marked change over recent months in the relationship between the level of adjustment plus seasonal borrowing and the federal funds rate. The current procedure of focusing on the degree of reserve restraint, as indexed by borrowed reserves, had been implemented with some flexibility in recent weeks in light of the substantial shortfall of borrowing in relation to expectations. The policy results had been satisfactory, but some members proposed that consideration be given to focusing more directly on the federal funds rate in carrying out open market operations, particularly if uncertainty about the borrowing-federal funds relationship were to persist. Others felt that despite its drawbacks, the current procedure had a number of advantages, including that of allowing greater scope for market forces to determine short-term interest rates. The Committee concluded that no changes in the current procedure were needed at this time, but that flexibility would remain important in accomplishing Committee objectives under changing circumstances. ■



## *Consumer and Community Affairs*

In 1988 the Federal Reserve Board used its rulewriting and enforcement authority to maintain statutory protections for consumers while easing regulatory burdens. This chapter examines the activities of the Federal Reserve System in support of those goals.

### **Regulatory Matters**

The Board issued Regulation CC to carry out the Expedited Funds Availability Act and revised Regulation C to implement statutory amendments that expanded the coverage of the Home Mortgage Disclosure Act and made the law permanent. The Board also proposed amendments to Regulation Z to implement the Fair Credit and Charge Card Disclosure Act of 1988, which provides that credit and charge card issuers must give consumers information about their plans earlier than currently required. In addition, the Board prepared regulations concerning home equity lines of credit to implement the Home Equity Loan Consumer Protection Act of 1988. In other matters, the Board reviewed the paperwork burden associated with several regulations in keeping with the Paperwork Reduction Act and issued four new publications for consumers: one to explain the provisions of the Expedited Funds Availability Act and a set of three pamphlets to clarify the mortgage-application process.

### **Regulation CC (Expedited Funds Availability)**

In May the Board issued Regulation CC, effective September 1, 1988, to implement the Expedited Funds Availability Act. The act and regulation address

delayed access to deposits and require, among other things, that depository institutions make funds deposited into accounts available within specified time periods. Banks and other depository institutions must give next-day availability, subject to certain conditions, for electronic payments, Treasury checks, postal money orders, state and local government checks, and checks written on the same institution where the check is being deposited. For next-day availability, deposits may have to be made in person to a teller or the depositor may have to use a special deposit slip made available by the institution.

The period within which institutions must make other check deposits available for withdrawal depends on whether a check is considered local or nonlocal in relation to the institution where it was deposited. A local check is one deposited in an institution located in the same Federal Reserve check processing region as the institution on which the check was written. In the case of a nonlocal check, the two institutions are located in different processing regions.

Funds must be made available by the third business day after deposit for local checks and by the seventh day after deposit for nonlocal checks. After September 1, 1990, these deposits must be made available sooner: by the second business day for local checks and by the fifth business day for nonlocal checks.

Institutions may invoke exceptions to the time periods in the law when handling new accounts, redeposited checks, emergency conditions, deposits exceeding \$5,000 in any one day, accounts that have been repeatedly overdrawn, and checks that the institution has reasonable cause

to believe will not be paid. In such cases the institution must notify the customer of the longer delay and indicate when the funds will be available.

Regulation CC requires depository institutions to disclose their specific policies on funds availability and to notify customers of a change in policy. An institution must give disclosures to new customers before opening an account and to anyone who asks for the information. A brief notice is required at all locations where an institution's employees accept deposits, at automated teller machines, and on all deposit slips printed with the customer's name and account number. Regulation CC includes model forms and clauses to help institutions make the required disclosures. To facilitate compliance, the Board in June released a Special Notice summarizing the requirements of the regulation.

In September the Board issued a pamphlet for consumers that explains the provisions of the act, "Making Deposits: When Will Your Money Be Available?" It outlines the availability schedule by type of deposit, lists the circumstances under which an institution may delay customers' funds beyond the normal limits, states the disclosure requirements, demonstrates endorsement procedures, and provides information on how to resolve errors.

### Regulation AA (Credit Practices Rule)

In July the Board granted a request from the State of California for an exemption from the cosigner provisions of Regulation AA (Credit Practices Rule) for state-chartered institutions. That rule prohibits banks from using certain remedies to enforce consumer credit obligations and from "pyramiding" late charges; it also affords special protections to cosigners.

To qualify for an exemption, the state must have a law that protects consumers at least as well as the corresponding federal provision. In the case of California, the Board granted the exemption after determining that the law with respect to a special notice given to cosigners is substantially equivalent to the federal law and that the state administers and enforces its laws effectively.

### Regulation C (Home Mortgage Disclosure)

In August the Board revised Regulation C to incorporate amendments to the Home Mortgage Disclosure Act. The act applies to institutions with more than \$10 million in assets and offices in metropolitan areas; it requires disclosure, and a geographic listing, of originations and purchases of home mortgage and home improvement loans.

The amendments, enacted by the Congress in February 1988, expand the coverage of the act to mortgage-banking subsidiaries of bank and thrift-institution holding companies and to savings and loan service corporations that originate or purchase mortgage loans. The act previously applied only to depository institutions and their majority-owned subsidiaries. The newly covered institutions will report data for loan originations and purchases made after August 19, 1988, in keeping with an amendment adopted by the Congress in November 1988. Without that amendment, institutions would have been required to report data for the entire calendar year.

Following an in-depth review through the Board's Regulatory Review Section, the Board revised the text of Regulation C to improve its clarity and expanded the instructions for the reporting form. These changes should make it easier for financial institutions to comply with the regulation.

The Board also amended the regulation to require that institutions disclose loan data related to the purchase or improvement of mobile and manufactured homes. Until now, such loans were reported only if these dwellings were treated as real estate under state law. This change became effective January 1, 1989.

### Regulation B (Equal Credit Opportunity)

In November the Board determined that the Equal Credit Opportunity Act (ECOA) and Regulation B preempt a portion of New York law because of the latter's inconsistency with the federal law. ECOA and Regulation B prohibit discrimination in any credit transaction on the basis of race, color, national origin, and other specified characteristics of the applicant. But to allow creditors to target a segment of the population that finds it difficult to obtain credit, such as an ethnic minority, the act and regulation allow creditors to offer special-purpose credit and to consider one or more characteristics of applicants for such credit (such as race or national origin). Because creditors under New York law could in no circumstance take any of the specified characteristics into account, they were in effect barred from offering special-purpose credit programs. As of November 11, 1988, the state of New York may not prohibit special-purpose credit programs or related inquiries that are permissible under federal law.

The Women's Business Ownership Act of 1988, signed into law in October, amends ECOA requirements applicable to business credit transactions. Although business credit has always been covered by ECOA and Regulation B, the regulatory requirements for retaining records and for notice of adverse action have differed from those applicable to consumer credit. The amendments will re-

quire creditors to keep records of a business application for at least one year and to notify business credit applicants, in writing, that they are entitled to a statement of reasons when they are turned down for credit. The Board will issue proposed amendments to Regulation B in early 1989. The changed requirements will take effect when the revisions to Regulation B are published in final form.

### Regulation Z (Truth in Lending): Adjustable-Rate Mortgages

A revision to Regulation Z regarding disclosures for adjustable-rate mortgages (ARMs) became effective in October. The amendment, adopted in December 1987, requires creditors to give consumers more detailed information about the variable-rate feature of closed-end mortgages with maturities longer than one year. The amendment, which applies to mortgages secured by the consumer's principal dwelling, requires creditors to give a description of the terms of the mortgage. The amendment also requires creditors to give borrowers historical data on changes in the index to show the potential effect on monthly payments. ARM disclosures must be given when the consumer gets an application form or before the consumer pays a non-refundable fee, whichever is earlier. An educational booklet describing the characteristics and risks related to ARMs must accompany these disclosures.

To provide guidance to creditors about the required ARM disclosures, the Board in September published a special update to the staff commentary. This official commentary applies to, and interprets, the requirements of Regulation Z and is a substitute for individual interpretations.

## Regulation Z: Credit Card Disclosures

In December the Board proposed to amend Regulation Z to require that consumers be given earlier disclosures about credit and charge card plans. Under the proposed amendments, which implement the Fair Credit and Charge Card Disclosure Act, issuers that offer cards to consumers by direct-mail solicitation must disclose the annual percentage rate, annual fees, transaction charges, grace periods, and the method used to calculate the balance on which the finance charge is computed. Previously, these disclosures could be made later, when the card was issued. Special rules will apply to disclosures in telephone solicitations and to application forms placed in retail establishments and in magazines.

Card issuers that charge fees for renewing an account must notify the consumer at least 30 days before the renewal payment is due. The notice must include the date when the card will expire if not renewed by the consumer; the cost (including membership fees) for continued use of the card; and information on how the consumer may close the account and avoid paying any fees.

The proposed changes also address credit insurance. A card issuer that changes insurance providers must give cardholders advance notice and the opportunity to cancel the insurance. The card issuer also must inform consumers of any increase in rate or substantial decrease in coverage that may result from the change.

## Regulation Z: Home Equity Lines of Credit

The Home Equity Loan Consumer Protection Act of 1988, signed into law in November, adds extensive requirements

for disclosures to be given at the time consumers receive an application form for home equity lines of credit and revises the rules for advertising such credit. The law further mandates certain consumer protections applicable to these programs. For example, it limits a creditor's ability to terminate the line of credit and accelerate any outstanding balance or to change the terms once a plan has been opened. The Board will issue proposed amendments to the regulation in early 1989.

The Board is also preparing a pamphlet for consumers that describes the features of home equity lines of credit, how they work, and how they compare with other types of credit programs. This pamphlet, or one substantially similar, must be given to consumers along with creditors' disclosures.

## Regulation Z: Determination of Preemption

In February the Board determined that federal law preempts a provision of an Indiana statute that is inconsistent with the disclosure requirements of Regulation Z. Indiana law requires loan brokers to give disclosures to potential borrowers and mandates that their fees and charges be included in calculating the finance charge and annual percentage rate. Under Regulation Z, charges for services provided by third parties, such as loan brokers, are not finance charges if the creditor does not require the services or does not retain the fees. The Board preempted the Indiana provision because it uses the same wording as that used in the federal law to refer to the disclosure of an amount that is different from the amount to be disclosed under federal law. The preemption took effect on October 1, 1988.

## Interpretations

In 1988 the Board continued to offer legal interpretations and guidance through 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, published by April 1 each year, help financial institutions and others apply the regulations to specific situations.

The Board published an update, effective August 1, to its staff guidelines on the Credit Practices Rule. The guidelines answer questions from banks about the rule and are updated periodically.

## Mortgage Brochures

In response to a congressional request, the Federal Reserve Board and the Federal Home Loan Bank Board in June published three brochures to improve consumer understanding of the mortgage application process. These brochures—on refinancings, lock-ins, and closing costs—were prepared in consultation with trade and consumer groups and with other government agencies.

## Reduction of Paperwork Burden

In May the Board reviewed the paperwork burden associated with five regulations—Regulation BB (Community Reinvestment), Regulation Z (Truth in Lending), Regulation E (Electronic Fund Transfers), Regulation B (Equal Credit Opportunity), and Regulation M (Consumer Leasing)—and one statute, the Right to Financial Privacy Act. As required by the Office of Management and Budget under the Paperwork Reduction Act, the Board conducts these reviews periodically for the possible reduction of regulatory requirements.

The bulk of the disclosures imposed by the Board's regulations are mandated by, or are needed to carry out the intent of, the underlying legislation. The requirements were already reduced significantly in recent years through the Board's own regulatory review program and through previous reviews for paperwork reduction. Following the latest review, the Board concluded that few opportunities exist for further reducing the paperwork burden in the absence of congressional action.

## Community Affairs

The Community Affairs Program of the Federal Reserve System took a major step in 1988 when the presidents of the 12 Reserve Banks formally established a Community Affairs subcommittee within their Conference of Presidents. The subcommittee will keep the presidents informed of current issues relating to community development and the Community Reinvestment Act.

A major focus of the Community Affairs Program, described by the Board at hearings in March before the Senate Committee on Banking, Housing and Urban Affairs, is to develop expertise in safe, sound, and thoughtful community development lending and then to share that expertise with member banks and others. During the year, staff members of the Community Affairs Program kept themselves up to date on the latest strategies and programs (such as tax credits for low-income housing and the use of new secondary market entities and techniques) by attending more than 125 seminars and workshops. The Community Affairs Officers from the Reserve Banks and staff members from the Board also took part in week-long training sessions on methods that can help lenders and community members form productive partnerships.

The Reserve Banks conducted 78 educational programs, many of them in conjunction with the Federal Home Loan Banks, the Department of Housing and Urban Development, and the Small Business Administration. Partnerships between banks and their communities, of the types explored at these conferences, are needed to address adequately the country's economic development. Many banks—from small and rural communities as well as from more metropolitan areas—have responded in a positive way to the information provided by the Reserve Banks' Community Affairs Officers.

Participation by financial institutions in community development takes a variety of forms. A number of California banks formed a consortium to address low-income housing needs. To coordinate their involvement in community development, lenders formed councils in Camden, New Jersey; in Harrisburg, Pennsylvania; and in Wilmington, Delaware. In Boston, financial institutions began an assessment of housing needs. In cooperation with Board staff members, the Economic Development Administration is encouraging banks and bank holding companies throughout the country to form community development corporations.

In 1988 the Reserve Banks also used community profiles, educational pamphlets, and newsletters to help banks, holding companies, and others address the economic development of their communities. The Federal Reserve Bank of Chicago inaugurated a community affairs newsletter, bringing to five the number now published by the System. These publications highlight emerging issues in community development and present case studies of successful programs that involve cooperation between banks and their communities.

In 1988, staff members of the Federal Reserve made 135 speeches at the request

of conference sponsors as diverse as the National League of Cities, the American Bankers Association, and National People's Action. Through these speeches as well as through seminars, conferences, and other meetings, Community Affairs staff members reached an estimated 13,000 people on the subject of community development.

## Examination Procedures

Amendments to Regulation Z that took effect in October 1988 require creditors to give consumers more detailed information about closed-end mortgages with variable rates. To ensure compliance by state member banks, the Board developed objectives, procedures, and a checklist for the compliance examination dealing with such mortgages. The other federal agencies that supervise financial institutions expect to adopt similar procedures.

Member agencies of the Federal Financial Institutions Examination Council (FFIEC)—the Board, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency, and the National Credit Union Administration—developed interagency examination procedures for Regulation CC (Expedited Funds Availability). The FFIEC also conducted and videotaped a training session for examiners, providing an overview that focuses on the schedules for availability of funds, disclosure requirements, and examination procedures. The videotape and a written "Course for Financial Institution Examiners" is available to compliance examiners of the five financial regulators.

The Federal Reserve continues to conduct separate examinations to monitor compliance with consumer protection laws and regulations and to monitor performance under the Community Reinvestment Act. State member banks are

examined at intervals determined by their own performance records. The longest interval between examinations, for banks with the best records of performance, is 24 months. Banks with poor performance records are examined as frequently as every 6 months.

The Federal Deposit Insurance Corporation reports that it changed the frequency of its compliance examinations in July 1988. The agency will examine banks with a poor record of performance every 12 months and banks with better records every 24 months. It has increased its staff of examiners, and as a result expects the number of compliance examinations completed in 1989 to increase by 30 percent. During 1988 the agency reorganized its compliance function in Washington, centralizing the responsibility for consumer compliance in the Office of Consumer Affairs.

The Federal Home Loan Bank Board has created a Division of Compliance Programs within the Office of Regulatory Activities to be responsible for consumer compliance examinations. The board adopted a Compliance Policy Statement in June 1988, urging savings and loan associations that are system members to develop sound internal compliance programs; the agency also distributed a manual, "Compliance: A Self-Assessment Guide," to all member institutions.

### **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 somewhat from 1987 levels, while compliance with the Electronic Fund Transfer Act remained substantially the same. This section summa-

rizes data gathered from the agencies for the reporting period July 1, 1987, to June 30, 1988.<sup>1</sup>

### **Truth in Lending Act (Regulation Z)**

Taken together, the five financial regulatory agencies report that 46 percent of all examined institutions were in full compliance with Regulation Z, down from 54 percent in 1987. Of the five agencies, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Board noted declines in compliance, while the Federal Home Loan Bank Board (FHLBB) and the National Credit Union Administration (NCUA) reported levels of compliance similar to those for the 1987 reporting period. Data from the Board, the OCC, and the NCUA (the agencies that provide frequency ranges) indicate that among the institutions not in full compliance, 78 percent had no more than five violations, an improvement over the 51 percent reported in that range for 1987.

The most frequent violations involved the failure to give accurate disclosures of the annual percentage rate; the number, amounts, and timing of payments scheduled to repay the obligation; the finance charge; the itemization of the amount financed; and the amount financed.

The FDIC issued one cease-and-desist order and the Board entered into one formal written agreement involving violations of Regulation Z. Under the Inter-agency Enforcement Policy on Regulation Z, a total of 279 institutions supervised by the Board, the FDIC, the

1. The federal agencies that regulate financial institutions do not use the same method to compile information on compliance; however, the data support the general conclusions presented here.

FHLBB, and the OCC reimbursed approximately \$2 million to 23,419 accounts, compared with \$1.2 million reimbursed to 10,507 accounts during the 1987 reporting period.

The Federal Trade Commission (FTC) continued its compliance program to enforce the credit-advertising requirements of Regulation Z, with an emphasis on advertisers of credit for the purchase of real estate and automobiles. Most companies contacted by the FTC promptly brought their advertising programs into compliance.

In conjunction with the National Association of Attorneys General, the FTC has also continued its enforcement program against fraud in telemarketing and other fraud involving charges to credit cards. Two actions were brought in federal district court, alleging violations of the Truth in Lending requirements for prompt notification of returns and crediting of refunds on credit card accounts.

The FTC issued a new pamphlet, "Home Equity Credit Lines." A checklist assists consumers in comparing different home equity loan programs. The FTC also published "Choosing and Using Credit Cards," which offers guidance on how to shop for a credit card and explains the consumer protections provided under federal law.

The Department of Transportation reported a satisfactory level of compliance with the Truth in Lending Act by foreign and domestic carriers under its jurisdiction. As the result of consumer inquiries investigated by its Consumer Affairs Division, the department 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—reported satisfactory levels of

compliance among the entities they supervise.

### Equal Credit Opportunity Act (Regulation B)

Among the institutions they examine, the five financial regulatory agencies reported a decline in the overall level of compliance with Regulation B. The number of institutions that had no violations declined from 74 percent in 1987 to 67 percent for the 1988 reporting period. The Board, the OCC, and the NCUA (the three agencies that collect data on the frequency of violations) report that 78 percent of the institutions not in full compliance had fewer than five violations. The most frequent violations involved the failure to meet the following requirements:

- Notify the applicant of the action taken within 30 days after the creditor receives a complete application.
- Provide a written notice of adverse action that contains the information required by the regulation.
- Request information for monitoring purposes about race or national origin and sex on applications involving the purchase or refinancing of a primary residence.
- Note the race or national origin and sex, based on the lender's visual observation, if an applicant chooses not to provide that information.
- Provide the specific reasons for credit denials and other adverse action.

The FTC continued an investigative program in which testers pose as credit applicants to monitor compliance with ECOA. Four finance companies were found to have practices that violate ECOA, leading FTC staff to recommend enforcement actions.

The other agencies that enforce the act—the Department of Transportation, the Farm Credit Administration, the



Interstate Commerce Commission, the Small Business Administration, the Securities and Exchange Commission, and the Packers and Stockyards Administration—report substantial compliance among the entities they supervise.

### Electronic Funds Transfer Act (Regulation E)

The five financial regulatory agencies report that 88 percent of examined institutions were in full compliance with Regulation E, a decline from last year's 90 percent. The four most frequent violations involved the failure to give the following disclosures:

- A periodic notice of the procedures for resolving alleged errors.
- A written statement outlining the terms and conditions of the EFT service.
- A periodic statement for each monthly cycle in which an EFT occurred.
- A summary of the consumer's liability for unauthorized transfers.

The fifth most frequent violation involved the failure promptly to investigate errors alleged by consumers and to inform them of the results of the investigation in a timely manner.

The other agencies that enforce the act—the Federal Trade Commission and the Securities and Exchange Commission—report a satisfactory level of compliance among the entities they supervise.

### Economic Effect of the Electronic Funds Transfer Act

In accordance with statutory requirements, the Board monitors the effects of the Electronic Funds Transfer Act on the costs and benefits of EFT services to financial institutions and consumers. During 1988, the economic effect of the act broadened as more financial institutions offered EFT services and as more consumers used them. About two-thirds

of the depository institutions in the United States provide EFT services that are covered by the requirements of the act and Regulation E.

Demand for EFT services has continued to grow. Consumers gained greater access to EFT services through the expansion of shared ATM systems. More than 86 percent of ATMs in the United States now participate in shared systems. Excluding balance inquiries, about 5 billion transactions were conducted at the 82,000 installed machines in the country.

The number of point-of-sale (POS) systems has also grown rapidly, though these machines still handle a relatively small share of total EFT transactions. The number of merchant terminals capable of supporting direct-debit POS transactions grew about 12 percent in 1988, from 38,800 to 43,400 terminals. POS terminals handled about 55 million transactions during 1988.

Each year, more consumers are electing to receive pay or government transfers by electronic direct deposit, and more corporations are offering direct deposit. In the public sector, about half of social security recipients receive monthly benefits electronically; and the number of military personnel who receive payroll and other benefits by automated direct deposit continues to grow. The Internal Revenue Service offers electronic deposit of income tax refunds to individuals who file their returns electronically.

The benefits to consumers from the Electronic Fund Transfer Act are difficult to measure because they cannot be isolated from protections that would have been provided in the absence of regulation. Statistics from examination reports do not suggest widespread violation of the consumer rights established by the act.

Data from the Board's Consumer Complaint Control System show no serious consumer problems with electronic

transactions. In 1988, 51 of the 2,196 complaints processed involved electronic transactions; of the 51, the Federal Reserve System forwarded the 23 complaints that did not pertain to state member banks to other agencies for resolution. None of the remaining 28 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 electronic transaction is probably not high enough to compromise its cost advantage over a check-based transaction.

As EFT systems mature, as transaction volume builds, and as start-up costs for compliance are amortized, compliance costs imposed by the act, per transfer and per dollar of transferred funds, will likely decline.

### Complaints against State Member Banks

In 1988 the Federal Reserve received 2,196 complaints: 1,832 by mail, 356 by telephone, and 8 in person. The Federal

Reserve investigated and resolved the 796 that were against state member banks (see accompanying table). The Board also received 184 written inquiries concerning consumer credit laws and banking practices. In responding to these complaints and inquiries, staff members of the Board and the Reserve Banks gave specific explanations of laws, regulations, and banking practices and provided printed materials on the general issues.

To evaluate compliance with System policies, the Board's Division of Consumer and Community Affairs regularly reviews a sample of the complaints handled by the Reserve Banks. The Board uses follow-up questionnaires to gauge, through the perceptions of complainants, how well the System handles cases. Consumers returned 44 percent of these questionnaires. Approximately 80 percent of the respondents found the explanations clear and understandable; 75 percent were satisfied with the promptness of handling; 95 percent said they were treated courteously by Federal Reserve staff; 90 percent reported that they would contact the Federal Reserve again if they had other problems with banks; and 75 percent found the resolu-

Consumer Complaints Received by the Federal Reserve System, by Subject, 1988

Subject	State member banks	Other lenders <sup>1</sup>	Total
Regulation B (Equal Credit Opportunity).....	86	52	138
Regulation E (Electronic Fund Transfers).....	28	23	51
Regulation M (Consumer Leasing).....	3	3	6
Regulation Q (Interest on Deposits).....	41	47	88
Regulation Z (Truth in Lending).....	157	316	473
Regulation BB (Community Reinvestment).....	0	1	1
Regulation CC (Expedited Funds Availability).....	1	30	31
Fair Credit Reporting Act.....	12	83	95
Fair Debt Collection Practices Act.....	10	24	34
Fair Housing Act.....	1	3	4
Municipal Securities Dealer Regulation.....	0	3	3
Transfer agents.....	2	1	3
Unregulated bank practices.....	455	706	1,161
Other <sup>2</sup> .....	0	108	108
<b>Total</b> .....	<b>796</b>	<b>1,400</b>	<b>2,196</b>

1. Referred by the Federal Reserve to the appropriate agencies.

2. Primarily miscellaneous complaints against business entities.

tion of their complaint acceptable. Many complaints involved practices that, although of concern to consumers, are permissible practices. Thus, a greater percentage of the respondents were satisfied with the System's handling of their complaint than with its resolution.

A second table summarizes the nature and resolution of the 796 complaints against state member banks. About 52 percent involved loan functions: 11 percent alleged discrimination on a prohibited basis, and 41 percent concerned credit denial on nonprohibited bases

(such as length of residency) and other unregulated lending practices (such as release or use of credit information). About 26 percent involved disputes concerning interest on deposits and general practices concerning deposit accounts.

### Unregulated Practices

In 1988 the Board continued to monitor, under section 18(f) of the Federal Trade Commission Act, complaints about banking practices that are not subject to existing regulations to focus on those that

Consumer Complaints Received by the Federal Reserve System, by Function and Resolution, 1988

Type of resolution	Total	Type of complaint					Other
		Loan function		Deposit function	Electronic fund transfers	Trust services	
		Discrimination	Other				
<b>Complaints about state member banks</b>							
Number .....	796	87	329	205	28	9	138
Percent .....	100	11	41	26	4	1	17
<b>Complaints about state member banks, by type</b>							
Insufficient information <sup>1</sup> .....	27	3	6	7	1	1	9
Information furnished to complainant <sup>2</sup> .....	89	9	46	21	0	0	13
Bank legally correct							
No accommodation .....	277	43	107	73	14	4	36
Accommodation made <sup>3</sup> .....	66	10	31	12	0	0	13
Clerical error, corrected .....	153	5	70	47	5	0	26
Factual dispute <sup>4</sup> .....	41	2	15	12	2	1	9
Bank violation, resolved <sup>5</sup> .....	18	4	10	2	2	0	0
Possible bank violation, unresolved <sup>6</sup> .....	2	0	1	0	0	0	1
Customer error .....	21	1	3	7	0	0	10
Pending, December 31 .....	102	10	40	24	4	3	21
<b>Complaints referred to other agencies<sup>7</sup> .....</b>	<b>1,400</b>	<b>56</b>	<b>644</b>	<b>294</b>	<b>23</b>	<b>16</b>	<b>367</b>
<b>Total, all complaints .....</b>	<b>2,196</b>	<b>143</b>	<b>973</b>	<b>499</b>	<b>51</b>	<b>25</b>	<b>505</b>

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.

may be unfair or deceptive. Three categories each accounted for 5 percent of the 1,161 complaints: improper crediting of deposits to accounts (59), credit denial based on credit history (58), and miscellaneous other practices (57). Complaints about improper crediting of deposits usually involved cases in which a customer held more than one account and the teller inadvertently credited funds to the wrong account. Many of the complaints about credit denials based on credit history indicated that the applicant underestimated the importance lenders give to a poor credit history or a lack of borrowing experience when considering the applicant's creditworthiness. The third category covered a wide range of practices, such as merchants' minimum-charge requirements on credit cards, the number of points charged on a mortgage loan, or a lender's failure to close on a mortgage loan by the agreed settlement date.

### **Community Reinvestment Act**

The Community Reinvestment Act (CRA) requires the Board 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 a manner consistent with safe and sound practices. The Board assesses the CRA record of state member banks during regular examinations, and takes 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.

The CRA program of the Federal Reserve consists of a compliance examination program, a community affairs program, and a program for analysis of CRA performance in connection with

applications of banks and bank holding companies.

Examiners trained in consumer regulation and CRA issues carry out the compliance program; they conduct examinations and produce reports dealing exclusively with these issues. During the 1988 reporting period (July 1, 1987, through June 30, 1988), Federal Reserve personnel examined 569 state member banks for compliance with the CRA. During these examinations, banks are counseled on ways to improve CRA performance, including techniques for more active involvement in community economic development.

The number of CRA protests and the increased complexity of protests involving interstate acquisitions have resulted in a greater emphasis on the applications process in recent years. To achieve a fair and equitable settlement of CRA issues arising during the application process, the Board carefully considers all relevant facts from the parties involved. The Board scrutinizes the CRA records, which may reflect problems for an applicant, whether or not a protest has been filed. In this process the Board often has obtained commitments for future improvement. When CRA issues arise, the Federal Reserve also provides a forum for protestants and applicants that wish to discuss their concerns privately and narrow differences caused by misunderstandings.

The number of applications of state member banks or bank holding companies protested because of CRA performance declined from the record high of 1987. In calendar year 1988, 31 applications were protested, compared with 36 in 1987. But the Board also handled 20 other applications in which adverse CRA ratings were at issue, compared with 15 such cases during 1987. In the protested cases, 6 protests were withdrawn following resolution of differences between

applicants and protestants. In 9 other instances, applications were approved after the applicant made commitments to the Board to improve its CRA performance. By year-end the Board had approved 27 of the 31 applications; the other 4 applications were still pending.

### Consumer Advisory Council

The Consumer Advisory Council (CAC) met in March, July, and October to advise the Board on its responsibilities under the consumer credit protection laws and discuss other issues relating to financial services to consumers. The CAC has 30 members from consumer groups, financial institutions, academia, and government. Its meetings are open to the public.

At the March meeting, the CAC considered proposed legislation for improved disclosures to consumers and for restrictions on credit features of home equity lines of credit. The CAC reviewed a December 1987 Board proposal that would have required earlier and additional Truth in Lending disclosures for these plans. The council urged the Board to move expeditiously in developing a final rule, though CAC members also recognized the need for protections for consumers (such as rate indexes that can be verified by the consumer through an outside source) that could be provided only by legislative action. The CAC recommended amending Regulation Z to provide a 90-day notice period (instead of the current 15 days) for a change in terms affecting an outstanding balance in a home equity line.

In March the CAC considered the Board's proposed rules implementing the Expedited Funds Availability Act. Several bankers expressed concern about a provision that mandates next-day availability without exception for government and cashier's checks, citing the risk of fraud on large-dollar items. The act

removes from mandated schedules certain items such as large-dollar deposits or checks the institution has reason to believe will not be paid; a majority of council members wanted the Board to seek statutory authority to extend the exceptions to all checks, including government and cashier's checks. Consumer and community representatives, noting that many low-income individuals desperately need next-day availability, opposed applying the exceptions to government checks.

Also in March the CAC recommended that the Board support legislation allowing banks, thrift institutions, and credit unions to sell insurance if they met certain conditions designed to protect consumers. These conditions would include legal protections against linking insurance sales to credit extensions, clear and understandable product disclosures, access to insurance and banking products that are affordable to low- and moderate-income persons, "at-cost" government-check-cashing services for noncustomers, and public disclosure of the CRA rating of an institution that applies for insurance powers. Six CAC members, representing both industry and consumer perspectives, opposed the recommendation.

At the July meeting the CAC considered the potential effects of a legislative proposal requiring banks to cash government checks for nondepositors for a small fee. Members were agreed that recipients of public-assistance and social-security checks should be able to cash those checks at a reasonable cost, but the members differed over the best way to accomplish this objective. Industry representatives, concerned about the potential for fraud and about the new direct and indirect costs for institutions under the proposed legislation, thought reliance on electronic fund transfer systems would be a better solution: direct deposit of

funds would minimize the potential for fraud, and the use of automated teller machines would provide convenience for recipients. Consumer representatives pointed out that only a small percentage of families with incomes under \$10,000 currently use automated teller machines.

In July the CAC considered alternatives to accommodate communities deprived of local banking services when a bank branch shuts down. The alternatives included community development credit unions (chartered around a geographic bond) and community development banks (designed to provide financial services and economic development in low- and moderate-income communities). The CAC also reviewed programs undertaken by banks and by the banking trade groups to develop alternative banking services. The CAC supported the concept that banks should give advance notice to the community when they decide to close a branch and urged the Board to publicize alternatives for communities lacking regular banking services.

In October the CAC considered disclosure rules on traditional second-mortgage transactions in the context of the new rules for early disclosure of terms on home equity lines of credit. Members suggested earlier disclosure of the credit costs, repayment terms, and risks associated in the more traditional closed-end transactions that involve second mortgages; the disclosures for these transactions are now given at settlement. Legal-aid attorneys and state government officials believe that with earlier disclosures, consumers would be more likely to avoid the less advantageous programs. Members from small banks were against the idea of having to provide additional disclosures because their institutions are not part of the problem being described.

Also in October, the CAC considered whether the information given on savings accounts enables depositors to check that

the interest received matches the rate advertised. The CAC generally endorsed the concept that depositors should have the information necessary to verify interest, though some members expressed concern about costs if institutions had to give a great deal of complicated data to consumers.

In 1988 the CAC also considered the following issues:

- Legislative proposals to amend the CRA.
- The Federal Reserve's implementation of CRA recommendations that were made by the CAC in 1983.
- Newspaper articles describing wide disparities in the practices of banks with respect to lending in predominantly white and predominantly minority neighborhoods.
- Regulatory issues that affect small financial institutions.
- The trend toward restructuring within the financial services industry.
- The exportation, by national banks, of interest rates and other charges across state lines.

### **Testimony and Legislative Recommendations**

In 1988 the Board testified before the Congress and made recommendations concerning the Community Reinvestment Act, government check cashing and basic banking, and expedited funds availability.

#### **Community Reinvestment Act**

The Board testified twice before the Senate Committee on Banking, Housing, and Urban Development concerning the Community Reinvestment Act. At oversight hearings in March the Board reported on the Federal Reserve's CRA program, which integrates compliance examinations, a strong community affairs

program, and a program for analysis of banks' CRA performance in deciding applications by banks and bank holding companies (see the section above on the CRA).

The Board's testimony in September provided comment on proposed amendments to the CRA in a comprehensive banking bill. While the Board recognizes that improvements in the implementation of the CRA can be made, it believes the current CRA requirements are fundamentally sound and workable, and it opposed major revisions. Any modification must be tailored carefully to preserve the balance between the needs of local communities and the safe and sound operation of banks and should not raise administrative obstacles that may tend to erase gains already achieved by the CRA. The Board believes that changes to the CRA should focus on two major criticisms: the lack of opportunity for individuals and community groups to contribute to the evaluation of the CRA performance of institutions, and that high CRA ratings may be given too readily.

The Board suggested some ways that would enable the public to participate in CRA assessments. Institutions could provide, in their annual public statement on the CRA, a discussion of the efforts they have made to meet their CRA responsibilities. Members of the public could then comment to the institution and to regulators on the institution's performance. In addition, federal regulators could publish every two years or so an evaluation of the CRA record of each financial institution. This evaluation would give the basis for the regulatory agency's analysis of an institution's CRA performance. The public could be invited to comment on this evaluation as well; and the agency would take these comments into account in reviewing applications by the institution. This approach would facilitate regular, meaningful, and

effective communication among banks, communities, and regulators about the community's needs and an institution's record of accomplishment in meeting its CRA responsibilities.

### Government Check Cashing and Basic Banking

The Board's testimony in September before the Senate banking committee also covered legislative proposals to impose new requirements for government-check cashing and basic banking services. The Board opposes the requirement that financial institutions cash government checks for nondepositors at a specified price. Electronic alternatives present a better long-term solution to problems in this area than focusing exclusively on check cashing; the processing cost would be much lower and the fee charged an individual to make cash available would probably be smaller than for cashing a check. Federal, state, and local agencies could arrange to transfer benefit payments electronically to depository institutions that agree to participate in a voluntary program, for example.

The Board does not support requiring that institutions offer basic transaction accounts at a regulated price. Any mandatory arrangement would be inflexible, the Board believes, and fee requirements would be extremely difficult to implement in regulations. In light of these problems, and the fact that as many as 50 percent of all financial institutions already offer basic banking services, the Board favors encouraging voluntary efforts by financial institutions to offer basic low-cost accounts—without mandating a specific program of services and fees.

### Expedited Funds Availability

The Expedited Funds Availability Act generally authorizes financial institutions

to impose holds for longer than the normal times under specific, limited circumstances. But these exceptions are not authorized for some checks on which the act requires next-day availability—Treasury and cashier's checks, for example. The Board supports amending the act to make the special exceptions applicable to all checks to reduce the risk of fraud.

The Board opposes the legislative codification of a recent court decision requiring that credit union share drafts payable through a bank be treated as local or nonlocal based on the location of the credit union (rather than the location of the bank). The Board believes this approach increases the risk associated with accepting these drafts for deposit and also makes it difficult for consumers to understand when the proceeds of credit union drafts are available for withdrawal. The Board recommended that the Congress amend the act to treat a draft as local or nonlocal based on the location of the payable-through bank.

### **Recommendations of Other Agencies**

Each year the Board asks those agencies that have enforcement responsibilities under Regulations B, E, and Z for recommended changes to the regulations or the underlying statutes.

The FDIC has recommended amending ECOA to prohibit discrimination on the basis of handicap, a change that would bring it into conformity with recent amendments to the Fair Housing Act. The FDIC also recommends amending ECOA to clarify congressional intent with respect to age discrimination. ECOA bars creditors from discriminating on the basis of age regardless of whether an applicant is young or old. But it allows creditors to take age into account in credit scoring systems that are “demonstrably

and statistically sound.” The FDIC reports that the largest volume of ECOA-related complaints involve credit card applications where “age” or “age group” has been cited as a reason for denial of credit. To eliminate the confusion inherent in the act's provisions, the FDIC recommends that the reference to “age” be replaced by the term “elderly age,” and suggests defining elderly to mean 62 years or older, as in Regulation B. ■



## Litigation

During 1988 the Board of Governors was named in 44 pending lawsuits, compared with 47 in 1987. Of the 13 new lawsuits filed in 1988, 6 raised questions under the Bank Holding Company Act, compared with 12 in 1987. As of December 31, 1988, 23 cases were pending, 15 of which involved questions under the Bank Holding Company Act.

### Bank Holding Companies— Antitrust Action

In 1988 no bank holding company acquisitions or mergers that had been approved by the Board were challenged by the Department of Justice under antitrust laws, and no such cases were pending from previous years.

### Bank Holding Company Act— Review of Board Actions

In *Independent Community Bankers Association of South Dakota v. Board of Governors*, No. 85-1496 (D.C. Circuit, filed August 7, 1985), petitioners sought review of 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). In an opinion dated June 5, 1987, the Court of Appeals affirmed the Board's order (820 F.2d 428). On January 11, 1988, the Supreme Court denied a petition for certiorari (108 S. Ct. 695).

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. 50,950, December 13, 1985). The Board's order was upheld by the Court of Appeals (855 F.2d 688). A petition for certiorari in the Supreme Court is pending (No. 88-1109).

In *Independent Community Bankers Association of South Dakota v. Board of Governors*, No. 86-5373 (8th Circuit, filed October 3, 1986), the Court of Appeals (838 F.2d 969) overturned the 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). On February 17, 1988, however, the provisions in the South Dakota statute that were challenged in this case were repealed.

In *Lewis v. Board of Governors*, Nos. 87-3455 and 87-3545 (11th Circuit, filed June 25, 1987), petitioner seeks 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). The cases have 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 (*Fed-*

*eral 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) the Court of Appeals (856 F.2d 282) upheld 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, September 1987, p. 744 and p. 740, respectively). On December 2, 1988, a petition for rehearing and rehearing en banc was denied. Several other cases involved petitions for review of similar Board orders. The petitions for review in these cases were denied by court orders dated January 19, 1989. These cases are as follows: *National Association of Casualty and Surety Agents et al. v. Board of Governors*, No. 88-1001 (D.C. Circuit, filed January 4, 1988), No. 88-1270 (D.C. Circuit, filed April 7, 1988), No. 87-1644 (D.C. Circuit, filed November 14, 1987), No. 87-1801 (D.C. Circuit filed December 21, 1987), No. 88-1206 (D.C. Circuit, filed March 18, 1988) and No. 88-1245 (D.C. Circuit, filed March 30, 1988); and *Independent Insurance Agents of America, Inc., et al. v. Board of Governors*, No. 87-1686 (D.C. Circuit, filed November 19, 1987).

In *Board of Trade of Chicago et al. v. Board of Governors*, No. 87-2389 (7th Circuit, filed September 1, 1987) petitioners sought 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). On January 20, 1988, the case was dismissed as moot by joint stipulation.

In *Citicorp v. Board of Governors*, No. 87-1475 (D.C. Circuit, filed Septem-

ber 9, 1987), petitioner sought 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 was dismissed on January 29, 1988.

In *Independent Insurance Agents of America, Inc. v. Board of Governors*, No. 87-4118 (2nd Circuit, filed September 17, 1987), petitioner sought 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 Board order was vacated on January 26, 1988, on the basis of a congressional moratorium (838 F.2d 627), and thus, no further judicial proceedings have been taken.

In *Irving Bank Corporation v. Board of Governors*, No. 88-1176 (D.C. Circuit, filed March 1, 1988), the Court of Appeals (845 F.2d 1035) upheld a Board order approving the application of the Bank of New York Company, Inc., to acquire Irving Bank Corporation (*Federal Reserve Bulletin*, vol. 74, April 1988, p. 257).

In *American Land Title Association v. Board of Governors*, No. 88-1872 (D.C. Circuit, filed December 16, 1988) petitioner seeks review of a Board order dated November 17, 1988, approving the application by First Wisconsin Corporation to acquire a company engaged in title insurance agency activities (*Federal Reserve Bulletin*, vol. 75, January 1989, p. 31). The case is pending.

### Other Litigation Involving Challenges to Board Procedures and Regulations

In 1988, 15 actions were taken, were pending, or were dismissed under the

Financial Institutions Supervisory Act and the Glass-Steagall Act.

### Financial Institutions Supervisory Act

In *Adams et al. v. Board of Governors*, No. 87-5311MN (8th Circuit, filed July 13, 1987), the Court of Appeals (855 F.2d 1336) on August 31, 1988, affirmed 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.

In *Northeast Bancorp, Inc. v. Board of Governors*, No. 87-1365 (D.C. Circuit, filed July 31, 1987), the Court of Appeals (849 F.2d 1499) denied a petition for 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.

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.

In *Stoddard v. Board of Governors*, No. 88-1148 (D.C. Circuit, filed February 25, 1988) petitioner seeks review of a Board order removing petitioner from the positions of director and officer of the Michigan National Bank of Detroit. The case is pending.

In *Bonilla v. Board of Governors*, No. 88-1464 (7th Circuit, filed March 11, 1988) petitioner seeks review of a Board order prohibiting petitioner from participation in the conduct of the affairs of any insured bank or bank holding company. The case is pending.

In *MCorp v. Board of Governors*, No. 88-2693 (N.D. Texas, filed October 28,

1988) plaintiff seeks to enjoin an enforcement proceeding. The case is pending.

### Glass-Steagall Act

In *Securities Industry Association v. Board of Governors*, No. 86-1412 (D.C. Circuit, filed July 14, 1986) petitioner sought review of 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 July 7, 1987, the Court of Appeals upheld the Board's order (821 F.2d 810). On January 11, 1988, the Supreme Court denied a petition for certiorari (108 S. Ct. 697).

In *Securities Industry Association v. Board of Governors*, No. 87-1169 (D.C. Circuit, filed April 17, 1987), the Court of Appeals (847 F.2d 890) upheld 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).

In *Securities Industry Association v. Board of Governors et al.*, No. 87-4041, (2nd Circuit, filed May 1, 1987), petitioner sought 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 1987, p. 607). On February 8, 1988, the Court of Appeals upheld the Board's order in substantial part (839 F.2d 47). A petition for certiorari was denied by the Supreme Court on June 13, 1988 (108 S. Ct. 2830). Several other cases that involve similar petitions for review were withdrawn after final disposition of this case by the Supreme Court. These cases are as follows: *Securities Industry Asso-*

*ciation 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), No. 87-4135 (2nd Circuit, filed October 8, 1987), and No. 87-4161 (2nd Circuit, filed December 24, 1987).

### Other Actions

In *Melcher v. Federal Open Market Committee*, No. 84-1335 (D. D.C., filed April 30, 1984), plaintiff challenged the constitutionality of the methods used to select certain members of the Federal Open Market Committee. On December 18, 1987, the Court of Appeals held the complaint should be dismissed on grounds of equitable discretion (836 F.2d 561). A petition for certiorari in the Supreme Court was denied on June 6, 1988 (108 S. Ct. 2034).

In *Jenkins et al. v. Board of Governors*, No. 87-1336 (D.C. Circuit, filed July 18, 1986) the Court of Appeals dismissed the petition for review of the Board order granting application for membership in the Federal Reserve System on June 2, 1988.

In *Brown v. United States Congress et al.*, No. 87-5586 (9th Circuit, filed March 2, 1987), plaintiff appealed the dismissal of his complaint seeking damages for alleged discrimination in home financing and mandatory injunction regarding the Board's monetary policy. The appeal was dismissed on March 8, 1988.

In *Barrett v. Greenspan*, No. 87-2280 (D. D.C., filed August 17, 1987), an action to enjoin an alleged discriminatory practice, was dismissed on July 8, 1988.

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.

In *Cohen v. Board of Governors*, No. 88-1061 (D. New Jersey, filed March 7, 1988) plaintiff seeks to require disclosure of documents under the Freedom of Information Act.

In *Fidata Trust Company New York v. Board of Governors*, No. 88-4846 (D. New Jersey, filed November 9, 1988) plaintiff seeks to enjoin the Board from disclosing certain documents involved in the Cohen case. Both actions are pending.

In *Credit Union National Association, Inc., et al. v. Board of Governors*, No. 88-1295 (D. D.C., filed May 13, 1988) a district court invalidated certain challenged provisions of the Board's Regulation CC relating to the treatment of credit union share drafts under the Expedited Funds Availability Act (53 Fed. Reg. 19,372, May 27, 1988) by order dated July 28, 1988.

In *White v. Board of Governors*, No. 88-623 (D. Nevada, filed July 29, 1988) plaintiff alleges discriminatory practices under the Age Discrimination In Employment Act. The case is pending. ■

## *Legislation Enacted*

In 1988 the Congress passed the following legislation directly affecting the Federal Reserve or the institutions it regulates.

### **Omnibus Trade and Competitiveness Act of 1988**

Public Law 100-418, the Omnibus Trade and Competitiveness Act of 1988, was enacted on August 23, 1988. Title III of the act addresses international financial policy and is summarized here.

Subtitle A of title III, the Exchange Rate and International Economic Policy Coordination Act of 1988, states policy goals for negotiations by the President and imposes new reporting requirements on the Secretary of the Treasury concerning the international coordination of economic and exchange rate policies. Subtitle A also amends the Federal Reserve Act to require that the Board include an analysis of the impact of the dollar exchange rate on the economy in the Board's yearly report to the Congress on economic development.

Subtitle B of title III, the International Debt Management Act of 1988, contains congressional findings and provisions concerning the debt of developing countries. It also expresses the sense of the Congress that federal regulators give banks wide latitude in negotiating reductions of principal and interest with sovereign debtors. Subtitle B also declares that it is the intent of the Congress (1) that federal agencies regulating depository institutions allow maximum flexibility in applying generally accepted accounting principles in determining the asset value and effects of restructured loans to heavily indebted sovereign borrowers; (2) that

these federal agencies require depository institutions with substantial loans to heavily indebted sovereign borrowers to recapitalize as appropriate to maintain adequate ratios of capital to assets; and (3) that the federal agencies ensure that depository institutions establish appropriate levels of reserves against loan losses.

Subtitle B further requires the federal banking agencies to submit data to the Congress annually concerning loan-loss exposure, reduction of risks associated with such exposure, the relationship between bank lending activity in heavily indebted foreign countries and U.S. exports to these countries and ways to encourage such lending, responses of regulatory authorities in other countries to international debt problems, and steps taken by heavily indebted countries to alleviate debt-servicing problems. The Board, together with the Comptroller of the Currency and the Federal Deposit Insurance Corporation are also required to submit a report analyzing regulatory and accounting obstacles to various forms of debt restructuring.

Subtitle E of title III, the Export Trading Company Act Amendments of 1988, amends the Bank Holding Company Act of 1956. The amendments establish standards for determining whether a company may be considered to be operated principally for the purposes of exporting goods and services produced in the United States. The amendments also prohibit the Board from proscribing a proposed investment in an export trading company solely on the basis of the leverage ratios of the company unless the asset-to-equity ratio is projected to be greater than 20 to 1. The amendments

limit the circumstances under which the Board may limit the maximum dollar value of the inventory of an export trading company.

Subtitle F of title III, the Primary Dealers Act of 1988, provides that neither the Board nor the Federal Reserve Bank of New York may designate or continue a prior designation of a foreign person as a primary dealer in government debt securities unless that person's country affords U.S. companies the same opportunities in the underwriting and distribution of government debt securities as are afforded domestic companies in that country. Designations made before July 31, 1987, are excepted; also excepted are previously designated primary dealers acquired by a foreign person prior to that date if the Federal Reserve Bank was notified before the acquisition. Exceptions are also made for citizens of countries that were negotiating or had in force as of January 1, 1987, a bilateral free trade agreement with the United States.

Subtitle G of title III, the Financial Reports Act of 1988, requires the Treasury, in conjunction with the Board and a number of other federal agencies, to report to the Congress on the home countries of foreign financial-service institutions doing business in the United States and on the types of financial services offered by persons from these countries. The report must also include information concerning the extent to which such countries deny national treatment to U.S. financial-service institutions, on efforts to eliminate discrimination, and on discussions authorized by subtitle G to reduce barriers to trade in financial services. The subtitle also requires the Board to report on issues concerning the treatment of loan loss reserves as part of banks' primary capital for regulatory purposes.

## **Management Interlocks Revision Act of 1988**

P.L. 100-650, the Management Interlocks Revision Act of 1988, enacted on November 10, 1988, amends the Depository Institution Management Interlocks Act. The 1988 act amends the definition of "affiliate" to allow companies to be considered affiliates if 25 percent or more of the voting stock in each company is beneficially owned by common shareholders. Previously, at least 50 percent of the voting stock had to be commonly owned for companies to be considered affiliates. Because affiliated companies are allowed to have management interlocks, the amendment will allow companies that are more loosely related to have directors and managers in common.

The new law makes the following additional provisions:

- Creates an exception for failed or failing depository institutions acquired by another depository institution or by the holding company of a depository institution.
- Creates a limited exception for directors in diversified savings and loan holding companies.
- Excludes advisory or honorary directors in depository institutions with assets of less than \$100 million from coverage by the act.
- Extends for an additional five years, to November 10, 1993, the grandfathering clause for interlocks that existed in 1978.

## **Anti-Drug Abuse Act of 1988**

P.L. 100-690, the Anti-Drug Abuse Act of 1988, enacted on November 18, 1988, includes amendments to the Right to Financial Privacy Act of 1978. Among other provisions, the amendments exempt agencies or departments of the United States from the procedures estab-

lished for the transfer of financial records under the Right to Financial Privacy Act, enabling such organizations to more easily transfer financial records to the attorney general.

To be transferred, records must have been obtained in the exercise of supervisory or regulatory functions and be believed to be relevant to a violation of federal criminal law. A similar exemption will allow financial institutions or supervisory agencies to provide law enforcement officials more easily with the records of directors, officers, employees, controlling shareholders, and certain borrowers when the records are relevant to suspected crimes against financial institutions by such insiders.

### **Fair Credit and Charge Card Disclosure Act of 1988**

P.L. 100-583, the Fair Credit and Charge Card Disclosure Act of 1988, enacted on November 3, 1988, amends the Truth in Lending Act to require that applications or solicitations for credit or charge cards disclose annual percentage rates, fees and charges, grace periods for payments, and methods used to calculate balances, as well as additional disclosures when renewal fees are due and when the credit insurer is charged.

The amendments require the Board to adopt implementing regulations, to collect information on the price and availability of credit cards, and to report to the Congress within one year on the profitability of credit card operations and on the effect of the amendments on profitability.

### **Home Equity Loan Consumer Protection Act of 1988**

The Congress enacted P.L. 100-709, the Home Equity Loan Consumer Protection Act of 1988, on November 23, 1988. The

act amends the Truth in Lending Act to establish additional requirements for disclosures, advertising, and other aspects of home equity lines of credit. The amendments require that applications for such credit disclose certain information including payment terms, the annual percentage rate of interest charged, the calculation of variable interest rates, maximum interest rates, and the timing of changes in rates.

The amendments address the timing and form of the disclosures with regard to solicitations or applications and require the information to be provided again at the time the home equity account is opened. The amendments also require certain disclosures in any advertisements related to home equity lines of credit and prohibits the use of misleading terms in such advertising.

Under the new provisions, the creditor must not be able to control the index to which a variable interest rate is linked. The act prohibits creditors from unilaterally terminating a credit line and requiring immediate payment except in the event of fraud, default by the debtor, or other action by the debtor that adversely affects the creditor's security interest.

The amendments also limit the circumstances under which the creditor may unilaterally change the terms of the credit agreement. Impositions of nonrefundable fees are also limited, and the amendments provide that consumers may obtain a refund of fees under certain circumstances.

The amendments require the Board to develop educational materials for consumers of home equity lines of credit and to report to the Congress on whether the use of terms such as "annual percentage rate" for different types of credit lines mislead consumers attempting to compare credit plans. The act requires the Board to develop regulations to implement the amendments.

### **Women's Business Ownership Act of 1988**

P.L. 100-533, the Women's Business Ownership Act of 1988, enacted on October 25, 1988, establishes a National Women's Business Council and amends the Small Business Act to provide for demonstration projects to provide services and assistance to small businesses owned by women.

The act also amends the Equal Credit Opportunity Act to require the Board to prescribe regulations to improve access to capital for small businesses owned by women. The amendments require creditors to maintain records of business loan applications by women and to give such applicants notice of their right to information concerning credit denials.

### **Housing and Community Development Act of 1987**

P.L. 100-242, the Housing and Community Development Act of 1987, enacted February 5, 1988, makes the Home Mortgage Disclosure Act of 1975 permanent and extends its coverage to the mortgage-banking subsidiaries of holding companies of depository institutions and to certain savings and loan service corporations. The new law also amends several existing statutes in order to improve the availability of low- and moderate-income housing in the United States. ■



## *Banking Supervision and Regulation*

During 1988 the international supervision of banking organizations reached an important milestone. Under the auspices of the Basle Committee on Banking Regulations and Supervisory Practices, the Federal Reserve and the other U.S. bank regulators reached an agreement with the central banks and banking supervisors of 11 industrialized nations on international guidelines for risk-based capital standards.<sup>1</sup> The agreement aims for more consistent capital standards throughout the world, thereby reducing a source of competitive inequity among international banking organizations. The agreement, which the Board adopted in December 1988, will be phased in over the next four years.<sup>2</sup> The risk-based framework will introduce more sensitivity to risk factors, including off-balance-sheet exposures, than the current leverage ratios provide. The standards should also encourage banking organizations, particularly those engaged in international activities, to strengthen their capital positions.

The guidelines constitute a major step in fulfilling the capital mandate set forth by the Congress in the International Lending Supervisory Act of 1983. When fully in place throughout the world, the risk-based capital standard promises support of a more stable international banking environment.

The Board also considered numerous proposals for expansions of banks and

nonbanks, the effects of which will continue the restructuring of the geographic and product environment that has evolved in recent years. The proposals included large interstate combinations as well as reorganizations and acquisitions for certain Texas-based institutions in financial difficulty. Under provisions granted by the Congress to cover emergencies, the Board expedited its processing of applications involving failing banks and distressed thrift institutions.

In addition, Division staff members provided technical assistance to other agencies in selecting an appropriate owner for failing institutions. Through this process, the agencies attempt to select a bidder that will provide optimum financial and managerial resources to the successor institution at the lowest possible cost.

The Board also took significant steps on the issue of securities underwriting and dealing by banking organizations. By way of background, the Board in 1987 approved proposals by banking organizations to underwrite and deal on a limited basis in investment-quality commercial paper, certain municipal revenue bonds, conventional residential mortgage-related securities, and securitized consumer loans in a manner consistent with the Glass-Steagall Act and the Bank Holding Company Act. The Board limited revenues from these approved activities to no more than 5 percent of total revenues for each organization. The Board also required that the organizations undertake these activities in separate securities subsidiaries under limitations that would insulate bank subsidiaries with federally insured deposits from related risks and to avoid possible conflicts of

---

1. The other U.S. regulators in the agreement are the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

2. For a discussion of the Board's action, see the section on policy statements in the chapter of this REPORT on "Record of Policy Actions of the Board of Governors."

interests, unfair competition, and other potential adverse effects.

In accordance with the provisions of the Competitive Equality Banking Act of 1987, the Congress placed a moratorium, until March 1, 1988, on bank holding companies engaging in these securities activities. Court rulings upheld the Board's action in large part. Subsequent to the expiration of the moratorium, several bank holding companies applied to the Board to underwrite and deal in a broad range of corporate debt and equity securities under the terms set by the Board in 1987. After extensive deliberations, the Board approved the applications in January 1989 subject to additional conditions. In particular, approval of activity in equities carries a one-year waiting period, after which the Board will determine whether the applicants have the managerial and operational structure required by the Board to commence the new activity.

### **Risk-Based Capital**

On March 1, 1988, the Federal Reserve issued for public comment its proposed guidelines for risk-based capital based on the December 1987 Basle Accord. These proposed guidelines superseded the proposal on risk-based capital issued for public comment in February 1987.

The Basle Accord was developed by the Basle Committee on Banking Regulations and Supervisory Practices, which consists of representatives of the central banks and supervisory authorities from 12 industrial countries.<sup>3</sup> The accord aimed to develop a broad-based capital framework applicable to international banking organizations from the major

industrial countries. The principle objectives of the framework were greater convergence in the measurement and assessment of capital adequacy internationally and strengthened capital positions of major international banking organizations.

After reviewing and incorporating public comments, the Board of Governors approved the final risk-based capital guidelines on December 14, 1988, for state member banks and bank holding companies. The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency issued similar guidelines early in 1989.

The domestic guidelines adopted by the Board establish a systematic analytical framework that (1) makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, (2) takes off-balance-sheet exposures into explicit account in assessing capital adequacy, and (3) minimizes disincentives to holding liquid, low-risk assets.

These guidelines consist of a definition of capital, a system for assigning assets and off-balance-sheet items to risk categories, a schedule for achieving a minimum risk-based capital ratio, and a phase-in period that provides for transitional arrangements. The minimum supervisory ratios reflected in the framework's transitional provisions will not become effective until December 31, 1990. The supervisory ratios in their final form will take effect December 31, 1992.

### **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, sur-

3. The 11 "Group of 10" countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States) plus Luxembourg.

veillance 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.<sup>4</sup>

#### *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, of which there were 1,063 at the end of 1988. These banks accounted for about 8 percent of all insured commercial banks and about 18 percent of the assets of all such banks.

The Federal Reserve in 1986 increased the frequency of scheduled examinations and inspections of state member banks

and bank holding companies. 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 1988, either the Federal Reserve or a state banking agency examined 1,083 state member banks at least once. Altogether, the state agencies conducted 344 examinations of state member banks, and the Federal Reserve conducted 875 examinations, some of them jointly with the state agencies. Under policy guidelines, Reserve Bank officials also held 348 meetings with directors of the largest state member banks in each state and with directors of those banks that displayed significant weaknesses.

#### *Bank Holding Companies*

In 1988 the number of bank holding companies increased by 31, to 6,474. These organizations control 9,025 commercial banks, which hold approximately 91 percent of the assets of all insured commercial banks in the United States.

Most large bank holding companies and smaller companies with significant nonbank assets are inspected annually under the 1986 guidelines. Others are inspected at least every three years or, in the case of the smallest companies without any nonbank assets, on a sample basis. The inspection focuses on the operations of the parent and the nonbanking companies. The subsidiary banks are examined by the appropriate banking regulators. In 1988, System examiners made 2,726 on-site inspections and 97 off-site inspections. State examiners made 49 inspections of bank holding companies. During 1988, Reserve Bank officials held 591 meetings with directors of the largest bank holding companies and with those of companies displaying significant weakness.

4. The Board's Division of Consumer and Community Affairs is responsible for reviewing compliance with consumer and civil rights laws. This 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.

## 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 1988 the Reserve Banks recommended, and the Board's staff initiated and worked on, 144 enforcement cases that involved 287 separate actions such as cease and desist orders, removals, and civil money penalties, most dealing with unsafe or unsound banking practices; of these, 54 cases involving 93 actions, were completed by year-end. The Board completed 6 civil money penalty actions and assessed a total of \$55,000. By year-end 1988, the Board collected \$40,000, 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 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. In 1988 the Federal Reserve examined 112 Edge and agreement corporations.

### *Foreign-Office Operations of U.S. Banking Organizations*

The Federal Reserve examines the international operations of state member banks, Edge corporations, and bank holding companies principally at the U.S. head offices of these organizations, where the ultimate responsibility for their foreign offices lies. In addition, the Federal Reserve conducts on-site reviews of important foreign offices at least every three years to supplement the results of the head-office examinations. In 1988 the Federal Reserve examined 12 foreign branches of state member banks and 34 foreign subsidiaries of Edge corporations and bank holding companies. In 1988 the Federal Reserve, 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 Spain. All the examinations abroad were conducted with the cooperation of the supervisory authorities of the countries in which the examinations took place.

### *U.S. Activities of Foreign Banks*

Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 1988, 264 foreign banks operated 457 state-licensed branches and agencies, of which 31 are insured by the Federal Deposit Insurance Corporation. At year-end these foreign banks also operated 81 branches and agencies li-

censed by the Office of the Comptroller of the Currency, of which 4 have FDIC insurance. Foreign banks also directly owned 18 Edge corporations and 9 commercial lending companies. In addition, foreign banks held a 25 percent or greater interest in 88 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 125 such offices during the past year.

### Specialized Examinations

The Federal Reserve conducts specialized examinations in the following areas of bank activity: data processing, trust activities, dealing and brokering government securities, dealing and clearing municipal securities, and transferring securities.

#### *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 1988, System examiners conducted 296 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*

During 1988 the Federal Reserve conducted 215 examinations of the trust functions of state member banks, trust companies that are members of the Federal Reserve System, and certain foreign and domestic trust companies that are subsidiaries of bank holding companies. At the end of 1988, 432 of these institutions exercised trust powers, approximately 10 percent of the total number of institutions in the industry. These 432 institutions held about 50 percent of the total assets administered by all such banks, trust companies and subsidiaries.

#### *Government Securities Dealers and Brokers*

Under the Government Securities Act of 1986, the Board is responsible for examining government securities dealer and brokerage activities of state member banks and of some foreign banks for compliance with the act and with the regulations of the Treasury Department. Forty-three state member banks, one branch of a foreign bank, and one agency of a foreign bank currently have on file with the Board notices that they are government securities dealers or brokers not otherwise exempt by Treasury Department regulations. Specialized examination procedures relating to government securities activities were revised by the Federal Reserve in September 1988 in light of regulatory amendments adopted by the Treasury Department.

#### *Municipal Securities Dealers and Clearing Agents*

The Securities Act Amendments of 1975 made the Board responsible for supervis-

ing state member banks and bank holding companies that act as municipal securities dealers or as clearing agencies. In 1988 the Board examined 26 state member banks that deal in municipal securities. Currently 50 such banks are registered with the Board. 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 1988.

### *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 1988, System examiners conducted examinations of 79 of the 165 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 use quarterly financial statements submitted by the banking organizations and compute numerous financial ratios, which are then analyzed by the staff members of the Division and of the Reserve Banks in order to determine whether banking organizations are potential emergency problems. 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 or other supervisory actions.

### Supervisory Policy

In addition to its enactment of risk-based capital guidelines, the Board in 1988 initiated or modified several other supervisory guidelines. The following sections summarize the principal aspects of these additional initiatives or changes and review other activities carried out during the year to enhance the supervisory program.

### Problem Loans in Agriculture

In 1987 the Congress passed the Competitive Equality Banking Act, which in part required 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. Banks seeking to amortize losses on qualified agricultural loans are required to apply to their Federal 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. At year-end 1988, eight state member banks were amortizing their loan losses under the program.

In a related action, effective December 31, 1987, the Federal Financial Institutions Examination Council (FFIEC) amended the regulatory reports for the banks amortizing their losses. 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 are treated as primary

capital for determining the adequacy of the bank's capital.

In 1988 the FFIEC revised the instructions for Call Reports so that transfers of securitized agricultural mortgages, under the Farmer Mac Program, could be reported as sales. Otherwise these assets would be reported as borrowings under the general rule governing the sale of assets with recourse.

### Relations with the States

The Board has provided a total of \$300,000 to the Education Foundation of State Bank Supervisors over the past three years. 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 FFIEC.

### Accounting Standards and Regulatory Reporting

The Board and its staff are continuing to work on eliminating, to the extent possible, differences between regulatory reporting requirements and generally accepted accounting principles (GAAP). In 1988 the Board incorporated GAAP in its regulatory requirements for reporting nonrefundable loan fees. Under the auspices of the FFIEC, the Board in November 1988 issued for public comment a proposal to require that the income from interest rate swaps be recognized over the life of the transaction for Call Report purposes, in a manner analogous to that under GAAP. This proposal would also require that changes in the market value

of interest rate swaps occurring after inception be recognized in the current period.

Progress was made toward the adoption of regulatory reporting standards for push-down accounting and futures that are consistent with GAAP. The Board also adopted Financial Accounting Standards Board (FASB) Statement 95, which replaced the statement of changes in financial position in the FR Y-6 annual reports filed by bank holding companies with a statement of cash flows.

Board staff members have served on various advisory committees of FASB and advisors to 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.

### 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 1988 the Federal Reserve conducted fifty sessions of various courses. The core banking program comprised four sessions of an introductory course, eight sessions of an intermediate course, and five sessions of an advanced course; each course lasted three weeks. A new course presented this year, Senior Forum for Current Regulatory Issues, is a continuing-education seminar for senior examiners. The other offerings covered sixteen sessions of a course on effective writing for banking supervision staff, five sessions of a credit analysis course, two sessions of a bank holding company applications course, six sessions on bank holding company inspections, one session on cash flow and

liquidity analysis, and two courses of one session each on consumer compliance.

Also, System staff attended two courses conducted jointly by a financial institutions regulator and the Federal Bureau of Investigation on white-collar crime and bank failures.

In 1988 the System participated in 111 sessions of courses offered by the FFIEC in specialized areas of income-property lending, trust department activities, off-balance-sheet risk, international banking, electronic data processing, activities of municipal securities dealers, payments system risks, white-collar crime, management training, conducting meetings with management, and instructor training.

During 1988 the Federal Reserve cosponsored with the World Bank two training sessions for senior supervisors from developing nations. Sixty-eight representatives from twenty-nine countries attended these programs.

In 1988 the Federal Reserve trained 1,194 System employees in System schools and 866 System employees in schools conducted by the FFIEC and other agencies, for a total of 2,060, in addition to 269 students from state agencies and 117 from foreign central banks.

### Federal Financial Institutions Examination Council

During 1988 the Federal Reserve adopted several policies recommended by the FFIEC.<sup>5</sup> The Board joined the other constituent agencies of the FFIEC in approving a policy statement concerning

selection of securities dealers and unsuitable investment practices. The Federal Reserve also endorsed a FFIEC proposal to inform financial institutions of the risks associated with large-scale integrated systems of financial software.

In March 1988 the Federal Reserve and other FFIEC agencies implemented a program for the electronic transfer of reports of condition and income by banks. CompuServe, Inc., has been designated collection agent for the agencies.

The FFIEC and other agencies also revised reporting requirements to accommodate special lending programs and to disclose certain off-balance-sheet activities. In addition, provision has been made to collect information on the type of audits performed on financial institutions by independent certified public accountants.

### 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 bank holding companies and state member banks. 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 overall 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.

5. The FFIEC consists of representatives from 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.



## 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*. Announcement of applications and notices received by the System but not yet acted on is made in the H.2 release.

## 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 1988, about 91 percent of the decisions met this standard.

## 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 1988, 89 percent of the applications were acted on under delegated authority.

## 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 1988 the Federal Reserve acted on 1,337 bank holding company and related applications. The Federal Reserve System approved 400 new bank holding companies plus 372 bank acquisitions by existing bank holding companies and 489 requests by existing companies to acquire nonbank firms engaged in activities closely related to banking. 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

## Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1988

Proposal	Direct action by the Board of Governors		Action under authority delegated by the Board of Governors					Total
			Staff Director of Division of Banking Supervision and Regulation		Office of the Secretary	Federal Reserve Banks		
	Approved	Denied	Approved <sup>1</sup>	Denied	Approved	Approved	Permitted	
Formation of hold- ing company .....	30	0	1	0	2	367	0	400
Merger of holding company .....	5	0	0	0	1	55	0	61
Retention of bank .....	0	0	0	0	0	1	0	1
Acquisition								
Bank .....	38	0	1	0	22	311	0	372
Nonbank .....	142	0	0	0	25	149	173	489
Bank service corporation .....	0	0	0	0	0	1	1	2
Other .....	0	0	12	0	0	0	0	12
<b>Total .....</b>	<b>215</b>	<b>0</b>	<b>14</b>	<b>0</b>	<b>50</b>	<b>884</b>	<b>174</b>	<b>1,337</b>

1. Two of the fourteen cases—the formation of a holding company and the acquisition of a bank—were specifically

delegated by the Board for joint action by the office shown and the General Counsel of the Board.

consider the views of certain other agencies on the competitive factors involved in the transaction.

During 1988 the Federal Reserve approved 75 merger applications: the Secretary of the Board approved 4 under authority delegated by the Board, and the Reserve Banks approved 71. 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 698 reports on competitive factors to the OCC and the FDIC in 1988.

## Change in Bank Control Act

The Change in Bank Control Act 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 1988 the Federal Reserve System acted on 198 proposed changes in control of state member banks and bank holding companies. The Reserve Banks consented to 192 proposals, the Secretary of the Board consented to 5 under authority delegated by the Board, and the Board consented to 1.

### Board Policy Decisions and Developments in Bank-Related Activities

In 1988 the Board approved several new nonbanking activities for individual bank holding companies. It also had under consideration other nonbanking proposals, including one to engage in modified leasing activities. A proposed rulemaking procedure would require Board approval for state bank affiliates of bank holding companies to establish or acquire operations subsidiaries. (In early 1989 the Board approved pending applications to engage in expanded securities underwriting and dealing activities.)

#### *Approval of Permissible Nonbank Activities*

In 1988 the Board for the first time approved the following activities for individual bank holding companies: (1) providing investment advisory and research services to retail customers in combination with securities brokerage activities; (2) providing financial advice to the Canadian federal and provincial governments, such as with respect to the issuance of their securities in the United States; (3) engaging in private placement of ineligible securities (for underwriting and dealing by banks) to a limited extent as an incidental activity related to under-

writing and dealing in securities; (4) providing management consulting services to failed savings and loan associations under the Management Consignment Program of the Federal Home Loan Bank Board, and assisting in the disposition of assets of such failed institutions; and (5) issuing and selling drafts and wire transfers that are payable in foreign currencies without limitation as to their face amount, but subject to certain limitations.

#### *Proposals to Engage in New Nonbanking Activities*

At year-end 1988 the Board was considering a proposal for bank holding companies to engage in leasing transactions in a manner consistent with expanded national bank leasing powers authorized by the Competitive Equality Banking Act of 1987. At year-end the Board also was considering a proposal for a bank holding company to function as a foreign currency options specialist on a securities exchange.

Also pending was a proposal to rescind an existing rule that permits bank holding companies, through their state-chartered bank subsidiaries, to establish or acquire nonbank operations subsidiaries engaged in activities that may be conducted by the parent bank. If adopted, this proposal would require bank holding companies to obtain approval to acquire or retain control of such nonbank operations subsidiaries. The Board also requested comment on a proposal to permit retention of all or most existing operations subsidiaries without further approval.

Other rulemaking proposals were under continuing review at year-end. These proposals, if adopted, would permit bank holding companies to acquire healthy thrift institutions and to engage in real estate investment and development activities subject to appropriate limitations.

### 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 by the Federal Reserve Banks under delegated authority 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 1988 the Federal Reserve reviewed 110 proposed stock repurchases by bank holding companies, 107 of which were acted on by the Reserve Banks on behalf of the Board.

### International Activities of U.S. Banking Organizations

The Board has several statutory responsibilities in supervising the international operations of U.S. banking organizations. The Board 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 branches, the Board considers the requirements of the law, the condition of the bank, and the bank's experience in international business. In 1988 the Board approved the opening of seven foreign branches.

By the end of 1988, 147 member banks were operating 854 branches in foreign countries and overseas areas of the United States; 113 national banks were operating 715 of these branches, and 34 state member banks were operating the remaining 139 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 can be booked at these facilities free from domestic reserve requirements and interest rate limitations. Subject to conditions specified by the Board, IBFs may be established by U.S. depository institutions, by Edge and agreement corporations, and by U.S. branches and agencies of foreign banks. By the end of 1988, 532 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 can invest in foreign financial organizations, such as finance companies and leasing companies, as well as in foreign banks. By the end of 1988, there were 112 Edge corporations, which had 49 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 1988 the Board reviewed and permitted 71 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. The Board also amended Regulation K to facilitate the ability of bank holding companies to engage in debt-for-equity swap transactions in certain developing countries.

### 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. The Export Trading Company Act Amendments of 1988 provide additional flexibility for bank holding companies engaging in export trading company activities. Since 1982 the Board has acted affirmatively on notifications by 45 bank holding companies to establish export trading 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 designed 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.

During 1988 the Federal Reserve, working in concert with the other federal banking agencies and the federal law enforcement community, focused its compliance efforts toward criminal operations that conduct cash transactions under the \$10,000 threshold and also use the banking system's wire transfer operations to launder money. The Federal Reserve has encouraged the institutions it supervises to report such suspicious activities to the federal enforcement authorities.

The Federal Reserve also supported the Omnibus Drug Initiative Act of 1988 which, among other provisions, intensified the recordkeeping requirements of banks that sell monetary instruments to nondeposit customers and provided the Secretary of the Treasury with the authority to conduct regional investigations of money laundering.

## 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 1988 there were 560 "G-lenders," of which 310 were subject to the Board's supervision. Of these 310, 171 were subject to regular inspection by the Federal Reserve System. During the year, Federal Reserve examiners inspected 53 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 G and U in general impose credit limits on loans whose purpose is the purchasing or carrying of publicly held equity securities and that are secured by such securities.

Regulation T limits the amount of credit that brokers and dealers may extend when securities serve as collateral for credit that is used to purchase or carry securities. This collateral must consist of stocks and bonds traded on national securities exchanges, of certain over-the-counter stocks that the Board designates as having characteristics similar to those of stocks listed on national exchanges, or of bonds meeting certain requirements.

The Division of Banking Supervision and Regulation monitors the market

activity of all over-the-counter (OTC) stocks to determine what stocks are subject to the Board's margin requirements. In 1988 the Board published the resulting "List of Marginable OTC Stocks" in February, May, August, and November. The November list consisted of 3,111 stocks.

In August 1988 the Board amended Regulation T, revising the definition of "OTC margin bond" to include certain foreign sovereign debt securities. The amendment permits broker-dealers to extend good faith loan value on long-term debt securities issued or guaranteed as a general obligation by a foreign sovereign, its provinces, states, or cities, or a supranational entity if there is available an explicit or implicit rating of the entity in one of the two highest rating categories by a nationally recognized statistical rating organization.

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 of securities. During the year, the Board processed three such agreements.

In 1988 the Securities Regulation Section of the Division of Banking Supervision and Regulation issued 65 interpretations of the margin regulations. Those that presented sufficiently impor-

tant or novel issues were published in the "Securities Credit Transactions Handbook," which is part of the Federal Reserve Regulatory Service. These interpretations serve as a guide to the margin regulations.

### Financial Disclosure by State Member Banks

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. The Board's financial disclosure rules are required by statute to be substantially similar to those issued by the Securities and Exchange Commission.

In 1988 the Board implemented a comprehensive revision of its reporting requirements that rescinded Regulation F in its entirety and added a new disclosure rule as part of Regulation H. To ease compliance, the new rule requires banks subject to Regulation H to use the forms prescribed by the Securities and Exchange Commission and receive annual audits of their financial statements. Small banks have the option of filing simplified quarterly reports.

At the end of 1988, 37 state member banks, most of which are of small or medium size, were registered with the Board under the Securities Exchange Act. Members of the Board's staff review the bank disclosures for compliance with the regulation.

#### Loans by State Member Banks to their Executive Officers, 1987-88

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
October 1-December 31, 1987 .....	1,132	21,817,715	6.0-20.5
January 1-March 31, 1988 .....	1,039	19,447,137	6.0-20.0
April 1-June 30, 1988 .....	1,078	20,166,780	6.5-21.0
July 1-September 30, 1988 .....	1,019	21,199,836	6.6-21.0

### **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 1987 and the first three quarters of 1988.

### **Federal Reserve Membership**

At the end of 1988, 5,450 banks were members of the Federal Reserve System, a decrease of 299 from the previous year. Member banks operated 30,391 branches on December 31, 1988, a net increase of 1,131 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. ■



## *Regulatory Simplification*

In 1978 the Board of Governors established the Regulatory Improvement Project, in the Office of the Secretary, 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. Under the program, Board staff members periodically review all existing regulations for adherence to these objectives. In 1986 the Board reaffirmed its commitment to regulatory improvement, renaming the project the Regulatory Review Section and creating a subcommittee of the Board called the Regulatory Policy and Planning Committee.

### **Availability of Information**

In the spring of 1987 the Board adopted a revised version of its "Rules Regarding Availability of Information." These rules cover three broad areas: requests under the Freedom of Information Act, handled by the Secretary of the Board; subpoenas, inquiries regarding law enforcement, and similar matters, handled by the Board's General Counsel; and the routine disclosure of supervisory activities, traditionally handled by the Staff Director of the Board's Division of Banking Supervision and Regulation and staff members at the Federal Reserve Banks. This revision, the first since the Board promulgated the rules in 1967, incorporates many procedures developed by the staff or suggested by the courts in the intervening years.

### **Home Mortgage Disclosure**

The Board revised its Regulation C to incorporate the 1988 amendments to the Home Mortgage Disclosure Act of 1975, which permanently extended the act and expanded its coverage to include mortgage banking subsidiaries of holding companies of depository institutions and savings and loan service corporations that originate or purchase mortgage loans. In adopting the final regulation, the Board made some changes in its proposed definitions to ensure that institutions already reporting under the act would not be subject to additional reporting burdens.

In the process of this revision, obsolete provisions were deleted, footnotes were either incorporated or eliminated, and the instructions to the report forms were significantly reworked to make them easier to follow.

### **Debt-Equity Swaps**

In August 1987 the Board liberalized provisions to Regulation K to permit certain investments abroad by U.S. banking organizations through swaps of debt for equity. In February 1988 the Board further liberalized the regulation as it applies to debt-for-equity investments in heavily indebted developing countries.

The new provisions permit investors to acquire up to 40 percent of the equity of foreign companies engaged in nonfinancial activities in the context of exchanging sovereign debt obligations for ownership interests in the companies. The revisions extend to 15 years the time period that companies acquired through the debt-for-equity conversions could be

held; the revisions also increased the amount that organizations may invest without giving prior notice to the Board, to the greater of \$15 million or 1 percent of the tangible equity of the bank holding company.

### **Issuance of Foreign Currency Deposits**

In light of the globalization of financial market transactions and the continuation of financial innovations, the Board decided that the Federal Reserve would no longer discourage the issuance of foreign currency deposits in the United States. The decision will become effective on January 1, 1990, to permit time for financial institutions to develop the procedures for handling the reporting of such accounts. The Board does not anticipate a significant demand for foreign currency deposits, in part because of the availability of competing instruments and also because foreign currency deposits will be subject to reserve requirements.

### **OTC Margin Bond**

The Board amended the definition of "OTC margin bond" in Regulation T (Credit by Brokers and Dealers) to make certain foreign sovereign debt securities marginable. The amendment permits brokers and dealers to extend "good faith" loan value on long-term debt securities issued as a general obligation by a foreign sovereign or supranational entity if these securities are given one of the two highest rating categories by a nationally recognized statistical rating organization. The amendment gives parity to U.S. broker-dealers with regard to banks and foreign dealers, who already could extend such credit.

### **Efforts to Assist Regulatory Compliance**

The Board created a special form of information release called a Special Notice to assist depository institutions in complying with the Expedited Funds Availability Act and the rule, Regulation CC, that implements it. The Board took this unusual step because the law and regulation is extremely lengthy, the time for compliance was short, and many financial institutions thought they were exempt because they provided next-day availability of funds.

One Special Notice, entitled "You Are Affected by the Expedited Funds Availability Law" and issued in June 1988, provided a one-page checklist of policies and notices that institutions had to have in place by September 1, the implementation date of the regulation. The notice also gave step-by-step instructions on compliance and provided sample forms that institutions could use in complying with the requirements for informing customers. The other Special Notice, issued in August, addressed the new endorsement standards to be used on the back of checks.

The Federal Reserve Banks sent the Special Notices to all depository institutions in the United States, and the Board provided ready-to-print copy to relevant trade associations to facilitate their distribution of the information. ■

## *Federal Reserve Banks*

The Expedited Funds Availability Act, which requires the Federal Reserve to ensure the prompt availability of deposited funds according to mandated schedules and to expedite the return of checks, was a major focus of the System's activities in 1988. The legislation, title VI of Public Law 100-86, the Competitive Equality Banking Act of 1987, was enacted in August 1987 and became effective on September 1, 1988 (see also "Record of Policy Actions of the Board of Governors" in this REPORT).

### **Regulation CC**

In December 1987 the Board proposed for public comment Regulation CC, which implements the Expedited Funds Availability Act. To better prepare the public to comment on the Board's proposals, the Reserve Banks during January 1988 conducted more than 220 seminars attended by about 17,000 participants from nearly 9,000 depository institutions to explain the provisions of the act and the proposed regulation. The Board received more than 1,000 comments on the proposals. After the Board approved the final Regulation CC in May, the Reserve Banks conducted an additional 290 seminars attended by approximately 37,000 participants from more than 16,000 depository institutions to explain the provisions of the regulation and the actions banks must take to comply.

In April the Board requested comment on a proposed concept under which banks presented with checks before 2:00 p.m. would be required to pay those checks with same-day funds without imposing presentment fees. The Board will analyze the more than 1,100 comments it received

to determine whether to put the idea into a formal regulatory proposal to be issued for public comment.

Also in April the Board approved standards to be used by depository institutions when endorsing checks during the collection and return process (appendix D of Regulation CC). The standard is designed to promote clear and uniform endorsements and to make it easier for paying banks to return unpaid checks. In August the Board issued a Special Notice that clarified the endorsement requirements and discussed the consequences of not endorsing checks in accordance with the standard.

In June the Board requested comment on a proposed amendment to Regulation CC to address the delayed disbursement of teller's checks. In comments received on the original proposal for Regulation CC, some banks said that the requirement to provide next-day availability for teller's checks might be particularly unfair because some banks issue teller's checks drawn on remote banks. In these cases, the bank of first deposit may be required to make funds available for withdrawal before it could reasonably be expected to receive funds through the collection process. The rule proposed in June would permit a bank to issue an official check drawn on another bank only if a bank of first deposit located in the same community as the issuing bank could receive credit for the check as early as a check drawn on the issuing bank.

In October the Board requested comment on proposed clarifying amendments to Regulation CC designed to aid compliance.

Under Regulation CC, the Board determines, upon the request of a state,

bank, or other interested party, whether a state law related to funds availability is preempted by federal law. The Board has issued such determinations for the laws of California, Connecticut, Illinois, Maine, Massachusetts, New Jersey, New Mexico, New York, and Rhode Island, as well as for the provision in the Uniform Commercial Code governing the availability of cash deposits.

### **Other Developments in the Pricing of Federal Reserve Services and in the Payments Mechanism**

In 1988 the Federal Reserve System as a whole recovered 100.6 percent of its operating expenses and imputed costs, compared with 104.6 percent in 1987. The reduced rate of recovery is attributable primarily to the costs of providing new services on returned checks in accordance with Regulation CC.

Revenue at the Reserve Banks from all priced services totaled \$801.7 million, and costs were \$796.6 million, for net revenue of \$5.2 million (see the section on Federal Reserve Bank financial statements for priced services, at the end of this chapter). 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).

### **Check Collection**

The operating and imputed costs of check collection by the Federal Reserve in 1988 were \$499.0 million (see the pro forma income statement for priced services, by service, and note 9, at the end of this chapter). Check operations for the year generated \$513.8 million in revenue and a net of \$10.2 million in other income and expenses. The number of checks handled

by the Reserve Banks was 17.6 billion, an increase of 3.6 percent from 1987.

The Board approved the implementation of new Federal Reserve services designed to accelerate the processing of returned checks by the Federal Reserve Banks and thus facilitate compliance by banks with the check return rules of Regulation CC. The new return services, which are explicitly priced, became effective September 1, 1988. Returned check fees are assessed on the paying or returning bank depositing returned checks with the Federal Reserve Bank. Also on September 1, Federal Reserve forward collection fees were reduced because of the elimination of the return cost component in those fees. In June the Board approved the prices and deadlines for the new Federal Reserve returned check services as well as the revised prices and deadlines for Federal Reserve forward collection services.

In May the Board converted into permanent services the System's pilot programs for truncation and for the electronic delivery of information captured through Magnetic Ink Character Recognition (MICR). Reserve Banks will initially provide truncation services only to paying banks that request this service locally; eventually the System intends to offer a national service by truncating a check (holding the physical check and transmitting payment information electronically) at the first Federal Reserve Bank to receive the check. Under the extended MICR service, Reserve Banks would deliver payment information by electronic transmission or magnetic tape, provide returned check and retrieval service, and deliver the checks to the paying bank several days later.

On September 1 the Reserve Banks implemented the provisions of Regulation CC (Expedited Funds Availability Act). The Reserve Banks also implemented new services designed to reduce

the risk to depository banks from making funds available for withdrawal more promptly. The Reserve Banks began serving as returning banks, as defined by Regulation CC, and accepting returned checks from any paying bank or returning bank.

In order to expedite the return process, Reserve Banks began to send returned checks directly to the bank of first deposit, thus bypassing intermediary endorsers. The Reserve Banks began overnight processing of local returned checks for dispatch with the forward collection checks the next morning. Nonlocal returned checks are prepared for high-speed processing ("qualified") by the first Federal Reserve office and dispatched to the second Federal Reserve office the following night. Federal Reserve offices also accept returned checks that have been qualified by the paying bank or prior returning bank and dispatch them as quickly as forward collection checks.

Because of the requirement in Regulation CC for expanded notification of return, the Reserve Banks also began processing notifications at the request of the paying bank for delivery to the bank of first deposit of any returned check for an amount greater than \$2,500.

### Electronic Payments

The Federal Reserve System is conducting a strategic study of its electronic payments services in the 1990s. One phase of the study is an evaluation of alternative delivery systems for electronic payments. In 1988 the Federal Reserve issued a request for proposals to test new technology. Concurrently, the Reserve Banks are improving the reliability of their current operating systems. In addition, the Federal Reserve contacted representatives of depository institutions and other users of payment services 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 1988 were \$38.9 million; revenues were \$42.7 million. The Reserve Banks processed 602.4 million commercial transactions in 1988, an increase of 26.8 percent over 1987.

In July 1988, operational measures designed to reduce risk in the ACH mechanism became effective. The measures include uniform procedures for Reserve Banks to monitor ACH payments originated by financially weak depository institutions; earlier deposit deadlines for returns of ACH debit transactions of \$2,500 or more; and uniform procedures for depository institutions to account for credit transactions that settle on holidays or other days when the institutions are closed.

Board staff members continued their analysis of the proposal, offered in December 1986, to modify the procedures for measuring daylight overdrafts and to redefine the finality of ACH transactions. The Board took no final action on the proposal in 1988.

Finally, the Reserve Banks continued to make progress in increasing the number of electronic connections to depository institutions for the delivery of ACH transactions. The Reserve Banks deployed a new software product by which depository institutions can gain access to Federal Reserve services, including ACH, through personal computers. The product should expand the electronic delivery of ACH transactions.

### Wire Transfer of Funds

The number of wire transfers originated during 1988 increased 5.7 percent over

1987, to 56.3 million. Service costs totaled \$64.3 million, while revenue amounted to \$69.6 million. In 1988 the basic fee for funds transfers was reduced from \$0.50 to \$0.47.

By year-end 1988, almost all electronic connections between Reserve Banks and depository institutions for funds transfers via low-volume computer terminals were converted to standard protocols and encrypted. The System also converted more than one-third of its high-volume connections by year-end.

To reduce the risk of service disruptions, the Reserve Banks completed a test to evaluate ways to process work for each other during a serious interruption in operations. The results led to improvements in the reliability of Federal Reserve electronic payment services. In November 1988 the Board approved the creation of a contingency processing center at the Los Angeles Branch to handle funds transfers, securities transfers, and ACH and accounting operations in the event of a severe interruption of service at the Federal Reserve Bank of San Francisco.

### 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 for currency in circulation.

Priced cash services received \$14.9 million in revenue in 1988; the cost of these services was \$14.2 million. In 1988, four Federal Reserve Districts provided transportation of cash by armored carrier and four Districts provided wrapped coin to depository institutions.

Major undertakings in 1988 included a determination of the optimal level of quality for the currency distributed to the public by Federal Reserve Banks. The

Federal Reserve also initiated a major automation effort that will enable the Board, the Reserve Banks, the Bureau of Engraving and Printing, and the U.S. Mint to better manage the supply of cash through the exchange of data. The Federal Reserve also continued to work with the Department of the Treasury to deter the counterfeiting of U.S. currency.

### Definitive Securities and Noncash Collection

The System received \$17.9 million in revenue for definitive safekeeping and noncash collection services in 1988; the cost of these services was \$16.7 million. The average number of definitive-securities issues and deposits maintained in safekeeping accounts at the Reserve Banks decreased 15.6 percent in 1988, to 138,000. The number of noncash collection items processed decreased 12.2 percent, to 3.3 million. Reserve Banks continue to search for ways to reduce costs as the volume of work decreases in both the definitive safekeeping and non-cash collection services.

### 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. Book-entry services for federal agency securities are treated as a Federal Reserve priced service; these services incurred costs of \$8.4 million and earned revenue of \$8.7 million in 1988. The Federal Reserve processed 2.2 million such transfers during the year, an increase of 8.5 percent from 1987.

The Federal Reserve sells savings bonds in its role as fiscal agent. Under a pilot program begun in 1987 and continued in 1988, the Ohio Over-the-Counter Savings Bonds project, all savings bonds sold over-the-counter in Ohio are being issued at the Pittsburgh Branch of the Federal Reserve Bank of Cleveland rather than at the financial institutions receiving the applications for purchase. The data from the pilot program indicate that centralized issuance saves money for the government and is acceptable to investors.

### Float

Federal Reserve float increased to a daily average of \$606 million in 1988, compared with \$454 million in 1987. 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.

### Income and Expenses

The accompanying table summarizes the income, expenses, and distribution of net earnings of the Federal Reserve Banks for 1988 and 1987.

Income, at \$19,526 million, was 10.7 percent higher than in 1987, primarily because of an increase of \$1,808 million in earnings on the System's holdings of

Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1988 and 1987<sup>1</sup>

Thousands of dollars

Item	1988	1987
Current income .....	19,526,431	17,633,012
Current expenses .....	1,205,960	1,146,911
Operating expenses <sup>2</sup> .....	1,081,685	1,033,288
Earnings credits granted .....	124,276	113,623
Current net income .....	18,320,471	16,486,101
Net addition to (deduction from) current net income .....	-489,058	1,843,552
Cost of unreimbursed services to Treasury .....	27,852	46,958
Assessments by the Board of Governors .....	248,655	252,545
For expenditures of Board .....	84,411	81,870
For cost of currency .....	164,245	170,675
Net income before payments to Treasury .....	17,554,906	18,030,150
Dividends paid .....	125,616	117,499
Payments to Treasury (interest on Federal Reserve notes) .....	17,364,319	17,738,880
Transferred to surplus .....	64,971	173,771

1. Details may not add to totals because of rounding.

2. Operating expenses include a net periodic credit for

pension costs of \$70 million in 1988 and \$49 million in 1987.

U.S. government securities. Total expenses were \$1,290 million (\$1,082 million in Reserve Bank operating expenses, \$124 million in earnings credits granted to depository institutions, and \$84 million in assessments for expenditures by the Board of Governors). The cost of currency was \$164 million. Income from financial services was \$657 million.

The profit and loss account showed a net deduction of \$489 million, resulting primarily from losses on assets denominated in foreign currencies. Statutory dividends to member banks totaled \$126 million, \$8 million more than in 1987. 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, termed interest on Federal Reserve notes, totaled \$17,364 million, compared with \$17,739 million in 1987. The payments consist of all income after the deduction of dividends and after the deduction of 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 1988, and table 7 shows a condensed statement for each Bank for 1914-88. A detailed account of the assessments and expenditures of the Board of Governors appears in the next chapter, "Board of Governors Financial Statements."

### Federal Reserve Bank Premises

During 1988 the Board of Governors authorized purchases of property for future expansion at the Atlanta Bank and at the Houston Branch of the Dallas Bank. The New York Bank initiated the design of its new operations center and the Minneapolis Bank completed the design of a new building for the Helena Branch. Construction of the new building for the Charlotte Branch of the Richmond Bank and the expansion of the main building of the Chicago Bank continued. Table 8, in the Statistical Tables section of this REPORT, shows the cost and book value of premises owned by the Federal Reserve Banks and Branches and of real estate acquired for future banking-house purposes.

### Securities and Loans of Federal Reserve Banks, 1986-88

Millions of dollars, except as noted

Item and year	Total	U.S. government securities <sup>1</sup>	Loans
<i>Average daily holdings<sup>2</sup></i>			
1986 .....	193,354	192,514	840
1987 .....	217,392	216,722	670
1988 .....	233,796	231,442	2,354
<i>Earnings</i>			
1986 .....	16,199	16,142	57
1987 .....	16,418	16,371	47
1988 .....	18,358	18,180	179
<i>Average interest rate (percent)</i>			
1986 .....	8.38	8.38	6.84
1987 .....	7.55	7.55	6.99
1988 .....	7.85	7.85	7.59

1. Includes federal agency obligations.

2. Based on holdings at opening of business.



**Holdings of Securities and Loans**

As shown in the preceding table, average daily holdings of securities and loans during 1988 amounted to \$233,796 million, an increase of \$16,404 million over 1987. Holdings of U.S. government securities increased \$14,720 million and loans increased \$1,684 million.

From 1987 to 1988 the average rate of interest on holdings of U.S. government securities increased, from 7.55 percent to 7.85 percent; and the average rate of interest on loans increased, from 6.99 percent to 7.59 percent.

**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 1985-88.

**Financial Statements for Priced Services**

The following tables show pro forma statements for priced services for 1988, including a balance sheet, income statements, and a breakdown of volumes.

**PRO FORMA BALANCE SHEET FOR PRICED SERVICES**

	As of December 31 (millions)	
	1988	1987
<b>SHORT-TERM ASSETS (Note 1)</b>		
Imputed reserve requirements on clearing balances .....	\$ 222.0	\$ 219.6
Investment in marketable securities .....	1,628.0	1,610.4
Receivables .....	57.7	58.3
Materials and supplies .....	6.4	4.9
Prepaid expenses .....	10.9	6.7
Net items in process of collection (float) .....	<u>967.0</u>	<u>675.7</u>
Total short-term assets .....	\$2,892.0	\$2,575.5
<b>LONG-TERM ASSETS (Note 2)</b>		
Premises .....	271.8	224.5
Furniture and equipment .....	126.1	110.9
Leases and leasehold improvements .....	6.1	3.0
Prepaid pension costs .....	<u>37.4</u>	<u>18.7</u>
Total long-term assets .....	441.4	357.1
<b>TOTAL ASSETS</b> .....	<u>\$3,333.4</u>	<u>\$2,932.7</u>
<b>SHORT-TERM LIABILITIES</b>		
Clearing balances and balances arising from early credit of uncollected items .....	\$2,817.0	\$2,505.7
Short-term debt .....	<u>75.0</u>	<u>69.9</u>
Total short-term liabilities .....	\$2,892.0	\$2,575.5
<b>LONG-TERM LIABILITIES</b>		
Obligations under capital leases .....	1.2	1.2
Long term debt .....	<u>128.1</u>	<u>107.2</u>
Total long-term liabilities .....	129.3	108.4
<b>TOTAL LIABILITIES</b> .....	3,021.3	2,684.0
<b>EQUITY</b> .....	<u>312.1</u>	<u>248.7</u>
<b>TOTAL LIABILITIES AND EQUITY (Note 3)</b> .....	<u>\$3,333.4</u>	<u>\$2,932.7</u>

Details may not add to totals because of rounding.

The accompanying notes are an integral part of these financial statements.

## PRO FORMA INCOME STATEMENT FOR PRICED SERVICES

	For the years ending December 31 (millions)	
	1988	1987
INCOME (Note 4)		
Services provided to depository institutions .....	\$667.7	\$649.7
EXPENSES (Note 5)		
Production expenses .....	<u>552.9</u>	<u>506.8</u>
INCOME FROM OPERATIONS .....	114.8	142.9
IMPUTED COSTS (Note 6)		
Interest on float .....	\$ 43.4	\$ 27.4
Interest on debt .....	16.2	16.1
Sales taxes .....	8.4	7.4
FDIC insurance .....	<u>1.8</u>	<u>1.8</u>
INCOME FROM OPERATIONS AFTER IMPUTED COSTS .....	44.9	90.2
OTHER INCOME AND EXPENSES (Note 7)		
Investment income .....	134.0	119.1
Earnings credits .....	<u>123.0</u>	<u>114.1</u>
INCOME BEFORE INCOME TAXES .....	55.9	95.2
IMPUTED INCOME TAXES (Note 8) .....	<u>18.1</u>	<u>32.3</u>
NET INCOME .....	<u>\$ 37.9</u>	<u>\$ 62.9</u>
MEMO		
Targeted return on equity (Note 8) .....	<u>\$ 32.7</u>	<u>\$ 29.3</u>

Details may not add to totals because of rounding.  
The accompanying notes are an integral part of these financial statements.

PRO FORMA INCOME STATEMENT FOR PRICED SERVICES, BY SERVICE  
(Note 9)

For the year ending December 31, 1988 (millions)

	Total	Com- mercial check collection	Wire transfer and net settlement	Com- mercial ACH	Definitive safekeeping and noncash collection	Book- entry securities	Cash services
INCOME FROM SERVICES .....	\$667.7	\$513.8	\$69.6	\$42.7	\$17.9	\$8.7	\$14.9
OPERATING EXPENSES .....	<u>552.9</u>	<u>436.6</u>	<u>61.2</u>	<u>36.2</u>	<u>15.8</u>	<u>7.7</u>	<u>14.1</u>
INCOME FROM OPERATIONS ...	114.8	77.2	8.4	6.6	2.1	1.0	.8
IMPUTED COSTS .....	<u>69.9</u>	<u>62.4</u>	<u>3.1</u>	<u>2.7</u>	<u>.9</u>	<u>.7</u>	<u>.1</u>
INCOME FROM OPERATIONS AFTER IMPUTED COSTS ..	44.9	14.7	5.4	3.9	1.2	.3	.7
OTHER INCOME AND EXPENSES, NET .....	<u>11.0</u>	<u>10.2</u>	<u>.3</u>	<u>.3</u>	<u>.1</u>	<u>*</u>	<u>.1</u>
INCOME BEFORE INCOME TAXES .....	\$ 55.9	\$ 24.9	\$ 5.7	\$ 4.2	\$ 1.3	\$ .3	\$ .8

\*Less than \$500,000 in absolute value.  
Details may not add to totals because of rounding.  
The accompanying notes are an integral part of these financial statements.

**REVENUE AND EXPENSES OF LOCALLY PRICED SERVICES**  
(Note 10)

For the year ending December 31, 1988 (millions)

	Total revenue	Operating cost	Float cost	Total cost	Net revenue
<i>Commercial check collection</i>					
Boston .....	\$ 36.6	\$ 31.6	\$ 4.4	\$ 36.0	\$ .6
New York .....	66.4	59.6	6.9	66.4	*
Philadelphia .....	24.7	18.7	1.1	19.8	4.8
Cleveland .....	30.1	25.4	1.7	27.0	3.0
Richmond .....	48.2	38.7	2.9	41.6	6.6
Atlanta .....	59.3	53.3	.6	53.9	5.4
Chicago .....	71.3	56.8	4.2	61.0	10.2
St. Louis .....	22.8	19.4	2.3	21.7	1.1
Minneapolis .....	29.4	24.9	.4	25.3	4.1
Kansas City .....	32.6	29.1	1.5	30.6	2.0
Dallas .....	37.7	30.5	2.6	33.1	4.6
San Francisco .....	54.6	44.5	5.6	50.1	4.5
System total .....	\$513.8	\$435.3	\$34.2	\$469.6	\$44.2
<i>Definitive safekeeping and noncash collection</i>					
Boston .....	\$ .8	\$ .7	*	\$ .7	\$ .1
New York .....	2.9	2.5	*	2.4	.4
Philadelphia .....	1.3	1.2	*	1.2	.1
Cleveland .....	2.1	1.8	.1	1.9	.2
Richmond .....	.9	.9	*	.9	*
Atlanta .....	2.6	2.4	*	2.3	.3
Chicago .....	2.7	2.0	*	2.0	.6
St. Louis .....	1.2	1.1	*	1.1	.1
Minneapolis .....	.9	1.0	*	.9	-.1
Kansas City .....	1.5	1.3	*	1.3	.2
Dallas .....	1.3	1.0	*	1.0	.2
San Francisco .....	*	*	*	*	*
System total .....	\$17.9	\$15.8	*	\$15.8	\$2.2
<i>Cash services</i>					
Boston .....	\$ .7	...	...	\$ .7	*
New York .....	*	...	...	*	*
Philadelphia .....	1.6	...	...	1.5	*
Cleveland .....	1.9	...	...	1.8	.2
Richmond .....	.1	...	...	.1	*
Atlanta .....	*	...	...	*	*
Chicago .....	.5	...	...	.4	*
St. Louis .....	.3	...	...	.3	*
Minneapolis .....	2.8	...	...	2.5	.3
Kansas City .....	.5	...	...	.5	*
Dallas .....	*	...	...	*	*
San Francisco .....	6.5	...	...	6.3	.2
System total .....	\$14.9	...	...	\$14.1	\$ .8

\*Less than \$500,000 in absolute value.

Details may not add to totals because of rounding.

The accompanying notes are an integral part of these financial statements.

**PRICED SERVICES VOLUMES**  
(Note 11)

Thousands of items, except as noted

	1988	1987	1986	Percent change	
				1987-88	1986-87
Fund transfers .....	56,334	53,278	49,900	5.7	7.1
Commercial ACH .....	602,406	475,114	362,557	26.8	31.0
Commercial checks .....	17,617,744	17,007,924	16,225,812	3.6	4.8
Securities transfers .....	2,236	2,061	1,719	8.5	19.9
Definitive safekeeping .....	138	163	165	-15.6	-1.0
Noncash collection .....	3,337	3,803	4,312	-12.2	-11.8
Cash transportation .....	341	357	363	-4.6	-1.4

The accompanying notes are an integral part of these financial statements.

**NOTES TO FEDERAL RESERVE BANK  
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 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 include 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 of \$18.7 million and a corresponding increase in this long-term asset account in 1988.

**(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 model for the private sector adjustment factor (PSAF). 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 1988 and in 1987. 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, during 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 1988. In the table, unrecovered float includes that generated by services to government agencies or by other central bank services.

Float recovered through income on clearing balances represents increased investable 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 interterritory 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 1988.

	Daily average (millions)
Total float .....	\$931.2
Unrecovered float .....	55.8
Float subject to recovery .....	875.4
Sources of recovery of float	
Income on clearing balances .....	105.4
As of adjustments .....	325.3
Direct charges .....	121.2
Per-item fees .....	323.6

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 3).

PRO FORMA INCOME STATEMENT, 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 include 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 consist 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 because 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. Expenses related to research and development projects are reported at the System level; the sum of expenses for the 12 Districts may not, therefore, equal the System total. 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. ■

# *Board of Governors Financial Statements*

The financial statements of the Board for the years 1988 and 1987 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 cash flows present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System at December 31, 1988 and 1987, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Board's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards and the financial audit standards in *Government Auditing Standards* issued by the Comptroller General. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.



Washington, D.C.  
February 24, 1989

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**  
**BALANCE SHEETS**

ASSETS	As of December 31,	
	1988	1987
<b>CURRENT ASSETS</b>		
Cash .....	\$ 7,312,846	\$ 7,705,996
Accounts receivable .....	602,478	908,883
Stockroom and cafeteria inventories, at cost .....	333,601	244,963
Prepaid expenses and other assets .....	654,077	760,903
Total current assets .....	<u>8,903,002</u>	<u>9,620,745</u>
PROPERTY, BUILDINGS AND EQUIPMENT, Net (Note 3) .....	58,487,676	63,356,924
OTHER ASSETS .....	-	429,357
Total assets .....	<u>\$67,390,678</u>	<u>\$73,407,026</u>
<b>LIABILITIES AND FUND BALANCE</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable .....	\$ 4,020,776	\$ 4,593,746
Accrued payroll and related taxes .....	2,915,138	2,547,172
Accrued annual leave .....	4,288,264	4,185,226
Other liabilities (Note 4) .....	<u>833,578</u>	<u>237,951</u>
Total current liabilities .....	<u>12,057,756</u>	<u>11,564,095</u>
FUND BALANCE .....	55,332,922	61,842,931
Total liabilities and fund balance .....	<u>\$67,390,678</u>	<u>\$73,407,026</u>

The accompanying notes are an integral part of these statements.



**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**  
**STATEMENTS OF REVENUES AND EXPENSES**  
**AND FUND BALANCE**

	For the years ended December 31,	
	1988	1987
<b>BOARD OPERATING REVENUES</b>		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures .....	\$ 84,410,500	\$ 81,869,800
Other revenues (Note 4) .....	<u>3,460,332</u>	<u>3,645,891</u>
Total operating revenues .....	<u>87,870,832</u>	<u>85,515,691</u>
<b>BOARD OPERATING EXPENSES</b>		
Salaries .....	56,229,044	53,811,021
Retirement and insurance contributions .....	7,095,176	6,245,296
Depreciation and losses (gains) on disposals .....	7,601,609	7,530,325
Travel .....	3,171,355	2,834,715
Utilities .....	3,169,953	3,195,502
Repairs and maintenance .....	3,099,672	2,731,026
Contractual services and professional fees .....	3,062,980	2,235,129
Postage and supplies .....	3,035,304	3,218,518
Software .....	2,461,366	2,764,635
Printing and binding .....	2,305,362	1,867,291
Equipment and facility rentals .....	876,944	1,398,787
Other expenses (Note 4) .....	<u>2,272,076</u>	<u>2,089,415</u>
Total operating expenses .....	<u>94,380,841</u>	<u>89,921,660</u>
BOARD OPERATING REVENUES (UNDER) EXPENSES .....	<u>(6,510,009)</u>	<u>(4,405,969)</u>
<b>ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES</b>		
Assessments levied on Federal Reserve Banks for currency costs .....	164,975,182	170,700,082
Expenses for currency printing, issuance, retirement, shipping, and research costs .....	<u>164,975,182</u>	<u>170,700,082</u>
CURRENCY ASSESSMENTS (UNDER) OVER EXPENSES .....	<u>—</u>	<u>—</u>
TOTAL REVENUES (UNDER) EXPENSES .....	<u>(6,510,009)</u>	<u>(4,405,969)</u>
FUND BALANCE, Beginning of year .....	<u>61,842,931</u>	<u>66,248,900</u>
FUND BALANCE, End of year .....	<u>\$ 55,332,922</u>	<u>\$ 61,842,931</u>

The accompanying notes are an integral part of these statements.

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**  
**STATEMENTS OF CASH FLOWS**

	For the years ended December 31,	
	1988	1987
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income .....	\$(6,510,009)	\$(4,405,969)
Adjustments to reconcile net income to net cash		
Depreciation and losses (gains) on disposals .....	7,601,609	7,530,325
Decrease in accounts receivable, inventories and prepaid expenses, and other assets .....	324,593	1,044,021
Decrease in other non-current assets .....	429,357	1,279,149
Increase in accrued annual leave .....	103,038	288,828
Increase (decrease) in accounts payable, accrued payroll and related taxes, and other liabilities .....	390,623	(616,694)
Net cash provided by operating activities .....	2,339,211	5,119,660
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from disposals of furniture and equipment .....	42,608	33,334
Capital expenditures .....	(2,774,969)	(6,093,208)
Net cash used in investing activities .....	(2,732,361)	(6,059,874)
<b>NET DECREASE IN CASH</b> .....	(393,150)	(940,214)
<b>CASH BALANCE, Beginning of year</b> .....	7,705,996	8,646,210
<b>CASH BALANCE, End of year</b> .....	\$ 7,312,846	\$ 7,705,996

The accompanying notes are an integral part of these statements.

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1988 AND 1987

## (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 made prepayments for computer equipment to be received in future years. In addition, maintenance on this and other computer equipment received during 1987 and 1988 has been prepaid through January 1989. For 1987 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, 1988, actuarial calculations showed that the fair value of the assets of the System's Plan exceeded the projected benefit obligations by 61 percent. Based on these calculations and similar calculations performed for 1987, it was determined that employer funding contributions were not required for the years 1988 and 1987 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 \$555,700 in 1988 and \$547,000 in 1987.

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 \$1,594,000 in 1988 and \$1,491,000 in 1987.

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 \$245,400 in 1988 and \$166,800 in 1987.

## (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,	
	1988	1987
Land and improvements . . . . .	\$ 1,301,314	\$ 1,301,314
Buildings . . . . .	63,290,586	62,903,355
Furniture and equipment . . . . .	38,865,250	37,005,912
	103,457,150	101,210,581
Less accumulated depreciation . . . . .	44,969,474	37,853,657
Total property, buildings and equipment . . . . .	<u>\$ 58,487,676</u>	<u>\$ 63,356,924</u>

## (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,	
	1988	1987
Other Revenues		
Contingency Processing Center fees . . . . .	\$1,672,667	\$1,593,050
Subscription revenues . . . . .	924,783	1,418,513
Miscellaneous . . . . .	862,882	634,328

## (4) OTHER REVENUES AND OTHER EXPENSES—Cont.

Total other revenues .....	<u>\$3,460,332</u>	<u>\$3,645,891</u>
Other Expenses		
Subsidies and contributions ...	\$ 697,237	\$ 649,919
Tuition, registrations and membership fees .....	571,271	517,097
Cafeteria operations, net .....	598,004	560,282
Miscellaneous .....	<u>405,564</u>	<u>362,117</u>
Total other expenses .....	<u>\$2,272,076</u>	<u>\$2,089,415</u>

Beginning in 1988, the Board began recognizing income from sale of publication subscriptions as revenue over the period the publications and statistical releases are supplied to the subscriber rather than the cash basis previously followed. Of \$1,574,783 received in 1988, \$650,000 represents unearned subscription revenue which is included in other liabilities.

(5) FEDERAL FINANCIAL INSTITUTIONS  
EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1988 and 1987, the Board paid \$187,200 and \$162,000, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1988 and 1987.

The Board serves as custodian for the Council's cash account. This cash is not reflected in the accompanying financial statements. It also processes accounting transactions, including payroll for most of the Council employees, and performs other administrative services for which the Board was reimbursed \$31,700 in each of the years 1988 and 1987.

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. ■

---

# *Statistical Tables*

1. Detailed Statement of Condition of All Federal Reserve Banks Combined,  
December 31, 1988<sup>1</sup>

ASSETS		
Gold certificate account .....		11,059,988
Special drawing rights certificate account .....		5,018,000
Coin .....		397,593
<i>Loans and securities</i>		
Loans to depository institutions .....	2,171,233	
Federal agency obligations		
Bought outright .....	6,966,477	
Held under repurchase agreement .....	2,100,735	
U.S. Treasury securities		
Bought outright		
Bills .....	112,781,960	
Notes .....	90,950,477	
Bonds .....	29,929,395	
Total bought outright .....	233,661,832	
Held under repurchase agreement .....	4,760,465	
Total securities .....	238,422,297	
Total loans and securities .....		249,660,742
<i>Items in process of collection</i>		
Transit items .....	6,943,601	
Other items in process of collection .....	1,795,238	
Total items in process of collection .....		8,738,839
<i>Bank premises</i>		
Land .....	108,905	
Buildings (including vaults) .....	564,838	
Building machinery and equipment .....	171,938	
Construction account .....	95,876	
Total bank premises .....	832,652	
Less depreciation allowance .....	192,971	639,681
Bank premises, net .....		748,586
<i>Other assets</i>		
Furniture and equipment .....	621,499	
Less depreciation .....	348,341	
Total furniture and equipment, net .....	273,158	
Denominated in foreign currencies <sup>2</sup> .....	9,128,949	
Interest accrued .....	3,182,481	
Premium on securities .....	1,691,882	
Due from Federal Deposit Insurance Corporation .....	3,316,178	
Overdrafts .....	56,259	
Prepaid expenses .....	158,108	
Suspense account .....	66,269	
Real estate acquired for banking-house purposes .....	7,038	
Other .....	172,120	
Total other assets .....		18,052,442
<b>Total assets .....</b>		<b>293,675,190</b>

## 1. -- Continued

LIABILITIES	
<i>Federal Reserve Notes</i>	
Outstanding (issued to Federal Reserve Banks) .....	271,492,172
Less held by Federal Reserve Banks .....	<u>41,852,740</u>
<b>Total Federal Reserve notes, net .....</b>	<b>229,639,432</b>
<i>Deposits</i>	
Depository institutions .....	<b>39,346,294</b>
U.S. Treasury, general account .....	<b>8,656,496</b>
Foreign, official accounts .....	<b>346,951</b>
<i>Other deposits</i>	
Officers' and certified checks .....	21,096
International organizations .....	87,001
Other <sup>3</sup> .....	<u>442,027</u>
<b>Total other deposits .....</b>	<b>550,124</b>
Deferred credit items .....	<b>7,451,424</b>
<i>Other liabilities</i>	
Discount on securities .....	3,335,154
Sundry items payable .....	50,656
Suspense account .....	44,948
All other .....	<u>28,579</u>
<b>Total other liabilities .....</b>	<b>3,459,337</b>
<b>Total liabilities .....</b>	<b><u>289,450,058</u></b>
CAPITAL ACCOUNTS	
Capital paid in .....	<b>2,112,566</b>
Surplus .....	<b>2,112,566</b>
Other capital accounts <sup>4</sup> .....	<u>0</u>
<b>Total liabilities and capital accounts .....</b>	<b><u>293,675,190</u></b>

1. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.

2. Of this amount \$1,478.8 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.

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.

2. Statement of Condition of Each Federal Reserve Bank,  
December 31, 1988 and 1987

Millions of Dollars

Item	Total		Boston	
	1988	1987	1988	1987
<b>ASSETS</b>				
Gold certificate account.....	11,060	11,078	680	706
Special drawing rights certificate account.....	5,018	5,018	314	314
Coin.....	395	408	20	27
<i>Loans</i>				
To depository institutions.....	2,170	3,815	42	47
Other.....	0	0	0	0
Acceptances held under repurchase agreements.....	0	0	0	0
<i>Federal agency obligations</i>				
Bought outright.....	6,966	7,553	423	466
Held under repurchase agreements.....	2,101	1,316	0	0
<i>U.S. Treasury securities</i>				
Bought outright <sup>1</sup> .....	233,662	218,906	14,181	13,502
Held under repurchase agreements.....	4,760	3,645	0	0
Total loans and securities.....	249,659	235,235	14,646	14,015
Items in process of collection.....	8,739	7,990	480	501
Bank premises.....	750	705	92	93
<i>Other assets</i>				
Denominated in foreign currencies <sup>2</sup> .....	0	7,773	0	257
All other.....	18,053	7,359	613	275
Interdistrict Settlement Account.....	0	0	605	-1,124
<b>Total assets.....</b>	<b>293,674</b>	<b>275,566</b>	<b>17,450</b>	<b>15,064</b>
<b>LIABILITIES</b>				
Federal Reserve notes.....	229,640	212,890	14,322	12,503
<i>Deposits</i>				
Depository institutions.....	39,347	41,784	2,386	1,863
U.S. Treasury, general account.....	8,656	5,313	0	0
Foreign, official accounts.....	347	244	5	5
Other.....	548	1,027	20	34
Total deposits.....	48,898	48,368	2,411	1,902
Deferred credit items.....	7,453	7,179	373	355
Other liabilities and accrued dividends <sup>3</sup> .....	3,457	3,035	194	168
<b>Total liabilities.....</b>	<b>289,448</b>	<b>271,472</b>	<b>17,300</b>	<b>14,928</b>
<b>CAPITAL ACCOUNTS</b>				
Capital paid in.....	2,113	2,047	75	68
Surplus.....	2,113	2,047	75	68
Other capital accounts.....	0	0	0	0
<b>Total liabilities and capital accounts.....</b>	<b>293,674</b>	<b>275,566</b>	<b>17,450</b>	<b>15,064</b>
<b>FEDERAL RESERVE NOTE STATEMENT</b>				
Federal Reserve notes outstanding (issued to Bank).....	271,492	253,313	16,862	15,123
Less: Held by Bank.....	41,852	40,423	2,540	2,620
<b>Federal Reserve notes, net.....</b>	<b>229,640</b>	<b>212,890</b>	<b>14,322</b>	<b>12,503</b>
<i>Collateral for Federal Reserve notes</i>				
Gold certificate account.....	11,060	11,078	...	...
Special drawing right certificate account.....	5,018	5,018	...	...
Other eligible assets.....	...	...	...	...
U.S. Treasury and federal agency securities.....	213,562	196,794	...	...
<b>Total collateral.....</b>	<b>229,640</b>	<b>212,890</b>	...	...



2. - Continued

New York		Philadelphia		Cleveland		Richmond	
1988	1987	1988	1987	1988	1987	1988	1987
3,310	3,177	389	385	655	664	917	933
1,489	1,489	162	162	314	314	461	461
14	16	29	24	25	28	62	63
34	2,787	168	131	890	63	122	181
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2,381	2,430	197	229	402	453	541	638
2,101	1,316	0	0	0	0	0	0
79,855	70,430	6,624	6,624	13,498	13,130	18,142	18,497
4,760	3,645	0	0	0	0	0	0
89,131	80,608	6,989	6,984	14,790	13,646	18,805	19,316
1,235	934	421	478	244	294	459	422
32	33	46	46	32	32	124	111
0	1,874	0	365	0	466	0	420
4,460	1,571	610	190	793	284	901	368
114	1,449	470	-599	-559	136	3,132	-1,736
<b>99,785</b>	<b>91,151</b>	<b>9,116</b>	<b>8,035</b>	<b>16,294</b>	<b>15,864</b>	<b>24,861</b>	<b>20,358</b>
78,077	70,471	6,655	5,706	13,704	12,987	20,096	16,550
9,199	11,653	1,777	1,648	1,894	2,124	3,836	2,902
8,656	5,313	0	0	0	0	0	0
237	130	7	7	8	9	9	8
310	438	6	28	14	42	45	61
18,402	17,534	1,790	1,683	1,916	2,175	3,890	2,971
795	875	375	369	266	317	387	383
1,379	1,189	90	83	178	159	242	226
<b>98,653</b>	<b>90,069</b>	<b>8,910</b>	<b>7,841</b>	<b>16,064</b>	<b>15,638</b>	<b>24,615</b>	<b>20,130</b>
566	541	103	97	115	113	123	114
566	541	103	97	115	113	123	114
0	0	0	0	0	0	0	0
<b>99,785</b>	<b>91,151</b>	<b>9,116</b>	<b>8,035</b>	<b>16,294</b>	<b>15,864</b>	<b>24,861</b>	<b>20,358</b>
84,057	75,709	10,019	9,048	16,071	15,192	23,687	21,052
5,980	5,238	3,364	3,342	2,367	2,205	3,591	4,502
<b>75,077</b>	<b>70,471</b>	<b>6,655</b>	<b>5,706</b>	<b>13,704</b>	<b>12,987</b>	<b>20,096</b>	<b>16,550</b>
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...

2. Statement of Condition of Each Federal Reserve Bank,  
December 31, 1988 and 1987—Continued

Millions of Dollars

Item	Atlanta		Chicago	
	1988	1987	1988	1987
<b>ASSETS</b>				
Gold certificate account .....	584	596	1,394	1,383
Special drawing rights certificate account .....	203	203	656	656
Coin .....	36	37	44	31
<i>Loans</i>				
To depository institutions .....	35	39	44	19
Other .....	0	0	0	0
Acceptances held under repurchase agreements .....	0	0	0	0
<i>Federal agency obligations</i>				
Bought outright .....	325	335	846	876
Held under repurchase agreements .....	0	0	0	0
<i>U.S. Treasury securities</i>				
Bought outright <sup>1</sup> .....	10,895	9,722	28,367	25,385
Held under repurchase agreements .....	0	0	0	0
Total loans and securities .....	11,255	10,096	29,257	26,280
Items in process of collection .....	721	615	774	620
Bank premises .....	59	57	100	70
<i>Other assets</i>				
Denominated in foreign currencies <sup>2</sup> .....	0	707	0	1,057
All other .....	1,076	228	4,185	3,185
Interdistrict Settlement Account .....	360	1,742	-1,715	2,605
<b>Total assets</b> .....	<b>14,294</b>	<b>14,281</b>	<b>34,695</b>	<b>35,887</b>
<b>LIABILITIES</b>				
Federal Reserve notes .....	8,889	9,206	29,658	30,029
<i>Deposits</i>				
Depository institutions .....	4,189	3,922	3,413	4,325
U.S. Treasury, general account .....	0	0	0	0
Foreign, official accounts .....	13	14	19	20
Other .....	5	52	107	145
Total deposits .....	4,207	3,988	3,539	4,490
Deferred credit items .....	657	604	565	522
Other liabilities and accrued dividends <sup>3</sup> .....	149	121	387	324
<b>Total liabilities</b> .....	<b>13,902</b>	<b>13,919</b>	<b>34,149</b>	<b>35,365</b>
<b>CAPITAL ACCOUNTS</b>				
Capital paid in .....	196	181	273	261
Surplus .....	196	181	273	261
Other capital accounts .....	0	0	0	0
<b>Total liabilities and capital accounts</b> .....	<b>14,294</b>	<b>14,281</b>	<b>34,695</b>	<b>35,887</b>
<b>FEDERAL RESERVE NOTE STATEMENT</b>				
Federal Reserve notes outstanding (issued to Bank) .....	12,528	13,288	32,902	31,890
Less: Held by Bank .....	3,639	4,082	3,244	1,861
<b>Federal Reserve notes, net</b> .....	<b>8,889</b>	<b>9,206</b>	<b>29,658</b>	<b>30,029</b>

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.

## 2. --Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1988	1987	1988	1987	1988	1987	1988	1987	1988	1987
368	351	168	169	490	562	676	669	1,429	1,483
160	160	66	66	216	216	307	307	670	670
29	28	11	13	30	31	28	29	67	81
95	38	12	10	30	68	688	416	10	16
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
205	218	99	114	262	300	391	448	894	1,046
0	0	0	0	0	0	0	0	0	0
6,875	6,322	3,329	3,290	8,789	8,693	13,105	12,986	30,002	30,325
0	0	0	0	0	0	0	0	0	0
7,175	6,578	3,440	3,414	9,081	9,061	14,184	13,850	30,906	31,387
422	502	383	435	1,542	1,454	696	572	1,362	1,163
21	20	24	23	47	47	22	20	151	153
0	241	0	256	0	334	0	661	0	1,135
412	130	371	81	572	181	2,085	257	1,975	609
742	723	1,010	-3	712	-100	-2,813	6	-2,058	-3,099
<b>9,329</b>	<b>8,733</b>	<b>5,473</b>	<b>4,454</b>	<b>12,690</b>	<b>11,786</b>	<b>15,185</b>	<b>16,371</b>	<b>34,502</b>	<b>33,582</b>
847	6,942	4,124	3,043	9,758	8,380	11,664	12,312	24,846	24,761
874	1,165	807	848	1,122	1,689	2,401	2,985	7,449	6,660
0	0	0	0	0	0	0	0	0	0
4	5	5	5	6	6	13	13	21	22
8	21	2	16	4	31	0	56	27	103
886	1,191	814	869	1,132	1,726	2,414	3,054	7,497	6,785
389	407	353	371	1,507	1,402	616	498	1,170	1,076
91	77	48	45	119	108	173	157	407	378
<b>9,213</b>	<b>8,617</b>	<b>5,339</b>	<b>4,328</b>	<b>12,516</b>	<b>11,616</b>	<b>14,867</b>	<b>16,021</b>	<b>33,920</b>	<b>33,000</b>
58	58	67	63	87	85	159	175	291	291
58	58	67	63	87	85	159	175	291	291
0	0	0	0	0	0	0	0	0	0
<b>9,329</b>	<b>8,733</b>	<b>5,473</b>	<b>4,454</b>	<b>12,690</b>	<b>11,786</b>	<b>15,185</b>	<b>16,371</b>	<b>34,502</b>	<b>33,582</b>
9,425	8,804	4,928	4,035	12,204	10,963	14,640	15,582	34,169	32,357
1,578	1,862	804	992	2,446	2,583	2,976	3,540	9,323	7,596
<b>7,847</b>	<b>6,942</b>	<b>4,124</b>	<b>3,043</b>	<b>9,758</b>	<b>8,380</b>	<b>11,664</b>	<b>12,312</b>	<b>28,846</b>	<b>24,761</b>

3. Federal Reserve Open Market Transactions, 1988<sup>1</sup>

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
<b>U.S. TREASURY SECURITIES</b>				
<i>Outright transactions (excluding matched transactions)</i>				
<b>Treasury bills</b>				
Gross purchases .....	0	346	560	423
Gross sales .....	49	538	0	0
Exchanges .....	0	0	0	0
Redemptions .....	600	1,600	0	0
<b>Others within 1 year</b>				
Gross purchases .....	0	0	0	1,092
Gross sales .....	0	0	0	0
Maturity shift .....	950	1,939	2,051	868
Exchanges .....	-754	-2,868	-2,089	-1,688
Redemptions .....	0	0	0	0
<b>1 to 5 years</b>				
Gross purchases .....	0	0	0	3,661
Gross sales .....	0	800	0	0
Maturity shift .....	-840	-952	-2,051	-823
Exchanges .....	749	2,643	2,089	1,434
<b>5 to 10 years</b>				
Gross purchases .....	0	0	0	1,017
Gross sales .....	0	175	0	0
Maturity shift .....	-110	-987	0	-45
Exchanges .....	5	150	0	254
<b>More than 10 years</b>				
Gross purchases .....	0	0	0	966
Gross sales .....	0	0	0	0
Maturity shift .....	0	0	0	0
Exchanges .....	0	75	0	0
<b>All maturities</b>				
Gross purchases .....	0	346	560	7,160
Gross sales .....	49	1,513	0	0
Redemptions .....	600	1,600	0	0
<i>Matched transactions</i>				
Gross sales .....	78,358	97,892	104,527	86,900
Gross purchases .....	78,513	99,139	104,572	85,608
<i>Repurchase agreements<sup>2</sup></i>				
Gross purchases .....	10,591	0	0	18,696
Gross sales .....	14,237	0	0	11,088
Net change in U.S. Treasury securities .....	-4,140	-1,520	605	13,476
<b>FEDERAL AGENCY OBLIGATIONS</b>				
<i>Outright transactions</i>				
Gross purchases .....	0	0	0	0
Gross sales .....	0	0	0	0
Redemptions .....	131	21	3	120
<i>Repurchase agreements<sup>2</sup></i>				
Gross purchases .....	4,042	0	0	4,243
Gross sales .....	5,357	0	0	1,447
Net change in agency obligations .....	-1,446	-21	-3	2,676
<b>Total net change in System Open Market Account .....</b>	<b>-5,586</b>	<b>-1,541</b>	<b>602</b>	<b>16,151</b>

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.

## 3. - Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
0	0	515	0	1,280	375	3,599	1,125	8,222
0	0	0	0	0	0	0	0	588
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	2,200
0	0	0	0	0	0	0	1,084	2,177
0	0	0	0	0	0	0	0	0
1,646	1,384	1,033	3,932	1,368	1,669	5,264	1,750	23,853
-4,324	-1,826	-87	-4,296	-1,646	-916	-2,391	-1,703	-24,587
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	1,824	5,486
0	0	0	0	0	0	0	0	800
-1,102	-1,384	-997	-1,821	-1,368	-1,544	-3,088	-1,750	-17,719
3,724	1,826	0	3,971	1,646	639	2,091	1,703	22,515
0	0	0	0	0	0	0	562	1,579
0	0	0	0	0	0	0	0	175
-387	0	-36	-2,111	0	-125	-2,145	0	-5,946
400	0	87	325	0	276	300	0	1,797
0	0	0	0	0	0	0	432	1,398
0	0	0	0	0	0	0	0	0
-157	0	0	0	0	0	-31	0	-188
200	0	0	0	0	0	0	0	275
0	0	515	0	1,280	375	3,599	5,028	18,863
0	0	0	0	0	0	0	0	1,563
0	0	0	0	0	0	0	0	2,200
115,287	73,708	81,979	124,875	113,886	98,804	98,618	93,650	1,168,486
115,115	72,966	83,464	123,220	113,384	97,897	100,680	93,584	1,168,143
15,871	10,520	22,978	0	35,800	4,715	17,867	15,575	152,614
23,478	5,334	28,164	0	30,191	7,727	16,463	14,815	151,498
-7,779	4,444	-3,186	-1,655	6,386	-3,544	7,064	5,721	15,871
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
11	0	67	10	0	75	14	135	587
4,771	5,083	12,355	0	12,107	2,223	4,763	7,672	57,258
7,566	2,843	14,594	0	8,225	4,454	5,132	6,853	56,473
-2,807	2,239	-2,306	-10	3,882	-2,306	-383	683	198
<b>-10,585</b>	<b>6,683</b>	<b>-5,492</b>	<b>-1,665</b>	<b>10,268</b>	<b>-5,850</b>	<b>6,681</b>	<b>6,404</b>	<b>16,070</b>

4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities,  
December 31, 1986-88<sup>1</sup>

Millions of dollars

Description	December 31			Increase or decrease (-)	
	1988	1987	1986	1988	1987
<b>U.S. Treasury securities, total</b> .....	<b>238,422</b>	<b>222,551</b>	<b>211,316</b>	<b>15,871</b>	<b>11,235</b>
<i>By term</i>					
1-15 days <sup>2</sup> .....	9,935	11,364	20,480	-1,429	-9,117
16-90 days .....	58,448	46,112	53,611	12,336	-7,499
91 days to 1 year .....	75,236	76,827	62,239	-1,591	14,588
1-5 years .....	55,326	47,512	36,469	7,814	11,043
5-10 years .....	12,568	15,313	15,451	-2,745	-138
More than 10 years .....	26,909	25,424	23,066	1,485	2,358
<i>By type of holding</i>					
<b>Held outright</b>					
Treasury bills <sup>3</sup> .....	112,782	107,691	103,775	5,091	3,916
Treasury notes .....	90,950	82,973	68,126	7,977	14,848
Treasury bonds .....	29,929	28,242	25,724	1,687	2,518
Held under RPs .....	4,760	3,645	13,691	1,115	-10,046
<b>Federal agency obligations, total</b> .....	<b>9,067</b>	<b>8,869</b>	<b>10,143</b>	<b>198</b>	<b>-1,274</b>
<i>By term</i>					
1-15 days <sup>2</sup> .....	2,271	1,561	2,704	710	-1,143
16-90 days .....	697	691	808	6	-118
91 days to 1 year .....	1,492	1,653	1,224	-161	428
1-5 years .....	3,419	3,416	3,854	3	-437
5-10 years .....	1,000	1,358	1,178	-358	180
More than 10 years .....	189	189	374	0	-185
<i>By type of holding</i>					
<b>Held outright</b>					
Federal Farm Credit Banks .....	1,997	2,294	2,486	-297	-192
Federal Home Loan Banks .....	2,251	2,251	2,252	0	-1
Federal Home Loan Financing Corporation .....	0	0	0	0	0
Federal Home Loan Mortgage Corporation .....	0	0	0	0	0
Federal Intermediate Credit Banks <sup>4</sup> .....	0	0	30	0	-30
Federal Land Banks .....	130	200	236	-70	-36
Federal Home Administration .....	35	99	101	-64	-3
Federal National Mortgage Association .....	2,387	2,490	2,490	-103	0
Federal National Sinking Fund .....	0	0	0	0	0
Government National Mortgage Association participation certificates <sup>4</sup> .....	0	51	67	-51	-16
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 .....	2,101	1,315	2,314	786	-998

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, 1988.

5. Number and Salaries of Officers and Employees of Federal Reserve Banks,  
December 31, 1988

Federal Reserve Bank (including) Branches	President	Other officers		Employees			Total	
	Annual salary (dollars)	Num- ber	Annual salaries (dollars)	Number		Annual salaries (dollars)	Num- ber	Annual salaries (dollars)
				Full- time	Part- time			
Boston .....	171,200	51	3,768,326	1,315	306	38,444,344	1,673	42,383,870
New York .....	198,500	158	13,326,575	3,715	53	109,593,220	3,927	123,118,295
Philadelphia .....	147,600	55	4,039,300	1,126	87	29,148,656	1,269	33,335,556
Cleveland .....	137,800	56	3,828,300	1,332	68	32,013,430	1,457	35,979,530
Richmond .....	150,000	81	5,487,900	1,801	142	42,365,154	2,025	48,003,054
Atlanta .....	163,000	72	4,907,660	2,194	91	52,162,030	2,358	57,232,690
Chicago .....	177,500	88	5,939,360	2,454	28	64,159,321	2,571	70,276,181
St. Louis .....	149,000	60	3,769,600	1,185	67	27,954,455	1,313	31,873,055
Minneapolis .....	133,000	44	2,978,700	979	142	25,311,846	1,166	28,423,546
Kansas City .....	146,500	63	4,201,800	1,605	57	38,686,861	1,726	43,035,161
Dallas .....	142,000	59	3,988,800	1,522	45	38,296,827	1,627	42,427,627
San Francisco .....	171,000	102	7,089,218	2,376	69	64,714,185	2,548	71,974,403
<b>Total .....</b>	<b>1,887,100</b>	<b>889</b>	<b>63,325,539</b>	<b>21,604</b>	<b>1,155</b>	<b>562,850,329</b>	<b>23,660</b>	<b>628,062,968</b>

## 6. Income and Expenses of Federal Reserve Banks, 1988

Dollars

Item <sup>1</sup>	Total	Boston	New York	Philadelphia	Cleveland
<b>CURRENT INCOME</b>					
Loans .....	355,503,582	1,917,148	4,067,423	2,486,347	555,846
U.S. Treasury and federal agency securities .....	18,179,534,091	1,099,303,526	6,178,080,704	522,231,597	1,055,774,529
Foreign currencies .....	299,843,275	9,892,553	78,629,814	14,368,529	16,607,328
Priced services .....	656,805,293	44,833,234	91,692,476	32,017,493	40,109,734
Other .....	34,745,057	651,088	24,766,126	567,153	571,323
<b>Total .....</b>	<b>19,526,431,297</b>	<b>1,156,217,539</b>	<b>6,380,785,220</b>	<b>571,611,487</b>	<b>1,114,447,833</b>
<b>CURRENT EXPENSES</b>					
Salaries and other personnel expenses .....	661,695,075	44,546,626	132,470,011	35,178,572	37,868,080
Retirement and other benefits <sup>2</sup> ..	63,785,742	8,638,103	23,675,231	7,649,904	8,001,485
Fees .....	14,926,898	5,006,138	1,941,067	518,633	1,609,136
Travel .....	25,358,327	1,113,434	3,358,905	1,099,409	1,933,977
Postage and other shipping costs .....	81,971,317	4,296,876	10,242,315	4,470,305	5,917,766
Communications .....	11,906,871	1,028,083	2,240,628	570,355	660,981
Materials and supplies .....	51,059,279	3,160,857	9,191,926	2,721,446	3,198,311
<i>Building expenses</i>					
Taxes on real estate .....	23,983,391	3,761,037	3,462,858	1,508,751	1,024,188
Property depreciation .....	28,407,981	2,361,790	3,246,647	1,626,416	1,499,255
Utilities .....	22,981,317	1,847,963	3,395,973	2,208,917	1,526,079
Rent .....	21,681,855	561,072	14,150,347	42,557	339,554
Other .....	18,822,842	899,469	3,371,365	1,336,957	759,240
<i>Equipment</i>					
Purchases .....	3,981,307	83,094	0	281,347	138,936
Rentals .....	26,577,783	385,069	5,372,028	900,332	2,309,366
Depreciation .....	77,321,209	5,471,218	15,107,959	4,156,659	4,755,947
Repairs and maintenance .....	45,940,759	3,322,267	7,229,142	2,214,105	3,093,988
Earnings-credit costs .....	124,275,559	7,837,385	13,064,312	8,872,596	11,043,526
Other .....	53,752,137	3,310,383	11,771,372	2,107,058	3,583,786
Shared costs, net <sup>3</sup> .....	0	(993,205)	438,940	2,371,756	169,828
Recoveries .....	(34,276,302)	(8,257,005)	(3,624,696)	(2,531,196)	(3,238,503)
Expenses capitalized <sup>4</sup> .....	(2,452,557)	(113,297)	(6,370)	(15,058)	(138,544)
<b>Total .....</b>	<b>1,321,700,790</b>	<b>88,267,357</b>	<b>260,099,960</b>	<b>77,289,822</b>	<b>86,056,383</b>
Reimbursements .....	(115,740,657)	(4,697,003)	(24,096,216)	(15,204,424)	(9,775,070)
<b>Net expenses .....</b>	<b>1,205,960,134</b>	<b>83,570,354</b>	<b>236,003,744</b>	<b>62,085,398</b>	<b>76,281,313</b>

For notes see end of table.



## 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
1,438,247,017	832,367,957	2,168,845,209	529,481,697	261,532,503	690,709,256	1,030,435,746	2,372,524,350
16,742,570	26,448,953	38,564,698	8,464,422	9,341,521	12,341,470	25,761,815	42,679,602
55,920,615	72,271,032	89,093,953	28,725,332	37,361,790	42,891,487	48,081,040	73,807,107
644,235	1,094,276	2,405,835	460,646	446,235	497,849	930,878	1,709,413
<b>1,512,542,017</b>	<b>934,103,037</b>	<b>2,468,884,122</b>	<b>574,233,014</b>	<b>312,293,467</b>	<b>750,274,112</b>	<b>1,258,076,204</b>	<b>2,492,963,246</b>
50,218,223	59,030,489	75,263,091	33,683,814	29,323,391	45,026,296	44,019,774	75,066,708
10,255,976	12,906,111	14,715,747	7,259,567	5,912,042	8,983,008	9,061,857	16,271,479
475,285	1,136,977	879,735	512,826	1,088,382	577,200	299,735	881,784
2,057,121	2,387,612	3,530,130	1,288,897	1,113,084	1,945,614	2,150,255	3,379,889
6,540,349	9,327,550	8,861,961	4,080,392	5,566,164	6,218,229	4,181,974	12,267,436
740,628	1,386,139	1,289,396	571,773	458,283	843,871	892,258	1,224,476
4,602,451	5,326,078	5,400,041	3,215,190	2,129,316	3,643,109	3,389,437	5,081,117
2,025,292	1,708,533	4,414,939	457,217	1,770,005	949,755	569,426	2,331,390
3,796,639	2,121,161	2,639,282	980,745	1,077,565	2,214,242	1,312,901	5,531,338
2,024,345	2,033,072	2,276,876	1,491,369	811,887	1,506,838	1,077,387	2,780,611
540,859	582,182	3,319,666	423,015	149,273	183,654	1,202,996	186,680
1,660,171	1,214,616	4,420,665	638,266	1,117,928	786,571	645,487	1,972,107
433,733	358,809	382,065	376,972	711,241	116,090	325,577	773,443
1,328,107	1,803,144	6,166,948	523,400	613,391	942,265	2,757,238	3,476,495
6,594,970	8,420,872	9,186,710	3,241,437	4,056,916	4,389,333	4,874,818	7,064,370
4,192,839	5,430,413	7,155,647	1,926,292	2,300,103	2,122,666	2,101,235	4,852,062
10,150,326	12,188,134	24,497,230	4,598,019	6,930,482	8,954,497	6,331,882	9,807,170
4,713,550	4,758,370	6,617,714	2,248,085	2,781,148	2,804,744	3,594,805	5,461,122
187,439	147,883	(6,408,496)	743,473	1,712,865	847,919	685,090	96,507
(4,534,181)	(1,922,976)	(2,338,276)	(1,176,488)	(695,407)	(756,083)	(1,485,502)	(3,715,989)
(185,148)	(257,126)	(609,606)	(94,417)	(52,158)	(403,391)	(497,970)	(79,472)
<b>107,818,974</b>	<b>130,088,043</b>	<b>171,661,465</b>	<b>66,989,844</b>	<b>68,875,901</b>	<b>91,896,427</b>	<b>87,490,659</b>	<b>154,710,723</b>
(7,414,075)	(8,588,131)	(12,412,611)	(7,269,273)	(3,654,226)	(5,498,505)	(5,070,307)	(12,060,816)
100,404,899	121,499,912	159,248,854	59,720,571	65,221,675	86,397,922	82,420,353	142,649,907

## 6. Income and Expenses of Federal Reserve Banks, 1988 — Continued

Item <sup>1</sup>	Total	Boston	New York	Philadelphia	Cleveland
<b>PROFIT AND LOSS</b>					
Current net income .....	18,320,471,163	1,072,647,185	6,214,326,244	509,526,088	1,038,166,519
<i>Additions to and deductions from current net income</i>					
Profits on sales of U.S.					
Treasury and federal agency securities .....					
	22,741,685	1,405,315	7,264,559	693,204	1,369,006
Other additions .....	87,590,510	20,824	990,764	9,075	6,765
Total additions .....	110,332,194	1,426,139	8,255,323	702,280	1,375,771
Loss on foreign exchange transactions .....					
	(510,875,399)	(16,858,888)	(134,871,105)	(24,522,019)	(28,098,147)
Other deductions .....	(88,514,766)	(34,534)	(1,020,938)	(15,248)	(108,533)
Total deductions .....	(599,390,166)	(16,893,423)	(135,892,044)	(24,537,267)	(28,206,680)
Net additions to or deductions(—) from current net income .....	(489,057,971)	(15,467,283)	(127,636,721)	(23,834,987)	(26,830,909)
Cost of unreimbursed Treasury services .....	27,852,349	1,499,201	5,038,020	2,691,151	1,924,431
<i>Assessments by Board</i>					
Board expenditures <sup>2</sup> .....	84,410,500	2,848,500	22,217,800	4,014,300	4,620,100
Cost of currency .....	164,244,653	9,688,687	53,879,756	4,421,601	10,064,330
Net income before payment to U.S. Treasury .....	17,554,905,689	1,043,143,514	6,005,553,947	474,564,049	994,726,749
Dividends paid .....	125,616,018	4,385,524	33,109,144	6,039,635	6,811,391
Payments to U.S. Treasury (interest on Federal Reserve notes) .....	17,364,318,571	1,032,070,290	5,698,704,285	462,991,264	985,705,508
Transferred to surplus .....	64,971,100	6,687,700	24,741,350	5,533,150	2,209,850
Surplus, January 1 .....	2,047,086,700	68,267,400	541,045,900	97,245,800	112,693,400
Surplus, December 31 .....	2,112,057,800	74,955,100	565,787,250	102,778,950	114,903,250

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. The effect of FASB 87 on the Reserve Banks was a reduction in expenses.

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.

6. —Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,412,137,113	812,603,125	2,309,635,267	514,512,443	247,071,793	663,876,190	1,175,655,855	2,350,313,340
1,939,690	1,004,209	2,623,055	655,362	343,892	908,663	1,357,682	3,177,049
52	2,570	12,040	720	60,396	241	86,449,276	37,785
1,939,742	1,006,779	2,635,095	656,082	404,288	908,904	87,806,957	3,214,834
(28,609,022)	(44,957,035)	(65,392,051)	(14,304,511)	(15,837,137)	(20,945,891)	(43,935,284)	(72,544,307)
(21,440)	(110,768)	(35,413)	(7,363)	(58,501)	(557,718)	(86,461,293)	(83,017)
(28,630,462)	(45,067,803)	(65,427,465)	(14,311,874)	(15,895,639)	(21,503,609)	(130,396,578)	(72,627,324)
(26,690,720)	(44,061,024)	(62,792,370)	(13,655,793)	(15,491,350)	(20,594,705)	(42,589,620)	(69,412,490)
2,443,149	2,347,652	3,696,045	1,217,001	1,219,849	1,634,799	1,888,319	2,252,731
4,724,500	7,452,600	10,758,000	2,375,900	2,596,100	3,476,700	7,387,300	11,938,700
12,825,070	7,134,247	23,270,501	5,379,479	2,368,162	6,483,890	9,540,917	19,188,013
1,365,453,674	751,607,603	2,209,118,351	491,884,270	225,396,332	631,686,095	1,114,249,699	2,247,521,406
7,163,926	11,283,631	16,088,003	3,495,521	4,004,145	5,127,698	10,515,965	17,591,436
1,348,753,798	725,345,821	2,181,326,998	487,948,950	217,151,037	624,448,198	1,121,027,434	2,229,845,820
9,535,950	14,978,150	11,703,350	439,800	4,241,150	2,110,200	(17,293,700)	84,150
113,919,900	180,789,500	261,303,050	58,019,850	62,604,650	84,801,500	175,324,750	291,071,000
123,455,850	195,767,650	273,006,400	58,459,650	66,845,800	86,911,700	158,031,050	291,155,150

7. Income and Expenses of Federal Reserve Banks, 1914-88<sup>1</sup>

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (-)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
<i>All Banks</i>					
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	-2,456,792	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.

## 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	40,327,237
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	75,283,818	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

## 7. Income and Expenses of Federal Reserve Banks, 1914-88 - 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	8,455,309,401	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 <sup>2</sup>	81,869,800	170,674,979
1988	19,526,431,297	1,205,960,134	(516,910,320)	84,410,500	164,244,653
<b>Total, 1914-88</b>	<b>238,510,484,581</b>	<b>17,741,836,222</b>	<b>1,999,244,205</b>	<b>1,271,014,708</b>	<b>1,967,511,010</b>
<i>Aggregate for each Bank, 1914-88</i>					
Boston	12,005,096,843	1,174,105,749	55,134,542	45,779,286	114,917,920
New York	69,376,122,412	3,525,480,072	534,167,103	328,683,786	492,365,339
Philadelphia	9,836,833,130	935,307,310	86,170,618	62,160,518	90,575,610
Cleveland	16,280,828,013	1,198,233,303	67,205,461	98,122,690	124,358,035
Richmond	18,788,385,425	1,393,781,737	92,183,673	66,169,276	185,156,576
Atlanta	9,898,281,276	1,524,845,146	182,174,022	94,744,360	120,997,307
Chicago	34,738,042,867	2,334,955,874	226,221,946	180,357,672	275,191,342
St. Louis	8,187,287,027	948,898,211	45,150,118	39,683,972	75,231,451
Minneapolis	4,313,264,726	816,101,971	66,677,954	37,826,415	34,325,191
Kansas City	10,348,387,248	1,126,493,481	86,680,029	54,354,709	94,968,427
Dallas	13,763,880,880	1,012,280,569	209,610,258	82,922,773	116,662,362
San Francisco	30,974,074,736	1,800,655,287	347,868,477	180,179,251	242,761,450
<b>Total</b>	<b>238,510,484,582</b>	<b>17,741,836,222<sup>4</sup></b>	<b>1,999,244,205</b>	<b>1,271,014,708</b>	<b>1,967,511,010</b>

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 \$2,240,750,999 transferred to surplus was reduced by direct changes 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 \$2,112,057,800 on Dec. 31, 1987.

4. See note 2, table 6.

## 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
125,616,018	...	...	17,364,318,571	...	64,971,100
<b>2,160,030,490</b>	<b>149,138,300</b>	<b>2,188,893</b>	<b>214,977,261,822</b>	<b>(3,657)</b>	<b>2,240,750,999<sup>3</sup></b>
89,004,996	7,111,395	280,843	10,543,845,860	135,411	84,049,925
586,093,192	68,006,262	369,116	64,355,883,827	(433,412)	603,043,821
116,936,323	5,558,901	722,406	8,594,442,847	290,661	117,109,172
175,777,068	4,842,447	82,930	14,618,489,864	(9,906)	128,137,043
108,956,701	6,200,189	172,493	16,990,867,850	(71,517)	129,335,658
147,368,065	8,950,561	79,264	7,982,401,044	5,491	201,034,190
298,326,916	25,313,526	151,045	31,561,621,600	11,682	288,335,154
68,733,059	2,755,629	7,464	7,033,553,602	(26,515)	63,600,278
60,824,362	5,202,900	55,615	3,354,818,340	64,874	70,723,013
90,002,435	6,939,100	64,213	8,971,201,935	(8,674)	91,051,650
131,996,042	560,049	102,083	12,466,603,395	55,337	162,308,528
286,011,331	7,697,341	101,421	28,503,531,658	(17,089)	301,022,567
<b>2,160,030,491</b>	<b>149,138,300</b>	<b>2,188,893</b>	<b>214,977,261,822</b>	<b>(3,657)</b>	<b>2,240,750,999</b>

8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1988<sup>1</sup>

Dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate <sup>4</sup>
	Land	Buildings (including vaults) <sup>2</sup>	Building machinery and equipment	Total <sup>3</sup>		
BOSTON.....	22,036,681	79,910,316	5,360,169	107,307,166	91,396,908	...
Annex.....	27,840	89,202	44,538	161,580	125,754	...
NEW YORK.....	3,436,277	18,207,333	21,735,584	43,379,194	28,050,650	...
Annex.....	477,863	1,136,219	745,855	2,359,936	783,785	...
Buffalo.....	887,844	2,693,268	2,265,777	5,846,889	3,077,117	...
PHILADELPHIA.....	1,876,601	52,360,437	5,903,704	60,140,742	45,902,623	...
CLEVELAND.....	1,074,281	6,478,201	6,475,744	14,028,226	8,659,744	1,224,363
Cincinnati.....	2,246,599	13,537,723	7,528,477	23,312,798	13,080,684	...
Pittsburgh.....	1,658,376	7,235,660	3,309,063	12,203,099	9,619,998	...
RICHMOND.....	3,912,575	55,853,002	14,314,313	74,079,889	55,450,587	...
Annex.....	522,733	3,725,466	3,924,584	8,172,784	3,716,505	...
Baltimore.....	6,476,114	26,826,903	3,842,189	37,145,206	32,591,159	...
Charlotte.....	1,902,406	15,484,515	946,943	18,333,865	16,950,727	...
ATLANTA.....	1,202,255	14,035,875	3,558,580	18,796,710	13,342,878	...
Birmingham.....	3,026,988	1,905,770	1,117,797	6,050,555	4,233,201	...
Jacksonville.....	880,258	17,486,169	0	18,366,427	18,366,427	909,313
Miami.....	3,717,791	11,965,974	2,111,664	17,795,429	14,935,299	...
Nashville.....	592,342	1,474,678	1,274,593	3,341,613	1,415,890	...
New Orleans.....	3,087,693	2,956,411	1,476,257	7,520,362	4,893,900	283,753
CHICAGO.....	4,511,942	92,922,805	14,265,111	111,699,858	92,508,787	...
Annex.....	53,066	904,562	426,419	1,384,047	1,252,166	...
Detroit.....	797,734	4,454,918	2,899,301	8,151,953	6,068,827	...
ST. LOUIS.....	700,378	11,162,871	5,283,870	17,147,118	10,924,792	...
Little Rock.....	1,148,492	2,082,669	1,003,022	4,234,183	2,551,767	...
Louisville.....	700,075	2,871,372	1,131,238	4,702,685	2,690,444	...
Memphis.....	1,135,623	4,216,382	2,126,755	7,478,760	4,750,245	...
MINNEAPOLIS.....	1,394,384	26,664,805	7,692,189	35,751,378	21,966,834	...
Helena.....	289,619	104,184	68,689	462,491	314,549	1,376,047
KANSAS CITY.....	1,798,804	9,987,268	8,802,665	20,588,737	16,837,800	149,948
Denver.....	3,187,962	3,422,762	3,505,761	10,116,484	7,570,687	...
Oklahoma City.....	646,386	2,381,207	2,153,371	5,180,963	4,404,446	...
Omaha.....	6,534,583	10,989,009	1,401,083	18,924,675	18,194,160	2,220,765
DALLAS.....	3,772,588	7,019,293	3,737,706	14,529,587	11,624,235	...
El Paso.....	262,477	1,398,307	393,301	2,054,085	1,652,768	...
Houston.....	2,049,064	3,535,591	983,006	6,567,661	5,876,471	...
San Antonio.....	482,284	2,857,743	658,346	3,998,373	3,326,538	...
SAN FRANCISCO.....	15,541,937	66,620,971	17,345,628	99,508,536	85,282,801	...
Los Angeles.....	3,891,887	48,580,244	8,334,890	60,807,022	57,992,081	3,094,592
Portland.....	207,381	2,010,290	649,432	2,867,103	2,492,808	...
Salt Lake City.....	480,222	2,032,415	1,293,985	3,806,622	2,848,852	...
Seattle.....	274,772	1,890,966	1,836,988	4,002,725	2,410,208	...
<b>Total.....</b>	<b>108,905,176</b>	<b>641,473,754</b>	<b>171,928,587</b>	<b>922,307,517</b>	<b>730,154,100</b>	<b>9,258,780</b>

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.



## 9. Operations in Principal Departments of Federal Reserve Banks, 1985-88

Operation	1988	1987	1986	1985
<i>Millions of pieces (except as noted)</i>				
Loans (thousands) .....	22	25	19	24
Currency received and counted .....	17,580	16,881	15,408	14,655
Currency verified and destroyed .....	5,910	5,217	5,584	5,744
Coin received and counted .....	17,137	19,871	20,461	19,691
Checks handled				
U.S. government checks .....	547	568	585	592
Postal money orders .....	144	146	140	130
All other .....	17,623	17,006	16,226	15,965
Issues, redemptions, and exchanges of U.S.				
Treasury and federal agency securities <sup>1</sup> .....	186	191	204	171
Transfer of funds .....	56	52 <sup>r</sup>	50	45
Food stamps redeemed .....	2,327	2,210	2,216	2,322
<i>Millions of dollars</i>				
Loans .....	537,952	151,323	193,424	307,856
Currency received and counted .....	195,647	216,151	197,516	182,095
Currency verified and destroyed .....	47,184	44,907	47,842	51,081
Coin received and counted .....	3,684	3,517	3,088	3,226
Checks handled				
U.S. government checks .....	608,307	610,678	606,029	538,261
Postal money orders .....	13,189	12,511	11,103	9,486
All other .....	11,789,787	11,453,158	10,546,900	9,557,753
Issues, redemptions, and exchanges of U.S.				
Treasury and federal agency securities <sup>1</sup> .....	89,516,419	90,056,338	75,447,899	65,866,333
Transfer of funds .....	160,730,050	152,453,528 <sup>2,r</sup>	125,028,070	109,126,369
Food stamps redeemed .....	10,748	10,322	10,475	10,915

1. Before 1988, data included book-entry securities transfers both sent and received. To eliminate double counting, the 1988 data include only the transfers sent.

2. Before 1987, data were compiled using a different methodology.  
r = Revised.

## 10. Federal Reserve Bank Interest Rates, December 31, 1988

Bank	Loans to depository institutions		
	Adjustment credit and seasonal credit <sup>1</sup>	Extended credit <sup>2</sup>	
		First 30 days of borrowing	After 30 days of borrowing <sup>3</sup>
All Federal Reserve Banks . .	6.5	6.5	9.55

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 established on March 8, 1985, and reestablished for 1986 and 1987 was not renewed for 1988. See sections 201.3(a) and 201.3(b)(1) of Regulation A.

2. Extended credit is available to depository institutions,

if 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.

11. Reserve Requirements of Depository Institutions<sup>1</sup>

Type of deposit, and deposit interval <sup>2</sup>	Depository institution requirements after implementation of the Monetary Control Act	
	Percent of deposits	Effective date
<i>Net transaction accounts</i> <sup>3,4</sup>		
\$0 million–\$41.5 million .....	3	12/20/88
More than \$41.5 million .....	12	12/20/88
<i>Nonpersonal time deposits</i> <sup>5</sup>		
By original maturity		
Less than 1½ years .....	3	10/6/83
1½ years or more .....	0	10/6/83
<i>Eurocurrency liabilities</i>		
All types.....	3	11/13/80

1. Reserve requirements in effect on Dec. 31, 1988. 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. 20, 1988, the exemption was raised from \$3.2 million to \$3.4 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. 20, 1988, for institutions reporting quarterly and Dec. 27, 1988, for institutions reporting weekly, the amount was increased from \$40.5 million to \$41.5 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 person and certain obligations issued to depository institution offices located outside the United States. For details, see section 204.2 of Regulation D.

12. Initial Margin Requirements under Regulations T, U, G, and X<sup>1</sup>

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only <sup>2</sup>
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.

13. Principal Assets and Liabilities and Number of Insured Commercial Banks,  
by Class of Bank, June 30, 1988 and 1987<sup>1</sup>

Asset and liability items shown in millions of dollars

Item	Total	Member banks			Nonmember banks
		Total	National	State	
June 30, 1988					
Loans and investments .....	2,127,678	1,578,619	1,272,273	306,346	549,059
Gross loans .....	1,647,363	1,251,938	1,015,857	236,080	395,425
Net loans .....	1,634,411	1,242,772	1,008,696	234,076	391,639
Investments .....	480,315	326,682	256,415	70,266	153,634
U. S. Treasury and federal agency securities .....	312,005	208,140	166,243	41,897	103,865
Other .....	168,310	118,542	90,172	28,369	49,769
Cash assets, total .....	209,506	160,869	128,296	32,573	48,637
Deposits, total .....	1,987,493	1,442,062	1,158,539	283,523	545,431
Interbank .....	59,880	52,186	36,723	15,463	7,694
Other transaction .....	583,727	434,515	343,650	90,865	149,212
Other nontransaction .....	1,532,856	1,084,780	886,457	198,322	448,076
Equity capital .....	184,226	132,593	102,708	29,885	51,634
Number of banks .....	13,274	5,530	4,459	1,071	7,744
June 30, 1987					
Loans and investments .....	1,997,678	1,472,286	1,178,461	293,825	525,392
Gross loans .....	1,536,916	1,163,780	935,008	228,772	373,136
Net loans .....	1,524,022	1,154,868	928,140	226,728	369,154
Investments .....	460,762	308,506	243,453	65,053	152,256
U. S. Treasury and federal agency securities .....	292,559	191,268	154,372	36,896	101,291
Other .....	168,203	117,239	89,081	28,157	50,964
Cash assets, total .....	217,237	168,383	132,045	36,338	48,854
Deposits, total .....	1,900,405	1,368,728	1,100,274	268,454	531,676
Interbank .....	65,613	57,655	42,405	15,250	7,957
Other demand .....	572,720	423,597	334,177	89,421	149,123
Other time and savings .....	1,436,543	1,005,562	822,651	182,911	430,981
Equity capital .....	172,546	123,456	97,100	26,356	49,090
Number of banks .....	13,829	5,818	4,724	1,094	8,011

1. All insured commercial banks in the United States.  
Details may not add to totals because of rounding.

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items – Year-End 1918–88, and Month-End 1988<sup>1</sup>

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock <sup>5</sup>	Special drawing rights certificate account	Treasury currency outstanding <sup>6</sup>
	U.S. Treasury and federal agency securities			Loans	Float <sup>2</sup>	All other <sup>3</sup>	Other Federal Reserve assets <sup>4</sup>	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	28,772	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

## 14. — Continued

Factors absorbing reserve funds											
Cur- rency in cir- cu- la- tion	Treasury cash hold- ings <sup>7</sup>	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve ac- counts <sup>4</sup>	Re- quired clear- ing bal- ances	Other Federal Reserve lia- bilities and capital <sup>4</sup>	Member bank reserves <sup>8</sup>			
		Treasury	For- eign	Other				With Federal Reserve Banks	Cur- rency and coin <sup>9</sup>	Re- quired <sup>10</sup>	Ex- cess <sup>10</sup>
4,951	288	51	96	25	118	0	0	1,636	0	1,585	51
5,091	385	51	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

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–88, and Month-End 1988<sup>1</sup>—Continued

Millions of dollars

Period	Factors supplying reserve funds											
	Federal Reserve Bank credit outstanding										Special drawing rights certificate account	Treasury currency outstanding <sup>6</sup>
	U.S. Treasury and federal agency securities			Loans	Float <sup>2</sup>	All other <sup>3</sup>	Other Federal Reserve assets <sup>4</sup>	Total	Gold stock <sup>5</sup>			
	Total	Bought outright <sup>12</sup>	Held under repurchase agreement									
1965	40,768	40,478	290	137	2,248	187	0	43,340	13,733	...		
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	7,154 <sup>3</sup>	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	12,063	
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	163,659	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	
1988	247,489	240,628	6,861	2,170	1,286	0	18,803	269,748	11,060	5,018	18,799	
1988												
Jan	225,834	225,834	0	333	396	0	15,954	242,517	11,068	5,018	18,197	
Feb	224,293	224,293	0	336	897	0	14,269	239,795	11,063	5,018	18,248	
Mar	224,895	224,895	0	2,311	298	0	15,038	242,542	11,063	5,018	18,313	
Apr	241,045	230,642	10,403	2,590	371	0	16,236	260,242	11,063	5,018	18,369	
May	230,460	230,460	0	3,304	122	0	14,388	248,274	11,063	5,018	18,425	
June	237,144	229,718	7,426	2,464	259	0	14,780	254,647	11,063	5,018	18,501	
July	231,651	231,651	0	3,650	774	0	16,365	252,440	11,063	5,018	18,531	
Aug	229,986	229,986	0	3,237	659	0	17,638	251,520	11,061	5,018	18,581	
Sept	240,524	230,764	9,490	2,154	1,199	0	18,248	261,855	11,062	5,018	18,637	
Oct	234,405	230,157	4,248	2,275	1,690	0	19,352	257,722	11,062	5,018	18,693	
Nov	241,086	235,803	5,283	2,328	389	0	18,168	261,971	11,059	5,018	18,743	
Dec	247,489	240,628	6,861	2,170	1,286	0	18,803	269,748	11,060	5,018	18,799	

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.



## 14. — Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings <sup>7</sup>	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts <sup>4</sup>	Required clearing balances	Other Federal Reserve liabilities and capital <sup>4</sup>	Member bank reserves <sup>8</sup>			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin <sup>9</sup>	Required <sup>10</sup>	Excess <sup>10,13</sup>
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 <sup>13</sup>
72,497	317	2,542	251	1,419 <sup>14</sup>	0	0	2,669	27,060	6,781	35,268	-1,360
79,743	185	2,113	418	1,275 <sup>14</sup>	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 <sup>15</sup>
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.
247,649	395	8,656	347	548	0	1,605	7,683	37,742	n.a.	n.a.	n.a.
223,152	438	10,276	355	315	0	1,674	6,926	33,664	n.a.	n.a.	n.a.
223,574	457	2,472	343	438	0	1,658	7,139	38,043	n.a.	n.a.	n.a.
227,073	479	2,403	534	436	0	1,671	7,047	37,106	n.a.	n.a.	n.a.
228,282	479	16,186	215	360	0	1,660	7,450	40,060	n.a.	n.a.	n.a.
232,732	459	3,030	288	491	0	1,660	7,235	37,098	n.a.	n.a.	n.a.
235,513	432	9,762	382	351	0	1,658	7,109	34,023	n.a.	n.a.	n.a.
234,990	397	3,910	269	291	0	1,642	7,200	38,352	n.a.	n.a.	n.a.
235,881	398	4,390	231	392	0	1,634	7,020	36,234	n.a.	n.a.	n.a.
235,527	389	13,023	338	358	0	1,605	7,899	37,433	n.a.	n.a.	n.a.
237,094	397	6,151	301	348	0	1,662	8,463	38,079	n.a.	n.a.	n.a.
242,472	402	5,198	251	398	0	1,613	8,058	38,399	n.a.	n.a.	n.a.
247,649	395	8,656	347	548	0	1,605	7,683	37,742	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) Eurodollar liabilities.

15. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy effective Nov. 19, 1975.

15. Changes in Number of Banking Offices in the United States, 1988<sup>1</sup>

Type of office and change	Total	Commercial banks <sup>2</sup>						Mutual savings banks	
		Total	Member			Nonmember		Insured	Non-insured
			Total	National	State	Insured	Non-insured <sup>3</sup>		
<b>Banks, Dec. 31, 1987...</b>	<b>14,375</b>	<b>14,004</b>	<b>5,749</b>	<b>4,640</b>	<b>1,109</b>	<b>7,994</b>	<b>261</b>	<b>370</b>	<b>1</b>
<i>Changes during 1988</i>									
New banks .....	231	228	99	69	30	129	0	3	0
Ceased banking operation .....	-201	-201	-103	-81	-22	-95	-3	-9	0
Banks converted into branches .....	-598	-586	-403	-344	-59	-183	0	-12	0
Other <sup>4</sup> .....	-13	-27	108	91	17	-131	-4	23	0
Net change .....	-581	-586	-299	-265	-34	-280	-7	5	0
<b>Banks, Dec. 31, 1988 ..</b>	<b>13,794</b>	<b>13,418</b>	<b>5,450</b>	<b>4,375</b>	<b>1,075</b>	<b>7,714</b>	<b>254</b>	<b>375</b>	<b>1</b>
<b>Branches and additional offices, Dec. 31, 1987 .....</b>	<b>47,981</b>	<b>45,411</b>	<b>29,260</b>	<b>23,924</b>	<b>5,336</b>	<b>16,019</b>	<b>132</b>	<b>2,565</b>	<b>5</b>
<i>Changes during 1988</i>									
De novo .....	1,459	1,320	775	628	147	538	7	139	0
Banks converted into branches .....	598	586	403	344	59	183	0	12	0
Discontinued .....	-942	-910	-604	-469	-135	-306	0	-32	0
Sale of branch .....	0	-21	-20	-12	-8	-1	0	21	0
Other <sup>4</sup> .....	371	281	577	525	52	-272	-24	90	0
Net change <sup>4</sup> .....	1,486	1,256	1,131	1,016	115	142	-17	230	0
<b>Branches and additional offices, Dec. 31, 1988 .....</b>	<b>49,467</b>	<b>46,667</b>	<b>30,391</b>	<b>24,940</b>	<b>5,451</b>	<b>16,161</b>	<b>115</b>	<b>2,795</b>	<b>5</b>

1. Preliminary. Final data will be available in the *Annual Statistical Digest, 1988*, forthcoming.

2. Includes stock savings banks and nondeposit trust companies.

3. As of Dec. 31, 1988, includes noninsured national trust companies.

4. Includes interclass changes.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1988

**Columbia Bank, Avondale, Arizona, to acquire assets and liabilities of The North American Bank, Phoenix, Arizona**

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 the depositors of The North American Bank.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(1/8/88)

Columbia Bank (Applicant) has assets of \$9.4 million and The North American Bank (Bank) has assets of \$30.5 million.

The Federal Deposit Insurance Corporation (FDIC) has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**Farmers & Merchants Bank and Trust Company, Aberdeen, South Dakota, to merge with Bank of Cresbard, Cresbard, 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 Bank of Cresbard.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(2/3/88)

Farmers & Merchants Bank and Trust Company (Applicant) has assets of \$94.2 million and Bank of Cresbard (Bank) has assets of \$8.9 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.

**Farmers State Bank of Western Illinois, New Windsor, Illinois, to merge the assets and liabilities of Bank of Viola, Viola, Illinois**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(12/18/87)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(2/18/88)

Farmers State Bank of Western Illinois (Applicant) has assets of \$28.4 million and Bank of Viola (Bank) has assets of \$10.9 million. Applicant and Bank are located in the same banking market. On a

pro forma basis, Applicant's market share will be 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.

**Citizens Bank and Trust Company, Baytown, Texas, to merge the assets and liabilities of First American Bank & Trust of Baytown, Baytown, 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 the depositors of First American Bank & Trust of Baytown.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(3/11/88)

Citizens Bank and Trust Company (Applicant) has assets of \$149.2 million and First American Bank & Trust of Baytown (Bank) has assets of \$35.7 million.

The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**Central Bank, Hollidaysburg, Pennsylvania, to merge the assets and liabilities of the Broad Top City office of Mellon Bank (Central), N.A., State College, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(3/4/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(3/28/88)

Central Bank (Applicant) has assets of \$159.8 million and the branch of Mellon Bank (Branch) has assets of \$4.1 million. Applicant and Branch 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.

**State Bank and Trust of Colorado Springs, Colorado Springs, Colorado, to merge the assets and liabilities of Citizens National Bank, Colorado Springs, Colorado**

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1988—Continued

**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 the depositors.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/21/88)**

State Bank and Trust (Applicant) has assets of \$12.7 million and Citizens National Bank (Bank) has assets of \$17.6 million.

The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**Interstate Bank North, Houston, Texas, to acquire the assets and liabilities of First National Bank of Kingwood, Kingwood, 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 the depositors.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/26/88)**

Interstate Bank North (Applicant) has assets of \$37.7 million and First National Bank of Kingwood (Bank) has assets of \$16.1 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**Citizens Bank and Trust Company, Baytown, Texas, to merge certain assets and liabilities of Lone Star Bank, Baytown, 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 the depositors.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/26/88)**

Citizens Bank and Trust Company (Applicant) has assets of \$19.0 million and Lone Star Bank (Bank) has assets of \$12.1 million.

The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**Citizens Bank, Smithville, Tennessee, to merge with Bank of Ardmore, Ardmore, Tennessee**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (2/26/88)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/6/88)**

Citizens Bank (Applicant) has assets of \$204 million and Bank of Ardmore (Bank) has assets of \$54 million. Applicant and Bank operate in the same banking market. On a pro forma basis, Applicant's market share will be 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.

**First Interstate Bank of California, Los Angeles, California, to merge with Bank of Contra Costa, Walnut Creek, California**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (4/29/88)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/16/88)**

First Interstate Bank of California (Applicant) has assets of \$19.6 billion and Bank of Contra Costa (Bank) has assets of \$175.9 million. Applicant and Bank are not located in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Irving Trust Company, New York, New York, to acquire certain assets and liabilities of the Seoul, South Korea, branch of Continental Illinois National Bank and Trust Company of Chicago, Chicago, Illinois**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (5/6/88)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/27/88)**

Irving Trust Company (Applicant) has assets of \$20.5 billion and the Seoul, South Korea, branch (Branch) has assets of \$129 million. Applicant and Bank are not located in the same banking market.

The banking factors and considerations relating

16. — Continued

to the convenience and needs of the community are consistent with approval.

**Beaver Trust Company, Beaver, Pennsylvania, to acquire the assets and liabilities of branch offices of First Seneca Bank, Butler, Pennsylvania and of Union National Bank, Pittsburgh, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/5/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8/11/88)

Beaver Trust Company (Applicant) has assets of \$187 million and the branches of First Seneca Bank and of Union National Bank (Branches) have acquired assets of \$46.8 million. Applicant and Branches 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.

**Norstar Bank, Hempstead, New York, to acquire certain assets and liabilities of three branches of Chemical Bank, New York, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7/22/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8/30/88)

Norstar Bank (Applicant) has assets of \$2.3 billion and the branches of Chemical Bank (Branches) have assets of \$108 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.

**First Community Bank, Inc., Princeton, West Virginia, to merge with First National Bank of Grafton, Grafton, West Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/12/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/7/88)

First Community Bank, Inc. (Applicant), has assets of \$250.6 million and First National Bank of Grafton (Bank) has assets of \$34.0 million. Applicant and Bank 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.

**Merchants State Bank, Freeman, South Dakota, to acquire certain assets and liabilities of Hurley State Bank, Hurley, South Dakota**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7/15/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/9/88)

Merchants State Bank (Applicant) has assets of \$22 million and Hurley State Bank (Branch) has assets of \$10 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.

**First Virginia Bank—South Central, Amherst, Virginia, to merge certain assets and liabilities of two branches of Colonial American National Bank, Roanoke, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/9/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/4/88)

First Virginia Bank—South Central (Applicant) has assets of \$43.6 million and the branches of Colonial American National Bank (Branches) have assets of \$2.5 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.

**Isabella Bank and Trust, Mount Pleasant, Michigan, to merge the assets and liabilities of the Shepherd branch of Commercial National Bank of Alma, Alma, Michigan**

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1988 – Continued

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(10/21/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(10/24/88)

Isabella Bank and Trust (Applicant) has assets of \$154.3 million and Commercial National Bank (Branch) has assets of \$4.2 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.

**Bank of Woodward, Woodward, Oklahoma, to assume the assets and liabilities of Bank of the Northwest, Woodward, Oklahoma**

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 Bank of the Northwest.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(11/15/88)

Bank of Woodward (Applicant) has assets of \$103 million and Bank of the Northwest (Bank) has assets of \$22 million.

The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**First Interstate Bank of California, Los Angeles, California, to merge with Point West Bancorp and its banking subsidiary, Point West Bank, both of Sacramento, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(10/12/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(11/23/88)

First Interstate Bank of California (Applicant) has assets of \$19.7 billion and Point West Bancorp (Bank) has banking assets of \$168.3 million. Applicant and Bank are not in the same banking market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**First Community Bank, Inc., Princeton, West Virginia, to merge with Valley Bank & Trust Company, Bluefield, West Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(11/4/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(11/29/88)

First Community Bank, Inc. (Applicant), has assets of \$283.4 million and Valley Bank & Trust Company (Bank) has assets of \$15.4 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.

**State Bank of Caledonia, Caledonia, Michigan, to acquire certain assets and deposit liabilities of the Middleville Branch of PrimeBank, Middleville, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(11/4/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(11/30/88)

State Bank of Caledonia (Applicant) has assets of \$56.9 million and the Middleville Branch (Branch) has deposit liabilities of \$8.9 million. Applicant and Bank 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.

**First Community Bank, Forest, Virginia, to assume deposit liabilities from three branches of Signet Bank/Virginia, Richmond, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(10/28/88)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(12/9/88)

First Community Bank (Applicant) has assets of \$27 million and the branches of Signet Bank/Virginia (Branches) have assumed deposits of \$48 million. Applicant and Branches do not operate in the same banking market.

## 16. — Continued

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

The FDIC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

**Continental Bank and Trust Company, Salt Lake City, Utah, to merge with Tracy-Collins Bank and Trust Company, Salt Lake City, Utah**

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 Tracy-Collins Bank and Trust Company.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/23/88)  
Continental Bank and Trust Company (Applicant) has assets of \$410.9 million and Tracy-Collins Bank and Trust Company (Bank) has assets of \$213.3 million.

**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 <sup>1</sup>	Assets (millions of dollars)	Date of approval
First of America—Straits Area, Cheboygan, Michigan ..... <i>Merger</i>	85	1/20/88
First of American Bank, N.A., Sault Ste. Marie, Michigan.....	52	
Trustcorp Bank, Toledo, Ohio ..... <i>Merger</i>	2,898	1/26/88
Trustcorp Co. Dayton, Dayton, Ohio Trustcorp Company, N.A., Columbus, Ohio.....	40	
Marine Bank of Champaign, Champaign, Illinois ..... <i>Merger</i>	100	3/18/88
Marine American National Bank of Champaign, Champaign, Illinois .	89	
Chemical Bank and Trust Company, Midland, Michigan ..... <i>Merger</i>	452	3/18/88
Chemical Bank Bay Area, Bay City, Michigan .....	9	
Trustcorp Bank, Lenawee, Adrian Michigan ..... <i>Merger</i>	147	4/15/88
Jipson—Carter State Bank, Blissfield, Michigan .....	31	
Old Kent Bank of Kalamazoo, Kalamazoo, Michigan ..... <i>Merger</i>	521	4/22/88
Old Kent Bank of Allegan, Allegan, Michigan .....	42	
Old Kent Bank of Battle Creek, Battle Creek, Michigan .....	41	
Old Kent Bank of South Haven, South Haven, Michigan.....	41	
Old Kent Bank of Three Rivers, Three Rivers, Michigan .....	32	

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1988 – Continued

Institution <sup>1</sup>	Assets (millions of dollars)	Date of approval
Sovran Bank/Central South, Nashville, Tennessee .....	2,700	7/1/88
<i>Merger</i>		
Sovran Bank/Williamson County, Franklin, Tennessee .....	349	
Bank One, Mansfield, Mansfield, Ohio .....	349	7/13/88
<i>Merger</i>		
Bank One, Ashland, Ashland, Ohio .....	70	
United Jersey Bank, Hackensack, New Jersey .....	4,025	8/1/88
<i>Merger</i>		
United Jersey Bank Edgewater N.A., Englewood, New Jersey .....	155	
United Jersey Bank, Hackensack, New Jersey .....	4,183	9/7/88
<i>Merger</i>		
United Jersey Bank/Wood Ridge, N.A., Wood Ridge, New Jersey .....	102	
Landmark Bank, Fairview Heights, Illinois .....	62	9/29/88
<i>Merger</i>		
Landmark Bank Edgemont, East St. Louis, Illinois .....	93	
Landmark Bank St. Clair County, O'Fallon, Illinois .....	29	
Landmark Bank, Mascoutah, Illinois .....	25	
First City Bank of Dallas, Dallas, Texas .....	1,600	9/29/88
<i>Merger</i>		
First City Bank-East Dallas, Dallas, Texas .....	105	
First City Bank-Market Center, N.A., Dallas, Texas .....	70	
First City Bank Valley View, Dallas, Texas .....	135	
First City Bank-Farmers Branch, Farmers Branch, Texas .....	155	
First City Bank of Garland, N.A., Garland, Texas .....	134	
First City National in Grand Prairie, Grand Prairie, Texas .....	80	
First City Bank of Lancaster, Lancaster, Texas .....	83	
First City Bank of Richardson, Richardson, Texas .....	240	
State Savings Bank of South Lyon, South Lyon, Michigan .....	46	10/20/88
<i>Merger</i>		
First of America Bank-Ann Arbor, Ann Arbor, Michigan .....	495	
Scottsdom Bank, Scottsdom, Arizona .....	52	11/16/88
<i>Merger</i>		
Thunderbird Bank, Phoenix, Arizona .....	315	
First City Bank of Dallas, Dallas, Texas .....	1,500	11/22/88
<i>Merger</i>		
First City Bank of Lewisville, Lewisville, Texas .....	131	
First City Bank of Plano, N.A., Plano, Texas .....	62	
First Interstate Bank of California, Los Angeles, California .....	19,700	11/23/88
<i>Merger</i>		
Point West Bank, Sacramento, California .....	168	



## 16. — Continued

Institution <sup>1</sup>	Assets (millions of dollars)	Date of approval
Cole Taylor Bank/Drovers, Chicago, Illinois .....	340	11/29/88
<i>Merger</i>		
Cole Taylor Bank/Main, Chicago, Illinois .....	287	
Cole Taylor Bank/Skokie, Skokie, Illinois .....	182	
Cole Taylor Bank/Ford City, Chicago, Illinois .....	291	
First City Bank of Dallas, Dallas, Texas .....	1,500	11/29/88
<i>Merger</i>		
First City Bank—Central Arlington, Arlington, Texas .....	87	
First City National Bank of Arlington, Arlington, Texas .....	245	
First City National Bank of Colley, Colleyville, Texas .....	55	
First City Bank—Forest Hill, Forest Hill, Texas .....	46	
First City National Bank of Fort Worth, Fort Worth, Texas .....	75	
Sovran Bank/Central South, Nashville, Tennessee .....	3,000	12/13/88
<i>Merger</i>		
Sovran Bank/Clarksville, Clarksville, Tennessee .....	135	
First Bank of Johnson City, Johnson City, Illinois .....	29	12/22/88
<i>Merger</i>		
First Bank of Carbondale, Carbondale, Illinois .....	26	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

### 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.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
 Approved by the Board of Governors, 1988 – Continued

Institution <sup>1</sup>	Assets (millions of dollars) <sup>2</sup>	Date of approval
The ACB Bank, Apple Creek, Ohio .....	. . .	1/27/88
<i>Merger</i>		
Apple Creek Banking Company, Apple Creek, Ohio .....	21	
Orrstown Interim Bank, Orrstown, Pennsylvania .....	. . .	2/5/88
<i>Merger</i>		
Orrstown Bank, Orrstown, Pennsylvania .....	74	
Commonwealth Bank, Arlington, Texas .....	. . .	4/1/88
<i>Merger</i>		
Commonwealth Bank-Lamar, N.A., Arlington, Texas .....	113	
Norstar Bank of Callicoon, Callicoon, New York .....	. . .	4/26/88
<i>Merger</i>		
Norstar Bank of Upstate NY, Albany, New York .....	94	
F&M Bank-Martinsburg, Martinsburg, West Virginia .....	. . .	5/23/88
<i>Merger</i>		
Merchants and Farmers Bank .....	53	
St. Elmo Bank, St. Elmo, Illinois .....	. . .	6/20/88
<i>Merger</i>		
Fayette County Bank, St. Elmo, Illinois .....	16	
New Bank, Madisonville, Tennessee .....	. . .	7/29/88
<i>Merger</i>		
Bank of Madisonville, Madisonville, Tennessee .....	86	
Richwood Interim Bank, Richwood, Ohio .....	. . .	8/18/88
<i>Merger</i>		
Richwood Banking Company, Richwood, Ohio .....	46	
Ripley Bank Merger Subsidiary, Inc., Ripley, West Virginia .....	. . .	8/29/88
<i>Merger</i>		
Bank of Ripley, Ripley, West Virginia .....	38	
Ranson Interim Bank, Ranson, West Virginia .....	. . .	9/26/88
<i>Merger</i>		
Blakeley Bank and Trust Company, Ranson, West Virginia .....	64	
Central Florida Bancshares, Inc., Maitland, Florida .....	. . .	11/4/88
<i>Merger</i>		
First American Bank of Orange County, Maitland, Florida .....	41	

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.

---

*Federal Reserve  
Directories and Meetings*

*Board of Governors of the Federal Reserve System*

December 31, 1988

*Term expires*

ALAN GREENSPAN of New York, <i>Chairman</i> <sup>1</sup> .....	January 31, 1992
MANUEL H. JOHNSON of Virginia, <i>Vice Chairman</i> <sup>1</sup> .....	January 31, 2000
MARTHA R. SEGER of Michigan .....	January 31, 1998
WAYNE D. ANGELL of Kansas .....	January 31, 1994
H. ROBERT HELLER of California .....	January 31, 1996
EDWARD W. KELLEY, JR., of Texas .....	January 31, 1990
JOHN P. LAWARE of Massachusetts .....	January 31, 2002

**OFFICE OF BOARD MEMBERS**

JOSEPH R. COYNE, *Assistant to the Board*  
 DONALD J. WINN, *Assistant to the Board*  
 BOB STAHLY MOORE, *Special Assistant to the Board*

**DIVISION OF MONETARY AFFAIRS**

DONALD L. KOHN, *Director*  
 DAVID E. LINDSEY, *Deputy Director*  
 BRIAN F. MADIGAN, *Assistant Director*  
 RICHARD D. PORTER, *Assistant Director*  
 NORMAND R. V. BERNARD, *Special Assistant to the Board*

**OFFICE OF STAFF DIRECTOR FOR MANAGEMENT**

S. DAVID FROST, *Staff Director*  
 EDWARD T. MULRENIN, *Assistant Staff Director*  
 PORTIA W. THOMPSON, *Equal Employment Opportunity Programs Officer*

**OFFICE OF STAFF DIRECTOR FOR FEDERAL RESERVE BANK ACTIVITIES**

THEODORE E. ALLISON, *Staff Director*

**OFFICE OF THE EXECUTIVE DIRECTOR FOR INFORMATION RESOURCES MANAGEMENT**

ALLEN E. BEUTEL, *Executive Director*  
 STEPHEN R. MALPHRUS, *Deputy Executive Director*

**OFFICE OF THE SECRETARY**

WILLIAM W. WILES, *Secretary*  
 BARBARA R. LOWREY, *Associate Secretary*  
 JAMES MCAFEE, *Associate Secretary*

**LEGAL DIVISION**

MICHAEL BRADFIELD, *General Counsel*  
 J. VIRGIL MATTINGLY, JR., *Deputy General Counsel*  
 RICHARD M. ASHTON, *Associate General Counsel*  
 OLIVER IRELAND, *Associate General Counsel*  
 RICKI R. TIGERT, *Assistant General Counsel*  
 MARYELLEN A. BROWN, *Assistant to the General Counsel*

**DIVISION OF RESEARCH AND STATISTICS**

MICHAEL J. PRELL, *Director*  
 EDWARD C. ETTIN, *Deputy Director*  
 THOMAS D. SIMPSON, *Associate Director*  
 LAWRENCE SLIFMAN, *Associate Director*  
 MARTHA BETHEA, *Deputy Associate Director*  
 PETER A. TINSLEY, *Deputy Associate Director*  
 MYRON L. KWAST, *Assistant Director*  
 SUSAN J. LEPPER, *Assistant Director*  
 MARTHA S. SCANLON, *Assistant Director*  
 DAVID J. STOCKTON, *Assistant Director*  
 JOYCE K. 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.

**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*  
 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*  
 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*  
 ROGER T. COLE, *Assistant Director*  
 JAMES I. GARNER, *Assistant Director*  
 JAMES D. GOETZINGER, *Assistant Director*  
 MICHAEL G. MARTINSON, *Assistant Director*  
 ROBERT S. PLOTKIN, *Assistant Director*  
 SIDNEY M. SUSSAN, *Assistant Director*  
 LAURA M. HOMER, *Securities Credit Officer*

**DIVISION OF CONSUMER AND COMMUNITY AFFAIRS**

GRIFFITH L. GARWOOD, *Director*  
 GLENN E. LONEY, *Assistant Director*  
 ELLEN MALAND, *Assistant Director*  
 DOLORES S. SMITH, *Assistant Director*

**DIVISION OF HUMAN RESOURCES MANAGEMENT**

DAVID L. SHANNON, *Director*  
 JOHN R. WEIS, *Associate Director*  
 ANTHONY V. DIGIOIA, *Assistant Director*  
 JOSEPH H. HAYES, JR., *Assistant Director*  
 FRED HOROWITZ, *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 (Programs and Budgets)*  
 DARRELL R. PAULEY, *Assistant Controller (Finance)*

**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*

*Federal Open Market Committee*

December 31, 1988

**Members**

ALAN GREENSPAN, *Chairman*, Board of Governors  
 E. GERALD CORRIGAN, *Vice Chairman*, President, Federal Reserve Bank of New York  
 WAYNE D. ANGELL, Board of Governors  
 ROBERT P. BLACK, President, Federal Reserve Bank of Richmond  
 ROBERT P. FORRESTAL, President, Federal Reserve Bank of Atlanta  
 H. ROBERT HELLER, Board of Governors  
 W. LEE HOSKINS, President, Federal Reserve Bank of Cleveland  
 MANUEL H. JOHNSON, Board of Governors  
 EDWARD W. KELLEY, JR., Board of Governors  
 JOHN P. LAWARE, Board of Governors  
 ROBERT T. PARRY, President, Federal Reserve Bank of San Francisco  
 MARTHA R. SEGER, Board of Governors

**Alternate Members**

ROGER GUFFEY, President, Federal Reserve Bank of Kansas City  
 SILAS KEEHN, President, Federal Reserve Bank of Chicago  
 THOMAS C. MELZER, President, Federal Reserve Bank of St. Louis  
 FRANK E. MORRIS, President, Federal Reserve Bank of Boston  
 JAMES H. OLTMAN, First Vice President, Federal Reserve Bank of New York

**Officers**

DONALD L. KOHN,  
*Secretary and Economist*  
 NORMAND R.V. BERNARD,  
*Assistant Secretary*  
 MICHAEL BRADFIELD,  
*General Counsel*  
 ERNEST T. PATRIKIS,  
*Deputy General Counsel*  
 MICHAEL J. PRELL,  
*Economist*  
 EDWIN M. TRUMAN,  
*Economist*  
 JOHN H. BEEBE,  
*Associate Economist*  
 J. ALFRED BROADDUS, JR.,  
*Associate Economist*

JOHN M. DAVIS,  
*Associate Economist*  
 RICHARD G. DAVIS,  
*Associate Economist*  
 DAVID E. LINDSEY,  
*Associate Economist*  
 CHARLES J. SIEGMAN,  
*Associate Economist*  
 THOMAS D. SIMPSON,  
*Associate Economist*  
 LAWRENCE SLIFMAN,  
*Associate Economist*  
 SHEILA L. TSCHINKEL,  
*Associate Economist*

PETER D. STERNLIGHT, *Manager for Domestic Operations,  
 System Open Market Account*  
 SAM Y. CROSS, *Manager for Foreign Operations,  
 System Open Market Account*

During 1988, the Federal Open Market Committee held eight regularly scheduled meetings (see Record of Policy Actions of the

Federal Open Market Committee in this REPORT.)

## *Federal Advisory Council*

December 31, 1988

### **Members**

- District 1—J. TERRENCE MURRAY, *President*, Fleet/Norstar Financial Group, Inc., *Chairman and Chief Executive Officer*, Fleet National Bank, Providence, Rhode Island
- District 2—WILLARD C. BUTCHER, *Chairman and Chief Executive Officer*, The Chase Manhattan Bank, N.A., New York, New York
- District 3—SAMUEL A. MCCULLOUGH, *President and Chief Executive Officer*, Meridian Bancorp, Inc., Reading, Pennsylvania
- District 4—THOMAS H. O'BRIEN, *President and Chief Executive Officer*, PNC Financial Corp., Pittsburgh, Pennsylvania
- District 5—FREDERICK DEANE, JR., *Chairman of the Board and Chief Executive Officer*, Signet Banking Corporation, Richmond, Virginia
- 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 of Omaha, Omaha, Nebraska
- District 11—T. C. FROST, *Chairman of the Board*, Frost National Bank, San Antonio, Texas
- District 12—PAUL HAZEN, *President and Chief Operating Officer*, Wells Fargo and Co., San Francisco, California

### **Officers**

- CHARLES T. FISHER, III, *President*
- BENNETT A. BROWN, *Vice President*
- HERBERT V. PROCHNOW, *Secretary*
- WILLIAM J. KORSVIK, *Associate Secretary*

### **Directors**

- SAMUEL A. MCCULLOUGH
- DONALD N. BRANDIN

The Federal Advisory Council met on February 4-5, May 5-6, September 8-9, and November 3-4, 1988. The Board of Governors met with the council on February 5, May 6, September 9, and November 4, 1988. The council, which is composed of one representative of the banking industry from each of

the twelve Federal Reserve Districts, is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with, and advise, the Board on all matters within the jurisdiction of the Board.

## *Consumer Advisory Council*

December 31, 1988

### Members

- NAOMI G. ALBANESE, *Former Professor of Home Economics*, Greensboro, North Carolina  
STEPHEN BROBECK, *Executive Director*, Consumer Federation of America, Washington, D.C.  
EDWIN B. BROOKS, *President*, Security Federal Savings and Loan Association, Richmond, Virginia  
JUDITH N. BROWN, *Treasurer*, American Association of Retired Persons, Edina, Minnesota  
MICHAEL S. CASSIDY, *Senior Vice President*, Chase Manhattan Bank, New York, New York  
BETTY TOM CHU, *Chairman*, Trust Savings Bank, Arcadia, California  
JERRY D. CRAFT, *Senior Vice President*, First National Bank of Atlanta, Atlanta, Georgia  
DONALD C. DAY, *President*, New England Securities Corporation, Boston, Massachusetts  
RICHARD B. DOBY, *Financial Services Consultant*, Doby and Associates, 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  
ELENA HANGGI, *Director*, Institute for Social Justice, Little Rock, Arkansas  
ROBERT A. HESS, *President and General Manager*, Wright Patman Congressional Federal Credit Union, Washington, D.C.  
ROBERT J. HOBBS, *Deputy Director*, National Consumer Law Center, Boston, Massachusetts  
RAMON E. JOHNSON, *Professor of Finance*, University of Utah, Salt Lake City, Utah  
ROBERT W. JOHNSON, *Professor of Management and Director*, Credit Research Center, Purdue University, West Lafayette, Indiana  
A. J. KING, *Chairman and Chief Executive Officer*, Valley Bank of Kalispell, Kalispell, Montana  
JOHN M. KOLESAR, *President*, Ameritrust Development Bank, Cleveland, Ohio  
ALAN B. LERNER, *Senior Executive Vice President*, Associates Corporation, Dallas, Texas  
RICHARD L. D. MORSE, *Professor of Family Economics*, Kansas State University, Manhattan, Kansas  
WILLIAM E. ODOM, *Chairman of the Board*, Ford Motor Credit Company, Dearborn, Michigan  
SANDRA R. PARKER, *Chairman*, Banking Committee, Richmond United Neighborhoods, Richmond, Virginia  
SANDRA PHILLIPS, *Executive Director*, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania  
JANE SHULL, *Director*, Institute for the Study of Civic Values, Philadelphia, Pennsylvania  
RALPH E. SPURGIN, *President and Chief Executive Officer*, Limited Credit Services, Inc., Columbus, Ohio  
LAWRENCE WINTHROP, *President*, Consumer Credit Counseling Service of Oregon, Inc., Portland Oregon



## Consumer Advisory Council—Continued

### Officers

STEVEN W. HAMM, *Chairman*

EDWARD J. WILLIAMS, *Vice Chairman*

The Consumer Advisory Council met with members of the Board of Governors on March 17–18, July 14–15, and October 27–28, 1988. 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, 1988

### Members

GERALD M. CZARNECKI, *Chairman of the Board and Chief Executive Officer*, HONFED, Honolulu, Hawaii

ROBERT S. DUNCAN, *Chairman, President, and Chief Executive Officer*, Magnolia Federal Bank for Savings, Hattiesburg, Mississippi

BETTY GREGG, *Immediate Past President and Chief Executive Officer*, Desert Schools Federal Credit Union, Scottsdale, Arizona

JAMIE J. JACKSON, *President*, Landmark Capital, Inc., 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

JOE C. MORRIS, *Chairman of the Board*, Columbia Savings Association, Overland Park, Kansas

JOSEPH W. MOSMILLER, *Chairman and Chief Executive Officer*, Loyola Federal Savings and Loan Association, Baltimore, Maryland

JANET M. PAVLISKA, *President and Chief Executive Officer*, Bank Five for Savings, Arlington, Massachusetts

LOUIS H. PEPPER, *Chairman and Chief Executive Officer*, Washington Mutual Savings Bank, Seattle, Washington

WILLIAM G. SCHUETT, *President and Chief Executive Officer*, Security Savings and Loan Association, Milwaukee, Wisconsin

DONALD B. SHACKELFORD, *Chairman of the Board*, State Savings Bank, Columbus, Ohio

### Officers

JAMIE J. JACKSON, *President*

GERALD M. CZARNECKI, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on February 25, May 24, September 13, and November 15, 1988. 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.

## *Officers of Federal Reserve Banks, Branches, and Offices*

December 31, 1988<sup>1</sup>

BANK, Branch, or facility	Chairman <sup>2</sup> Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON <sup>3</sup> .....	George N. Hatsopoulos Richard N. Cooper	Frank E. Morris Robert W. Eisenmenger	
NEW YORK <sup>3</sup> .....	John R. Opel Ellen V. Futter	E. Gerald Corrigan James H. Oltman	
Buffalo.....	Mary Ann Lambertsen		John T. Keane
PHILADELPHIA.....	Nevius M. Curtis Peter A. Benoliel	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND <sup>3</sup> .....	Charles W. Parry John R. Miller	W. Lee Hoskins William H. Hendricks	
Cincinnati.....	Owen B. Butler		Charles A. Cerino <sup>4</sup>
Pittsburgh.....	James E. Haas		Harold J. Swart <sup>4</sup>
RICHMOND <sup>3</sup> .....	Robert A. Georgine Hanne M. Merriman	Robert P. Black Jimmie R. Monhollon	
Baltimore.....	Thomas R. Shelton		Robert D. McTeer, Jr. <sup>4</sup>
Charlotte.....	G. Alex Bernhardt		Albert D. Tinkelenberg <sup>4</sup>
<i>Culpeper</i> .....			John G. Stoides <sup>4</sup>
ATLANTA.....	Bradley Currey, Jr. Larry L. Prince	Robert P. Forrestal Jack Guynn	Delmar Harrison <sup>4</sup>
Birmingham.....	Roy D. Terry		Fred R. Herr <sup>4</sup>
Jacksonville.....	E. William Nash, Jr.		James D. Hawkins <sup>4</sup>
Miami.....	Sue McCourt Cobb		James T. Curry, III
Nashville.....	Condon S. Bush		Donald E. Nelson
New Orleans.....	Sharon A. Perlis		Robert J. Musso
CHICAGO <sup>3</sup> .....	Robert J. Day Marcus Alexis	Silas Keehn Daniel M. Doyle	
Detroit.....	Richard T. Lindgren		Roby L. Sloan <sup>4</sup>
ST. LOUIS.....	Robert L. Virgil, Jr. H. Edwin Trusheim	Thomas C. Melzer James R. Bowen	
Little Rock.....	James R. Rodgers		John F. Breen
Louisville.....	Lois H. Gray		Howard Wells
Memphis.....	Sandra B. Sanderson		Paul I. Black, Jr.
MINNEAPOLIS.....	Michael W. Wright John A. Rollwagen	Gary H. Stern Thomas E. Gainor	
Helena.....	Marcia S. Anderson		Robert F. McNellis

BANK, Branch, or <i>facility</i>	Chairman <sup>2</sup> Deputy Chairman	President First Vice President	Vice President in charge of Branch
<b>KANSAS CITY</b> .....	Irvine O. Hockaday, Jr. Fred W. Lyons, Jr.	Roger Guffey Henry R. Czerwinski	
Denver .....	James C. Wilson		Kent M. Scott
Oklahoma City .....	Patience S. Latting		David J. France
Omaha .....	Kenneth L. Morrison		Harold L. Shewmaker
<b>DALLAS</b> .....	Bobby R. Inman	Robert H. Boykin	Tony J. Salvaggio <sup>4</sup>
El Paso .....	Hugh G. Robinson	William H. Wallace	
Houston .....	Peyton Yates		Sammie C. Clay
San Antonio .....	Walter M. Mischer, Jr. Robert F. McDermott		Robert Smith III <sup>4</sup> Thomas H. Robertson
<b>SAN FRANCISCO</b> .....	Robert F. Erburu Carolyn S. Chambers	Robert T. Parry Carl E. Powell	John F. Hoover <sup>4</sup>
Los Angeles .....	Richard C. Seaver		Thomas C. Warren <sup>5</sup>
Portland .....	Paul E. Bragdon		Angelo S. Carella <sup>4</sup>
Salt Lake City .....	Don M. Wheeler		E. Ronald Liggett <sup>4</sup>
Seattle .....	Carol A. Nygren		Gerald R. Kelly <sup>4</sup>

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 November 30 and December 1, 1988.

The Executive Committee of the Conference of Chairmen during 1988 comprised Robert J. Day, Chairman; Robert F. Erburu, Vice Chairman; and John R. Opel, member.

On December 1, 1988, the Conference elected its Executive Committee for 1989, naming Robert F. Erburu as Chairman, Bradley Currey, Jr. as Vice Chairman, and Peter A. Benoliel 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 November 3, 1987, the Conference elected Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, as its Chairman for 1988, and Robert P. Forrester, President of the Federal Reserve Bank of Atlanta, as its Vice Chairman. The Conference appointed Carolyn A. Verret, of the Federal Reserve Bank of Minneapolis, as its Secretary, and Christopher G. Brown, of the Federal Reserve Bank of Atlanta, as its Assistant Secretary.

## Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet periodically for the consideration of operations and other matters.

On November 20, 1987, the Conference elected Thomas E. Gainor, First Vice President of the Federal Reserve Bank of Minneapolis, as its Chairman for 1988, and Jack Guynn, First Vice President of the Federal Reserve Bank of Atlanta, as its Vice Chairman. The Conference appointed Carolyn A. Verret, of the Federal Reserve Bank of

Minneapolis, as its Secretary, and Christopher G. Brown, of the Federal Reserve Bank of Atlanta, as its 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."

*Term expires  
Dec. 31*

District 1 – BOSTON

*Class A*

William C. Bullock, Jr. ....	Former Chairman, Merrill/Northstar, Bangor, Maine	1988
Joel B. Alvord .....	Chairman and Chief Executive Officer, Shawmut National Corporation, Hartford, Connecticut	1989
Richard D. Wardell .....	President and Chief Executive Officer, National Iron Bank of Salisbury, Salisbury, Connecticut	1990

*Class B*

Matina S. Horner .....	President, Radcliffe College, Cambridge, Massachusetts	1988
Richard M. Oster .....	President and Chief Executive Officer, Cookson America, Inc., Providence, Rhode Island	1989
Stephen R. Levy .....	Chairman and Chief Executive Officer, Bolt Beranek and Newman, Inc., Cambridge, Massachusetts	1990

*Class C*

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
Richard L. Taylor .....	President, Taylor Properties, Inc., Boston, Massachusetts	1990

District 2 – NEW YORK

*Class A*

John F. McGillicuddy .....	Chairman of the Board and Chief Executive Officer, Manufacturers Hanover Trust Company, New York, New York	1988
Alberto M. Paracchini .....	Chairman of the Board and President, Banco de Ponce, Ponce, Puerto Rico	1989
J. Kirby Fowler .....	President and Chief Executive Officer, The Flemington National Bank and Trust Company, Flemington, New Jersey	1990

*Class B*

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

	<i>Term expires Dec. 31</i>
John F. Welch, Jr. ....	1990
Chairman and Chief Executive Officer, GE, Fairfield, Connecticut	
<i>Class C</i>	
Maurice R. Greenberg .....	1988
President and Chief Executive Officer, American International Group, Inc., New York, New York	
John R. Opel .....	1989
Chairman of the Executive Committee, International Business Machines Corporation, Armonk, New York	
Ellen V. Futter .....	1990
President, Barnard College, Columbia University, New York, New York	

## BUFFALO BRANCH

*Appointed by the Federal Reserve Bank*

R. Carlos Carballada .....	1988
President and Chief Executive Officer, Central Trust Company, Rochester, New York	
Donald I. Wickham .....	1988
President, Tri-Way Farms, Inc., Stanley, New York	
Harry J. Sullivan .....	1989
President, Salamanca Trust Company, Salamanca, New York	
Norman W. Sinclair .....	1990
President and Chief Executive Officer, Lockport Savings Bank, Lockport, New York	

*Appointed by the Board of Governors*

Mary Ann Lambertsen .....	1988
Vice President, Human Resources, The Quaker Oats Company, Fisher-Price Division, East Aurora, New York	
Matthew Augustine .....	1989
President and Chief Executive Officer, Eltrex Industries, Inc., Rochester, New York	
Paul E. McSweeney .....	1990
Executive Vice President, United Food and Commercial Workers, District Union Local One, AFL-CIO, Amherst, New York	

## District 3 – PHILADELPHIA

*Class A*

Clarence D. McCormick .....	1988
President, Farmers and Merchants National Bank, Bridgeton, New Jersey	
George A. Butler .....	1989
Chairman and Chief Executive Officer, First Pennsylvania Bank, N.A., Philadelphia, Pennsylvania	
Constantinos I. Costalas .....	1990
Chief Executive Officer, Glendale National Bank of New Jersey, Voorhees, New Jersey	

*Term expires  
Dec. 31*

*Class B*

Nicholas Riso .....	Executive Vice President, AHOLD, U.S.A., Harrisburg, Pennsylvania	1988
Carl E. Singley .....	Partner, White, McClelland, and Singley, Philadelphia, Pennsylvania	1989
Charles F. Seymour .....	Chairman, Jackson-Cross Company, Philadelphia, Pennsylvania	1990

*Class C*

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
Jane G. Pepper .....	President, The Pennsylvania Horticultural Society, Philadelphia, Pennsylvania	1990

District 4—CLEVELAND

*Class A*

William A. Stroud .....	Chairman and Chief Executive Officer, First-Knox Banc Corporation, Mount Vernon, Ohio	1988
Frank Wobst .....	Chairman and Chief Executive Officer, Huntington Bancshares Incorporated, Columbus, Ohio	1989
William H. May .....	Chairman and President, First National Bank of Nelsonville, Nelsonville, Ohio	1990

*Class B*

Daniel M. Galbreath .....	President, John W. Galbreath and Company, Columbus, Ohio	1988
Laban P. Jackson, Jr. ....	Chairman of the Board, International Spike, Inc., Lexington, Kentucky	1989
Verna K. Gibson .....	President, The Limited Stores, Inc., Columbus, Ohio	1990

*Class C*

John R. Miller .....	Former President and Chief Operating Officer, The Standard Oil Company (Ohio), Cleveland, Ohio	1988
Charles W. Parry .....	Director and Retired Chairman and Chief Executive Officer, Aluminum Company of America, Pittsburgh, Pennsylvania	1989
Robert D. Storey .....	Partner, Burke, Haber, and Berick, Cleveland, Ohio	1990

## CINCINNATI BRANCH

*Appointed by the Federal Reserve Bank*

Robert A. Hodson .....	President and Chief Executive Officer, 1st Security Bank, Hillsboro, Ohio	1988
Robert M. Duncan .....	President, First National Bank of Louisa, Louisa, Kentucky	1989
Jack W. Buchanan .....	President, Sphar and Company, Inc., Winchester, Kentucky	1990
Jerry L. Kirby .....	Chairman of the Board, President, and Chief Executive Officer, Citizens Federal Savings and Loan Association, Dayton, Ohio	1990

*Appointed by the Board of Governors*

Kate Ireland .....	National Chairman, Frontier Nursing Service, Wendover, Kentucky	1988
Owen B. Butler .....	Chairman of the Board (Retired), The Procter and Gamble Company, Cincinnati, Ohio	1989
Marvin Rosenberg .....	Partner, Towne Properties, Ltd., Cincinnati, Ohio	1990

## PITTSBURGH BRANCH

*Appointed by the Federal Reserve Bank*

Lawrence F. Klima .....	President, The First National Bank of Pennsylvania, Erie, Pennsylvania	1988
Thomas G. Dove .....	Chairman of the Executive Committee and Chief Executive Officer, Wheeling Dollar Bank, Wheeling, West Virginia	1989
George A. Davidson, Jr. ....	Chairman and Chief Executive Officer, Consolidated Natural Gas Company, Pittsburgh, Pennsylvania	1990
Stephen C. Hansen .....	President and Chief Executive Officer, Dollar Bank, F.S.B., Pittsburgh, Pennsylvania	1990

*Appointed by the Board of Governors*

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
Milton A. Washington .....	President and Chief Executive Officer, Allegheny Housing Rehabilitation Corporation, Pittsburgh, Pennsylvania	1990



*Term expires  
Dec. 31*

District 5—RICHMOND

*Class A*

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
John F. McNair III .....	President and Chief Executive Officer, Wachovia Bank and Trust Company, N.A. and The Wachovia Corporation, Winston-Salem, North Carolina	1990

*Class B*

Edward H. Covell .....	President, The Covell Company, Easton, Maryland	1988
Thomas B. Cookerly .....	President, Broadcast Division, Allbritton Communications, Washington, D.C.	1989
Jack C. Smith .....	Chairman of the Board and Chief Executive Officer, K-VA-T Food Stores, Inc., Grundy, Virginia	1990

*Class C*

Robert A. Georgine .....	President, Building and Construction Trades Department, AFL-CIO, Washington, D.C.	1988
Leroy T. Canoles, Jr. ....	President, Kaufman and Canoles, Norfolk, Virginia	1989
Hanne M. Merriman .....	President and Chief Executive Officer, Honeybee, Inc., New York, New York	1990

BALTIMORE BRANCH

*Appointed by the Federal Reserve Bank*

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
Raymond V. Haysbert, Sr. ...	President and Chief Executive Officer, Parks Sausage Company, Baltimore, Maryland	1990

*Appointed by the Board of Governors*

Thomas R. Shelton .....	President, Case Foods, Inc., Salisbury, Maryland	1988
-------------------------	--	------

	<i>Term expires Dec. 31</i>
John R. Hardesty, Jr. ....	1989
President, Preston Energy, Inc., Kingwood, West Virginia	
Gloria L. Johnson .....	1990
Deputy Director of Administration, The Baltimore Museum of Art, Baltimore, Maryland	

### CHARLOTTE BRANCH

#### *Appointed by the Federal Reserve Bank*

J. Donald Collier .....	1988
President and Chief Executive Officer, Orangeburg National Bank, Orangeburg, South Carolina	
James G. Lindley .....	1988
Chairman and Chief Executive Officer, South Carolina National Corporation, and Chairman, President and Chief Executive Officer, The South Carolina National Bank, Columbia, South Carolina	
John A. Hardin .....	1989
Chairman of the Board and President, First Federal Savings Bank, Rock Hill, South Carolina	
James M. Culberson, Jr. ....	1990
Chairman and President, The First National Bank of Randolph County, Asheboro, North Carolina	

#### *Appointed by the Board of Governors*

G. Alex Bernhardt .....	1988
President, Bernhardt Industries, Inc., Lenoir, North Carolina	
Anne M. Allen .....	1989
Vice President, Allen Construction Company, Greensboro, North Carolina	
William E. Masters .....	1990
President, Perception, Inc., Easley, South Carolina	

### District 6—ATLANTA

#### *Class A*

Virgil H. Moore, Jr. ....	1988
Chairman and Chief Executive Officer, First Farmers and Merchants National Bank, Columbia, Tennessee	
Mary W. Walker .....	1989
Vice Chairman, The National Bank of Walton County, Monroe, Georgia	
E. B. Robinson, Jr. ....	1990
Chairman and Chief Executive Officer, Deposit Guaranty National Bank and Deposit Guaranty Corporation, Jackson, Mississippi	

#### *Class B*

Bernard F. Sliger .....	1988
President, Florida State University, Tallahassee, Florida	

		<i>Term expires Dec. 31</i>
Paul W. Green .....	President and Chief Executive Officer, American Cast Iron Pipe Company, Birmingham, Alabama	1989
Gary J. Chouest .....	President, Edison Chouest Offshore, Inc., Galliano, Louisiana	1990
<i>Class C</i>		
Larry L. Prince .....	President and Chief Operating Officer, Genuine Parts Company, Atlanta, Georgia	1988
Bradley Currey, Jr. ....	President, Rock-Tenn Company, Norcross, Georgia	1989
Edwin A. Huston .....	Senior Executive Vice President-Finance, Ryder System, Inc., Miami, Florida	1990

**BIRMINGHAM BRANCH**

*Appointed by the Federal Reserve Bank*

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, Jr. ....	President and Chief Executive Officer, First National Bank of Scottsboro, Scottsboro, Alabama	1989
Harry B. Brock, Jr. ....	Chairman and Chief Executive Officer, Central Bank of the South, Birmingham, Alabama	1990

*Appointed by the Board of Governors*

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
A. G. Trammell .....	President, Alabama Labor Council, AFL-CIO, Birmingham, Alabama	1990

**JACKSONVILLE BRANCH**

*Appointed by the Federal Reserve Bank*

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

	<i>Term expires Dec. 31</i>
Buell G. Duncan, Jr. ....	1990
Chairman, President, and Chief Executive Officer, Sun Bank, N.A., Orlando, Florida	
<i>Appointed by the Board of Governors</i>	
E. William Nash, Jr. ....	1988
President, South-Central Operations, The Prudential Insurance Company of America, Jacksonville, Florida	
Sandra H. Gray .....	1989
Co-Owner, Gemini Springs Farm, DeBary, Florida	
Winnie F. Taylor .....	1990
Professor of Law, University of Florida, Gainesville, Florida	

### MIAMI BRANCH

*Appointed by the Federal Reserve Bank*

William H. Losner .....	1988
President and Chief Executive Officer, The First National Bank of Homestead, Homestead, Florida	
James H. Robinson .....	1989
President, Sun Bank/South Florida, N.A., Fort Lauderdale, Florida	
Robert M. Taylor .....	1990
Chairman and Chief Executive Officer, The Mariner Group, Inc., Fort Myers, Florida	
Frederick A. Teed .....	1990
President and Chief Executive Officer, Community Savings, F.A., Riviera Beach, Florida	

*Appointed by the Board of Governors*

Sue McCourt Cobb .....	1988
Attorney, Greenberg, Traurig, Askew, Hoffman, Lipoff, Rosen, and Quentel, P.A., Miami, Florida	
Jose L. Saumat .....	1989
Chairman, Kaufman and Roberts, Inc., Miami, Florida	
Robert D. Apelgren .....	1990
President, Apelgren Corporation, Pahokee, Florida	

### NASHVILLE BRANCH

*Appointed by the Federal Reserve Bank*

W. L. Calloway, Jr. ....	1988
Chairman, Quality Lawn Systems, Inc., Nashville, Tennessee	
Shirley A. Zeitlin .....	1988
President, Shirley Zeitlin and Company Realtors, Nashville, Tennessee	
James A. Rainey .....	1988
Chairman, Sovran Financial Corporation/ Central South, Nashville, Tennessee	

	<i>Term expires Dec. 31</i>
Lawrence A. Roseberry ..... Chairman, First National Bank and Trust Company, Chairman and Chief Executive Officer, First Franklin Bancshares, Inc., Athens, Tennessee	1990
<i>Appointed by the Board of Governors</i>	
Condon S. Bush ..... President, Bush Brothers and Company, Dandridge, Tennessee	1988
Patsy R. Williams ..... Partner, Rhyne Lumber Company, Newport, Tennessee	1989
Victoria B. Jackson ..... President and Chief Executive Officer, Diesel Sales and Service, Inc. and Pro diesel, Inc., Nashville, Tennessee	1990

NEW ORLEANS BRANCH

*Appointed by the Federal Reserve Bank*

Robert M. Shofstahl ..... President and Chief Executive Officer, Pelican Homestead and Savings Association, Metairie, Louisiana	1988
Alan R. Barton ..... President and Chief Executive Officer, Mississippi Power Company, Gulfport, Mississippi	1988
Robert S. Gaddis ..... President and Chief Executive Officer, Trustmark National Bank, Laurel, Mississippi	1989
Ronald M. Boudreaux ..... President and Chief Executive Officer, First National Bank of St. Landry Parish, Opelousas, Louisiana	1990

*Appointed by the Board of Governors*

Sharon A. Perlis ..... President, Sharon A. Perlis, (APLC), Metairie, Louisiana	1988
James A. Hefner ..... President, Jackson State University, Jackson, Mississippi	1989
Caroline G. Theus ..... President, Inglewood Land and Development Company, Alexandria, Louisiana	1990

District 7—CHICAGO

*Class A*

John W. Gabbert ..... President and Chief Executive Officer, First of America Bank-LaPorte, N.A., LaPorte, Indiana	1988
B. F. Backlund ..... Chairman and Chief Executive Officer, Bartonville Bank, Bartonville, Illinois	1989
Barry F. Sullivan ..... Chairman of the Board, First Chicago Corporation, Chicago, Illinois	1990

	<i>Term expires Dec. 31</i>
<i>Class B</i>	
Max J. Naylor .....	Farmer, Jefferson, Iowa 1988
Paul J. Schierl .....	Chairman of the Board and Chief Executive Officer, Fort Howard Corporation, Green Bay, Wisconsin 1989
Edward D. Powers .....	Chairman of the Board and Chief Executive Officer, Mueller Company, Decatur, Illinois 1990
<i>Class C</i>	
Charles S. McNeer .....	Chairman of the Board and Chief Executive Officer, Wisconsin Energy Corporation, Milwaukee, Wisconsin 1988
Robert J. Day .....	Chairman and Chief Executive Officer, USG Corporation, Chicago, Illinois 1989
Marcus Alexis .....	Dean, College of Business Administration, University of Illinois at Chicago, Chicago, Illinois 1990

## DETROIT BRANCH

*Appointed by the Federal Reserve Bank*

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
James A. Aliber .....	Chairman of the Board and Chief Executive Officer, First Federal of Michigan, Detroit, Michigan 1990
Frederik G. H. Meijer .....	Chairman of the Board, Meijer, Incorporated, Grand Rapids, Michigan 1990

*Appointed by the Board of Governors*

Phyllis E. Peters .....	Director, Professional Standards Review, Touche Ross and Company, Detroit, Michigan 1988
Richard T. Lindgren .....	Former President and Chief Executive Officer, Cross and Trecker Corporation, Bloomfield Hills, Michigan 1989
Beverly Beltaire .....	President, P R Associates, Inc., Detroit, Michigan 1990

## District 8—ST. LOUIS

*Class A*

Vacancy .....	1990
---------------	------

	<i>Term expires Dec. 31</i>	
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
H. L. Hembree III .....	Chairman of the Executive Committee, Merchants National Bank, Fort Smith, Arkansas	1990
<i>Class B</i>		
Robert J. Sweeney .....	Consultant, Murphy Oil Corporation, El Dorado, Arkansas	1988
Frank M. Mitchener, Jr. ....	President, Mitchener Farms, Inc., Sumner, Mississippi	1989
Roger W. Schipke .....	Senior Vice President, GE Appliances, GE, Louisville, Kentucky	1990
<i>Class C</i>		
Robert L. Virgil, Jr. ....	Dean, John M. Olin School of Business, Washington University in St. Louis, St. Louis, Missouri	1988
H. Edwin Trusheim .....	Chairman and Chief Executive Officer, General American Life Insurance Company, St. Louis, Missouri	1989
Janet McAfee Weakley .....	President, Janet McAfee, Inc., Clayton, Missouri	1990

LITTLE ROCK BRANCH

*Appointed by the Federal Reserve Bank*

Robert C. Connor, Jr. ....	President, Union National Bank of Little Rock, Little Rock, Arkansas	1988
Patricia M. Townsend .....	President, Townsend Company, Stuttgart, Arkansas	1989
David Armbruster .....	President, First America Federal Savings Bank, Fort Smith, Arkansas	1990
W. Wayne Hartsfield .....	President and Chief Executive Officer, First National Bank, Searcy, Arkansas	1990

*Appointed by the Board of Governors*

James R. Rodgers .....	Airport Manager, Little Rock Regional Airport, Little Rock, Arkansas	1988
L. Dickson Flake .....	President, Barnes, Quinn, Flake, and Anderson, Inc., Little Rock, Arkansas	1989
William E. Love .....	President, Sound-Craft Systems, Inc., Morrilton, Arkansas	1990

Term expires  
Dec. 31

## LOUISVILLE BRANCH

*Appointed by the Federal Reserve Bank*

Allan S. Hanks .....	Director, The Anderson National Bank, Lawrenceburg, Kentucky	1988
Morton Boyd .....	President, First Kentucky National Corporation, Louisville, Kentucky	1989
Irving W. Bailey II .....	President and Chief Operating Officer, Capital Holding Corporation, Louisville, Kentucky	1990
Wayne G. Overall, Jr. ....	President, First Federal Savings Bank, Elizabethtown, Kentucky	1990

*Appointed by the Board of Governors*

Lois H. Gray .....	Chairman of the Board, James N. Gray Construction Company, Inc., Glasgow, Kentucky	1988
Thomas A. Alvey .....	Delegate, Owensboro Council of Labor, Owensboro, Kentucky	1989
Raymond M. Burse .....	President, Kentucky State University, Frankfort, Kentucky	1990

## MEMPHIS BRANCH

*Appointed by the Federal Reserve Bank*

William H. Brandon, Jr. ....	President, First National Bank of Phillips County, Helena, Arkansas	1988
Michael J. Hennessey .....	President, Munro and Company, Inc., Wynne, Arkansas	1989
Thomas M. Garrott .....	President and Chief Operating Officer, National Bank of Commerce and National Commerce Bancorporation, Memphis, Tennessee	1990
Larry A. Watson .....	Chairman of the Board and President, Liberty Federal Savings Bank, Paris, Tennessee	1990

*Appointed by the Board of Governors*

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
Seymour B. Johnson .....	Owner, Kay Planting Company, Indianola, Mississippi	1990



*Term expires  
Dec. 31*

District 9—MINNEAPOLIS

*Class A*

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
Joel S. Harris .....	President, Yellowstone Holding Company, Columbus, Montana	1990

*Class B*

Richard L. Falconer .....	District Manager—Finance, U.S. West Communications, Minneapolis, Minnesota	1988
Bruce C. Adams .....	Partner, Triple Adams Farms, Lansford, North Dakota	1989
Earl R. St. John, Jr. ....	President and Owner, St. John Forest Products, Inc., Spalding, Michigan	1990

*Class C*

John A. Rollwagen .....	Chairman and Chief Executive Officer, Cray Research Inc., Minneapolis, Minnesota	1988
Michael W. Wright .....	Chairman, President, and Chief Executive Officer, Super Valu Stores, Inc., Minneapolis, Minnesota	1989
Delbert W. Johnson .....	President and Chief Executive Officer, Pioneer/Norelkote, Minneapolis, Minnesota	1990

HELENA BRANCH

*Appointed by the Federal Reserve Bank*

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
F. Charles Mercord .....	President and Managing Officer, First Federal Savings Bank of Montana, Kalispell, Montana	1989

*Appointed by the Board of Governors*

Marcia S. Anderson .....	President, Bridger Canyon Stallion Station, Inc., Bozeman, Montana	1988
Warren H. Ross .....	President, Ross 8-7 Ranch, Inc., Chinook, Montana	1989

Term expires  
Dec. 31

## District 10--KANSAS CITY

*Class A*

Robert L. Hollis .....	Chairman of the Board and Chief Executive Officer, First National Bank and Trust Company, Okmulgee, Oklahoma	1988
Harold L. Gerhart, Jr. ....	President and Chief Executive Officer, First National Bank, Newman Grove, Nebraska	1989
Roger L. Reisher .....	Co-Chairman, FirstBank Holding Company of Colorado, Lakewood, Colorado	1990

*Class B*

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
S. Dean Evans, Sr. ....	Partner, Evans Grain Company, Salina, Kansas	1990

*Class C*

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
Thomas E. Rodriguez .....	President and General Manager, Thomas E. Rodriguez and Associates, P.C., Aurora, Colorado	1990

## DENVER BRANCH

*Appointed by the Federal Reserve Bank*

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
Henry A. True III .....	Partner, True Companies, Casper, Wyoming	1989
Junius F. Baxter .....	Chairman of the Board and Chief Executive Officer, Bank Western, a Federal Savings Bank, Denver, Colorado	1990

*Appointed by the Board of Governors*

Anthony W. Williams .....	Attorney, Williams, Turner, & Holmes, P.C., Grand Junction, Colorado	1988
James C. Wilson .....	Management Consultant, Longmont, Colorado	1989
Gilbert Sanchez .....	President, New Mexico Highlands University, Las Vegas, New Mexico	1990

*Term expires  
Dec. 31*

**OKLAHOMA CITY BRANCH**

*Appointed by the Federal Reserve Bank*

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
William H. Crawford .....	Chairman and Chief Executive Officer, First National Bank and Trust Company, Frederick, Oklahoma	1989

*Appointed by the Board of Governors*

John F. Snodgrass .....	President and Trustee, The Samuel Roberts Noble Foundation, Inc., Ardmore, Oklahoma	1988
Patience S. Latting.....	Oklahoma City, Oklahoma	1989

**OMAHA BRANCH**

*Appointed by the Federal Reserve Bank*

John R. Cochran .....	President and Chief Executive Officer, Norwest Bank Nebraska, N.A., Omaha, Nebraska	1988
John T. Selzer .....	President, Scottsbluff National Bank and Trust Company, Scottsbluff, Nebraska	1989
Charles H. Thorne .....	Chairman of the Board, First Federal Savings and Loan Association of Lincoln, Lincoln, Nebraska	1989

*Appointed by the Board of Governors*

Janice D. Stoney .....	President and Chief Executive Officer, Northwestern Bell Telephone Company, Omaha, Nebraska	1988
Kenneth L. Morrison .....	President, Morrison Enterprises, Hastings, Nebraska	1989

**District 11 – DALLAS**

*Class A*

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
T. C. Frost .....	Chairman of the Board, The Frost National Bank, San Antonio, Texas	1990

*Class B*

Robert Ted Enloe III .....	President, Lomas and Nettleton Financial Corporation, Dallas, Texas	1988
----------------------------	---	------

	<i>Term expires Dec. 31</i>
Gary E. Wood .....	President, Texas Research League, Austin, Texas 1989
Robert L. Pfluger .....	Rancher, San Angelo, Texas 1990
<i>Class C</i>	
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
Bobby R. Inman .....	Chairman of the Board and Chief Executive Officer, Westmark Systems Inc., Austin, Texas 1990

## EL PASO BRANCH

*Appointed by the Federal Reserve Bank*

Humberto F. Sambrano .....	Partner, Urban General Contractors, Inc., El Paso, Texas 1988
David L. Stone .....	President, The Portales National Bank, Portales, New Mexico 1989
Henry B. Ellis .....	President and Chief Credit Officer, MBank El Paso, N.A., El Paso, Texas 1990
Ethel Ortega Olson .....	Owner, NAMBE of Ruidoso, Ruidoso, New Mexico 1990

*Appointed by the Board of Governors*

Peyton Yates .....	President, Yates Drilling Company, Artesia, New Mexico 1988
Vacancy .....	1989
Diana S. Natalicio .....	President, The University of Texas at El Paso, El Paso, Texas 1990

## HOUSTON BRANCH

*Appointed by the Federal Reserve Bank*

Jeff Austin, Jr. ....	President, First National Bank of Jacksonville, Jacksonville, Texas 1988
Janard M. Gross .....	President, Gross Builders, Inc., Houston, Texas 1989
Clive Runnells .....	President and Director, Runnells Cattle Company, Bay City, Texas 1990
David E. Sheffield .....	Vice Chairman, Texas National Bank of Victoria, Victoria, Texas 1990

*Appointed by the Board of Governors*

Gilbert D. Gaedcke, Jr. ....	Chairman of the Board and Chief Executive Officer, Gaedcke Equipment Company, Houston, Texas 1988
------------------------------	---

	<i>Term expires Dec. 31</i>
Walter M. Mischer, Jr. ....	1989
President and Chief Operating Officer, The Mischer Corporation, Houston, Texas	
Andrew L. Jefferson, Jr. ....	1990
Attorney, Jefferson and Mims, Houston, Texas	

SAN ANTONIO BRANCH

*Appointed by the Federal Reserve Bank*

Jane Flato Smith .....	1988
Investor and Rancher, San Antonio, Texas	
C. Ivan Wilson .....	1989
Chairman of the Board and Chief Executive Officer, First City Bank of Corpus Christi, Corpus Christi, Texas	
Robert T. Rork .....	1990
Regional Chairman, NCNB Texas, Dallas, Texas	
Sam R. Sparks .....	1990
President, Sam R. Sparks, Inc., Progreso, Texas	

*Appointed by the Board of Governors*

Robert F. McDermott .....	1988
Chairman of the Board and President, United Services Automobile Association, San Antonio, Texas	
Lawrence E. Jenkins .....	1989
Vice President (Retired), Austin Division, Lockheed Missiles & Space Co., Inc., Austin, Texas	
Ruben M. Garcia .....	1990
Chief Executive Officer, Modern Machine Shop, Inc., Laredo, Texas	

District 12—SAN FRANCISCO

*Class A*

Spencer F. Eccles .....	1988
Chairman and Chief Executive Officer, First Security Corporation, Salt Lake City, Utah	
Rayburn S. Dezember .....	1989
Chairman of the Board and Chief Executive Officer, Central Pacific Corporation, and Chairman, American National Bank, Bakersfield, California	
R. Blair Hawkes .....	1990
President and Chief Executive Officer, Ireland Bank, Malad City, Idaho	

*Class B*

Togo W. Tanaka .....	1988
Chairman, Gramercy Enterprises, Inc., Los Angeles, California	
John C. Hampton .....	1989
President and Chief Executive Officer, Willamina Lumber Company, Portland, Oregon	
John N. Nordstrom .....	1990
Co-Chairman of the Board, Nordstrom, Inc., Seattle, Washington	

*Term expires  
Dec. 31*

*Class C*

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
Cordell W. Hull .....	Executive Vice President and Director, Bechtel Group, Inc., San Francisco, California	1990

## LOS ANGELES BRANCH

*Appointed by the Federal Reserve Bank*

Howard C. McCrady .....	Vice Chairman, Valley National Corporation, Phoenix, Arizona	1988
William L. Tooley .....	Chairman, Tooley and 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
Ross M. Blakely .....	Chairman of the Executive Committee of the Board, Coast Savings and Loan, Los Angeles, California	1990

*Appointed by the Board of Governors*

Thomas R. Brown, Jr. ....	Chairman of the Board, Burr-Brown Corporation, Tucson, Arizona	1988
Yvonne Brathwaite Burke ....	Partner, Jones, Day, Reavis and Pogue, Los Angeles, California	1989
Richard C. Seaver .....	Chairman, Hydril Company, Los Angeles, California	1990

## PORTLAND BRANCH

*Appointed by the Federal Reserve Bank*

Stuart H. Compton .....	Chairman and Chief Executive Officer, Pioneer Trust Bank, N.A., Salem, Oregon	1988
Wayne E. Phillips, Jr. ....	Vice President, Phillips Ranch, Inc., Baker, Oregon	1989
Stephen G. Kimball .....	President and Chief Executive Officer, Baker Boyer Bancorp, Walla Walla, Washington	1990
G. Dale Weight .....	Chairman of the Board and Chief Executive Officer, Benjamin Franklin Savings and Loan Association, Portland, Oregon	1990

*Term expires  
Dec. 31*

*Appointed by the Board of Governors*

G. Johnny Parks .....	Former Northwest Regional Director, International Longshoremen's and Warehousemen's Union, Portland, Oregon	1988
Paul E. Bragdon .....	Assistant to the Governor for Education, Office of the Governor, Salem, Oregon	1989
Sandra A. Suran .....	Small Business Advocate, State of Oregon, Salem, Oregon	1990

**SALT LAKE CITY BRANCH**

*Appointed by the Federal Reserve Bank*

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
Curtis H. Eaton .....	President and Vice Chairman of the Board, Twin Falls Bank and Trust Company, Twin Falls, Idaho	1990
Virginia P. Kelson .....	Management Consultant in Organization Development, Salt Lake City, Utah	1990

*Appointed by the Board of Governors*

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
Don M. Wheeler .....	President, Wheeler Machinery Company, Salt Lake City, Utah	1990

**SEATTLE BRANCH**

*Appointed by the Federal Reserve Bank*

W. W. Philip .....	Chairman and Chief Executive Officer, Puget Sound Bancorp, Tacoma, Washington	1988
H. H. Larison .....	President, Columbia Paint and Coatings, Spokane, Washington	1989
B. R. Beeksmas .....	Chairman of the Board, InterWest Savings Bank, Oak Harbor, Washington	1990
William S. Randall .....	Chairman, President and Chief Executive Officer, First Interstate Bank of Washington, N.A., Seattle, Washington	1990

*Appointed by the Board of Governors*

Byron I. Mallott .....	Chief Executive Officer, Sealaska Corporation, Juneau, Alaska	1988
------------------------	--	------

		<i>Term expires Dec. 31</i>
Carol A. Nygren .....	Partner, Laventhol and Horwath, Seattle, Washington	1989
Irma Goertzen .....	Hospital Administrator, University Hospital, University of Washington, Seattle, Washington	1990



---

# *Index*

# Index

- Acceptances, bankers** (*See* Bankers acceptances)
- Accounting standards, 173
- Adjustable-rate mortgages  
(*See* Regulations: Z)
- Agriculture
  - Loans, 172–73
  - Seasonal credit program, 68, 70, 71
  - U.S. Department of, Packers and Stockyards Administration, 150, 151
- American Bankers Association, 148
- American Institute of Certified Public Accountants, 173
- Anti-Drug Abuse Act of 1988, 164
- Assets and liabilities
  - Banks, by class, 227
  - Board of Governors, 197–202
  - Federal Reserve Banks, 206–09
- Audits (*See* Examinations, inspections, regulations, and audits)
- Availability of funds and collection of checks (*See* Regulations: CC)
  
- Balance of payments** (*See* International developments, review of 1988)
- Bank Control Act, 176
- Bankers acceptances
  - Authority to purchase and to enter into repurchase agreements, 73–75
  - Federal Reserve Banks Holdings, 206–09
- Bank holding companies  
(*See also* Regulations: Y)
  - Antitrust Action, 179
  - Applications by, processing and notice of Board decisions, 174–78
  - Bank Merger Act, 175
  - Board decisions, 175, 176, 177
  - Change in Bank Control Act, 176
  - Delegation of applications, 175
  - Enforcement, 170
  - Examination, inspection, and regulation, 169, 184
  - International activities, 170, 178
  - Legislative recommendations, 156–57
  - Litigation, 159–62
  - Number and assets, 169
  - Bank holding companies—  
Continued
    - Policy statement, 67–68
    - Stock repurchases by, 178
    - Surveillance and monitoring, 172
    - Transfer agents, 172
    - Unregulated practices, 153
  - Bank Holding Company Act of 1956  
(*See also* Regulations: Y)
    - Foreign investments, 179
    - Legislative recommendations and litigation, 159, 163, 175
    - Regulation and compliance, 174–78
  - Bank Holding Companies and Change in Bank Control (*See* Regulations: Y)
  - Bank Merger Act, 175
  - Banking offices, changes in number, 232
  - Banking supervision and regulation by Federal Reserve System, 167–82
  - Bank mergers and consolidations, 233–40
  - Bank Secrecy Act, 179
  - Basic banking, 157
  - Basle Accord, 168
  - Basle Committee on Banking Regulations and Supervisory Practices, 167–68
  - Board of Governors  
(*See also* Federal Reserve System)
    - Cash, sources, uses, and balance at end of 1988, 197–202
    - Consumer Advisory Council  
(*See* Consumer Advisory Council)
    - Financial statements, 197–202
    - Interpretations (*See* Interpretations)
    - Litigation, 159–62
    - Members and officers, 242–43
    - Policy actions (*See* Policy actions)
    - Pricing of Federal Reserve services  
(*See* Fees)
    - Publications (*See* Publications)
    - Regulations (*See* Regulations)
    - Regulatory simplification, 183–84
    - Salaries, 213
  - Branch banks
    - Federal Reserve (*See* Federal Reserve Banks, Branches)
    - Foreign branches of U.S. banking organizations, 170, 178–179

- California**, state exemption, 144
- Call reports (*See* Condition statements)
- Capital accounts
  - Banks, by class, 222
  - Federal Reserve Banks, 205, 206, 208
- Check clearing and collection
  - Fees for Federal Reserve services, 66, 185–96
  - Float (*See* Float)
  - Volume of operations, 191, 223
- Commercial banks (*See also* Insured commercial banks)
  - Banking offices, changes in number, 232
  - Supervision and regulation by Federal Reserve System, 167–82
  - Transfers of funds (*See* Transfers of funds)
- Commodity Credit Corporation, 8
- Community Affairs Program, 147
- Community Reinvestment Act
  - Examination under, 148, 154
  - Testimony, 156
- Competitive Equality Banking Act of 1987 (*See also* Expedited Funds Availability Act), 65, 168, 172, 177, 185
- Comptroller of the Currency, 148, 149, 163, 168, 171, 176
- CompuServe, Inc., 174
- Condition statements of Federal Reserve Banks, 204–09
- Conference of State Bank Supervisors, 173
- Consumer Advisory Council, 155, 246
- Consumer and community affairs, 143–58
- Consumer Complaint Control System, 151
- Course for Financial Institution Examiners, 148
- Credit (*See also* Loans)
  - Card disclosures, 146
  - Equal Credit Opportunity (*See* Truth in Lending Act)
  - Mortgages, 17, 63, 144–45, 146, 147, 165, 166, 183
  - Seasonal program, 68, 70, 71
  - Special purpose credit programs, 145
- Credit by Brokers and Dealers (*See* Regulations: T)
- Credit Practices Rule (*See* Regulations: AA)
- Currency and coin services, 188
- Currency and Foreign Transactions Reporting Act (*See* Bank Secrecy Act)
- Definitive securities**, 188
- Debt–equity swaps (*See also* Regulations: K), 183
- Depository institutions
  - Checks (*See* Check clearing and collection)
  - Interest on deposits (*See* Interest rates)
  - Reserve requirements (*See* Regulations: D)
  - Reserves and related items, 228–31
  - Services to (*See* Fees)
- Deposits
  - Banks, by class, 227
  - Checks (*See* Check clearing and collection)
  - Federal Reserve Banks, 206–09, 228–31
  - Interest rates (*See* Interest rates)
  - Reserve requirements (*See* Reserve requirements of depository institutions)
- Directors, Federal Reserve Banks and Branches, list, 250–70
- Discount rates at Federal Reserve Banks (*See* Interest rates)
- Dividends
  - Federal Reserve Banks, 189, 216–17, 218–21
- Earnings of Federal Reserve Banks** (*See also* Federal Reserve Banks, income and expenses), 189, 214–21
- Economy in 1988, 5–11
  - Business, 7, 32, 47
  - Foreign, 20–22, 30, 46
  - Government, 8, 33, 49
  - Households, 5, 31, 46
  - Labor markets, 9, 33, 49
  - Price developments, 10, 34, 49
- Economic Development Administration, 148
- Edge and agreement corporations
  - Examinations, 170
  - International activities, 170, 178, 179
- Educational activities (*See* Training)
- Education Foundation of State Bank Supervisors, 173
- Electronic data processing, 171
- Electronic Funds Transfer Act
  - Compliance, 151
  - Economic effects, 151
- Electronic funds transfer (*See* Transfers of funds *and* Regulations: E)

- Equal Credit Opportunity Act
  - Compliance, 145
  - Regulation B (*See* Regulations: B)
- Examinations, inspections, regulation, and audits
  - Bank holding companies, 169
  - Compliance, 148, 149
  - Federal Reserve Banks, 185–96
  - International banking activities, 170, 178
  - Specialized, 171
  - State member banks, 169
  - Surveillance and Monitoring program, 169, 172
- Exchange Stabilization Fund, 20
- Expedited Funds Availability Act, 65–67, 143–44, 157–58, 162, 184
- Expenses (*See* Income and expenses)
- Export Trading Companies, 179
  
- Fair Credit and Charge Card Disclosure Act of 1988**, 146, 165
- Fair Housing Act, 158
- Farm Credit Administration, 150, 180
- Farmer Mac Program, 173
- Federal Advisory Council, 245
- Federal agency securities
  - Authority to purchase and to enter into repurchase agreements, 73–75, 96–97, 133
  - Federal Reserve Bank holdings and earnings, 190, 206–12, 228–29
  - Federal Reserve open market transactions, 1988, 210–11
  - Repurchase agreements, 73–75, 205, 206–09, 210–11, 212
- Federal Bureau of Investigation, 174
- Federal Deposit Insurance Corporation, 148, 149, 163, 168, 170, 176
- Federal Financial Institutions Examination Council, 67, 148, 172, 174
- Federal Home Loan Bank Board, 147, 148, 149, 177, 180
- Federal National Mortgage Association, 188
- Federal Open Market Committee
  - Examinations, 189
  - Meetings, 78, 89, 97, 104, 114, 121, 126, 134
  - Members and officers
    - Calendar-year membership change, 133
    - List, 244
  - Policy actions, 73–151
- Federal Reserve Act
  - Examinations, 189
  - Legislative recommendations and litigation, 163–66
  - Provisions, 170
- Federal Reserve Banks
  - Assessments for expenses of Board of Governors, 199, 216–17, 218–21
  - Bank premises, 190, 204, 206–09, 222
  - Branches
    - Bank premises, 190, 199, 222
    - Chicago, 148
    - Directors, list, 250–70
    - St. Louis, 57
    - Vice presidents in charge, 248
  - Capital accounts, 205, 206–09
  - Chairmen and deputy chairmen, 248–49
  - Check collection, 186–87
  - Coin and currency service, 188
  - Condition statement, 204–09
  - Delegated authority, 175, 176
  - Deposits, 205, 206–09, 231
  - Directors, list, 250–70
  - Dividends paid, 189, 216–17, 219, 221
  - Examination or audit, 189
  - Income and expenses, 189, 191, 192
  - Interest rates, 68, 70, 224
  - Loans and securities, 190, 204, 206–09, 212, 214, 228, 230
  - Officers and employees, number and salaries, 213
  - Operations, volume, 191, 194, 223
  - Premises, 190
  - Presidents and first vice presidents, 213, 248–49
  - Pricing of services, 186–89, 191–96, 228–29
  - Priced services, pro forma balance sheet, 191
  - Profit and loss, 230–31
  - Training, 148, 173
- Federal Reserve Board (*See* Board of Governors)
- Federal Reserve notes
  - Condition statement data, 206–09
  - Cost of issuance and redemption, 188, 199, 201, 216–17
  - Interest paid to U.S. Treasury on, 189, 192
  - Litigation, 159
- Federal Reserve's Reciprocal Currency (Swap) Network, 24

- Federal Reserve System (*See also* Board of Governors)  
 Banking supervision and regulation by, 167–82  
 Consumer affairs (*See* Consumer and community affairs)  
 Foreign currency operations (*See* Foreign currencies)  
 Maps, 280–81  
 Membership, 182  
 Training, 148, 173
- Federal Savings and Loan Insurance Corporation, 17, 55
- Federal Trade Commission  
 Act, 153  
 Pamphlets, 150
- Fees  
 Federal Reserve services to depository institutions  
 Automated clearinghouse service, 187  
 Check clearing and collection, 186  
 Coin and currency, 188  
 Electronic payments, 187  
 Pricing of, 186–89, 214–15  
 Securities, 188  
 Wire transfers of funds, 187
- Financial Accounting Standards Board, 173
- Financial Institutions Supervisory Act, 161, 170
- Financial markets and monetary policy, 12–18
- Float (*See also* Check clearing and collection), 187, 188, 189
- Foreign banking and financing (*See* Regulations: K)
- Foreign branches of U.S. banking organizations, 179
- Foreign currencies  
 Authorization and directive for operations in, and review of documents, 24, 76, 78  
 Deposit issuance, 184  
 Federal Reserve income on, 214–17
- Freedom of Information Act, 183
- Garn–St Germain Depository Institutions Act of 1982, 64**
- Glass–Steagall Act, 161, 167
- Gold certificate accounts of Reserve Banks and gold stock, 206–09, 228, 230
- Government check cashing, 157
- Government Securities Act of 1986, 171
- Home equity lines of credit, 146, 150, 165**
- Home Equity Loan Consumer Protection Act of 1988, 146, 165
- Home Mortgage Disclosure Act of 1975 (*See* Regulations: C)
- Housing and Community Development Act of 1987, 166
- Housing and Urban Development, U.S. Department of, 148
- Income and expenses**  
 Board of Governors, 197–202  
 Federal Reserve Banks, 189–90, 192–93, 214–21
- Indiana, state preemption, 146
- Insured commercial banks (*See also* Commercial banks)  
 Assets and liabilities, by class of bank, 227  
 Banking offices, changes in number, 232  
 Number, by class of bank, 227
- Interagency Enforcement Policy, 149
- Interest on deposits (*See* Interest rates)
- Interest rates  
 Federal Reserve Banks  
 Discount rates, 1988, 68, 70  
 Votes, 71  
 Table, 224
- Internal Revenue Service, 151, 180
- International banking activities, 170, 178
- International banking facilities, 178
- International banking operations (*See* Regulations: K)
- International developments, review of 1988, 19, 24
- International Lending Supervisory Act of 1983, 167
- International Monetary Fund, 22
- International transactions, 22–24
- Interpretations of regulations, 147
- Interstate Commerce Commission, 151
- Investments  
 Banks, by class, 227  
 Federal Reserve Banks, 204, 206–09  
 Foreign, by U.S. banking organizations, 179  
 State member banks, 227
- Justice, U.S. Department of, 159**
- Labor market developments, 9–10**

- Legislation enacted (*See also* specific act), 163–66
- Legislative recommendations  
Board of Governors, 156  
Other agencies with enforcement responsibilities, 158
- Litigation  
Bank holding companies, 159–62  
Board procedures and regulations, challenges to, 160–62
- Loans (*See also* Credit)  
Agricultural (*See* Agriculture)  
Banks, by class, 227  
Executive officers of state member banks, 182  
Federal Reserve Banks  
Depository institutions, 204, 206–09, 214–17, 230  
Holdings and income, 190–91, 204, 206–09, 214, 228, 230  
Interest rates, 68, 70, 224  
Mortgage, brochures, 146, 147  
Volume of operations, 223
- Management and Budget, Office of**, 147
- Management Consent Program, FHLBB, 177
- Management Interlocks Revision Act of 1988, 164
- Margin credit regulation (*See* Regulations: T)
- Margin requirements, 226
- Member banks (*See also* Depository institutions and National banks)  
Assets, liabilities, and capital accounts, 227  
Banking offices, changes in number, 232  
Borrowings and loans (*See* Loans)  
Foreign branches, 178  
Membership in Federal Reserve System, 182  
Number, 227  
Reserve requirements, 225  
Reserves and related items, 228–31  
State member banks  
(*See* State member banks)  
Surveillance and monitoring program, 169, 172  
Transfers of funds  
(*See* Transfers of funds)
- Monetary Control Act of 1980, 63
- Monetary policy  
Aggregates. 15–18
- Monetary policy—Continued  
Financial markets relative to, 12–18, 35–40  
Reports to the Congress, 25–60  
Review of 1988, 3–11
- Mortgages  
Brochures by Federal Trade Commission, 147  
Home Equity Loan Consumer Protection Act of 1988, 165  
Home mortgage disclosure, 17, 63, 144–45, 146, 183  
Housing and Community Development Act of 1987, 166  
Mutual savings banks, 232
- National Association of Attorneys General**, 150
- National Association of Securities Dealers, 180
- National banks (*See also* Member banks)  
Assets, liabilities, and capital accounts, 227  
Banking offices, changes in number, 232  
National Credit Union Administration, 148, 149, 180  
National League of Cities, 148  
National People's Action, 148  
National Women's Business Council, 166  
New York, state preemption, 145  
Nonmember depository institutions  
Assets and liabilities, 227  
Banking offices, changes in number, 232  
Number, 227
- Omnibus Trade and Competitiveness Act of 1988**, 163, 180
- Organization for Economic Cooperation and Development, 21
- OTC margin bond (*See also* Regulations: T), 184
- Over-the-counter marginable stocks, 180
- Paperwork Reduction Act**, 147
- Payments mechanism (*See* Fees)
- Policy actions  
Board of Governors  
Discount rates at Federal Reserve Banks, 68–71  
Regulations, 68–71  
Statements and other actions. 62. 67

## Policy actions—Continued

- Federal Open Market Committee  
(*See also* System Open Market Account), 73–141
- Presidents and vice presidents of Federal Reserve Banks
  - Conferences, 249
  - List, 248–49
  - Salaries of presidents, 213
- Pricing of Federal Reserve services, 185–89, 191–96, 214–15
- Profit and loss, Federal Reserve Banks, 216–17
- Publications
  - “Compliance: A Self Assessment Guide,” 149
  - Mortgage brochures, 146, 147
- Real estate loans** (*See* Mortgages)
- Regulation of banking organizations  
(*See* Banking supervision and regulation by Federal Reserve System)
- Regulations (*See also* Regulatory review program)
  - B, Equal Credit Opportunity
    - Compliance, 150
    - New York, state preemption, 145
  - C, Home Mortgage Disclosure
    - Revision and adoption of new reporting forms, 63
    - Revision to incorporate amendments to Home Mortgage Disclosure Act, 144, 166, 183
  - D, Reserve Requirements of Depository Institutions
    - Amendment to increase transaction balances, 63
  - E, Electronic Funds Transfer
    - Compliance, 151
  - K, International Banking Operations
    - Amendment to liberalize conditions on debt-for-equity swaps, 64
  - T, Credit by Brokers and Dealers
    - Amendment, foreign debt securities for margin credit, 65
  - Y, Bank Holding Companies and Change in Bank Control
    - Amendment to implement Competitive Equality Banking Act of 1987, 65
  - Z, Truth in Lending
    - Compliance, 149
    - Credit card disclosures, 146

## Regulations—Continued

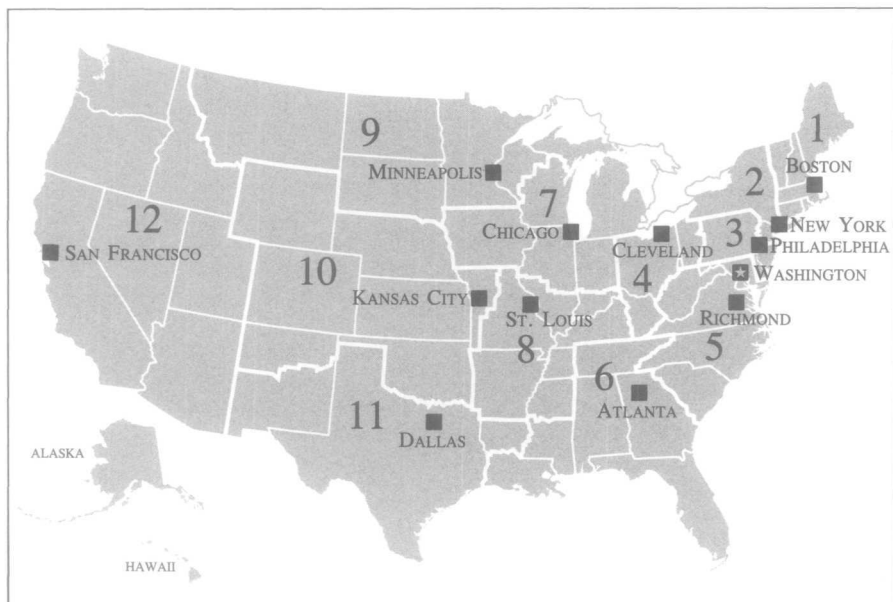
- Z, Truth in Lending—Continued
  - Home equity lines of credit, 146
  - Indiana, state preemption, 146
  - Revision, adjustable-rate mortgages, 145
- AA, Credit Practices Rule
  - California, state exemption, 144, 147
- CC, Expedited Funds Availability
  - Adoption, Expedited Funds Availability Act, 65, 143, 148
  - Interim rules regarding payable-through checks, 66
- Regulatory review program, 144, 147, 183–84
- Regulatory Policy and Planning Committee, 183
- Regulatory simplification, 183–84
- Report on Formal Enforcement Actions, 170
- Repurchase agreements
  - Authority to purchase and to enter into, 73–75
  - Bankers acceptances (*See* Bankers acceptances)
  - Federal agency securities (*See* Federal agency securities)
  - U.S. Treasury securities (*See* U.S. Treasury securities)
- Reserve requirements of depository institutions
  - Regulation D (*See* Regulations: D) Securities, 180
  - Table, 225
- Reserves and related items, 228–31
- Right to Financial Privacy Act, 147, 164
- Risk-based capital standards, 67, 168
- Rules Regarding Availability of Information, 183
- Salaries**
  - Board of Governors, 199
  - Federal Reserve Banks, 213
- Schools (*See* Training)
- Seasonal credit program, 68, 70, 71
- Securities (*See also* specific types)
  - Credit, 226
  - Dealers, policy statement, 67
  - Definitive, 188
  - Over-the-counter, 180
  - Regulation, 180
  - Securities Act Amendments of 1975, 171
  - Securities and Exchange Commission, 151, 180, 181

- Securities Exchange Act of 1934, 180, 181  
 Senior Forum for Current Regulatory Issues, 173
- Small Business Act, 166
- Small Business Administration, 148, 151
- Special drawing rights, 204, 206–09, 228, 230
- State member banks  
 (*See also* Member banks)  
 Applications by, 175, 178  
 Assets and liabilities, 227  
 Bank Control Act, 176  
 Bank Holding Company Act, 175  
 Bank Merger Act, 175  
 Banking offices, changes in number, 232  
 Board decisions, 175, 177  
 Calendar-year membership change, 133  
 Complaints against, 152  
 Examinations and inspections, 169, 184  
 Financial disclosure by, 181  
 Fees (*See* Fees)  
 Interest on deposits (*See* Interest rates)  
 Loans to executive officers, 182  
 Membership in Federal Reserve System, 182  
 Mergers and consolidations (*See* Bank mergers and consolidations)  
 Number, by class of bank, 169, 227  
 Reserve requirements (*See* Reserve requirements of depository institutions)  
 Surveillance and monitoring, 172  
 Transfer agents, 172
- Stock market credit (*See* Securities credit)
- Supervision of banking organizations  
 (*See* Banking supervision and regulation by Federal Reserve System)
- System Open Market Account  
 Authority to effect transactions in domestic operations  
 Domestic Open Market Operations  
 Authorization for, 73–75, 96–97, 133  
 Domestic Policy Directive, 75, 78, 89, 97, 104, 114, 121, 126, 134  
 Foreign Currency Directive, 78  
 Foreign currency operations  
 Authorization for, 76
- Transfer Agents, 172
- Transfers of funds (*See also* Fees and Regulations: E)  
 Check clearing and collection (*See* Check clearing and collection)  
 Federal Reserve operations, volume, 191, 194, 223  
 Pricing of Federal Reserve services, 186–89, 191–96, 214
- Transportation, U.S. Department of, 150
- Treasury, U.S. Department of, 171
- Treasury securities  
 Authority to buy, to enter into repurchase agreements, and to lend, 73, 96, 133  
 Bank holdings, by class of bank, 227  
 Federal Reserve Banks  
 Holdings, 191, 204, 206–09, 212, 228, 230  
 Income, 189, 214–21  
 Transfers by, 189  
 Open market transactions, 210–11  
 Repurchase agreements  
 Authorization for, 73  
 Board policy statement, 62, 67  
 Tables, 204, 206–09, 210–11, 212, 228, 230
- Truth in Lending Act (*See* Regulations: Z)
- World Bank**, 22, 174
- Women's Business Ownership Act of 1988, 145

**Thrift Institutions Advisory Council**, 247  
 Training, 148, 173



## Maps of the Federal Reserve System



### LEGEND

*Both pages*

- Federal Reserve Bank city
- ★ Board of Governors of the Federal Reserve System

*Facing page*

- Federal Reserve Branch city
- Branch boundary

### NOTE

The Federal Reserve officially identifies the Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska, and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: the New York Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The Board of Governors revised the boundaries of the System most recently in August 1986.

